CONSTITUTIONAL COURT OF SOUTH AFRICA

Case CCT 209/22

In the matter between:

CAPITEC BANK LIMITED Applicant

And

COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

Neutral citation: *Capitec Bank Limited v Commissioner for the South African Revenue Service* [2024] ZACC 1

Coram: Zondo CJ, Maya DCJ, Kollapen J, Mathopo J, Mhlantla J, Rogers J, Theron J, Tshiqi J and Van Zyl AJ[*]

Judgment: Rogers J (unanimous)

Heard on: 5 September 2023

Decided on: 12 April 2024

Summary: Value-Added Tax Act 89 of 1991 — whether a supply free of charge may constitute a taxable supply

Value-Added Tax Act 89 of 1991 — section 16(3)(c) — whether the supply of an insurance contract to borrowers who pay interest and fees made exclusively in the course or furtherance of an exempt activity — whether the amount in section 16(3)(c) may be apportioned where the insurance contract is supplied only partly in

[*] Van Zyl AJ was present at the hearing but was unable to participate in the disposition of the case.

the course or furtherance of an enterprise — significance of taxpayer's failure to plead apportionment

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ORDER

On appeal from the Supreme Court of Appeal of South Africa (hearing an appeal from the Tax Court sitting in Cape Town):

1. The late filing of the application for leave to appeal is condoned.
2. Leave to appeal is granted.
3. The appeal succeeds to the extent set out below.
4. The orders of the Tax Court and Supreme Court of Appeal are set aside.
5. The assessment for the applicant's November 2017 value-added tax period is remitted to the respondent for examination and assessment in accordance with the principles set out in this judgment.
6. The parties must bear their own costs in the Tax Court.
7. The applicant must pay the respondent's costs in the Supreme Court of Appeal, including the costs of two counsel.
8. The parties must bear their own costs in this Court.

JUDGMENT

ROGERS J (Zondo CJ, Maya DCJ, Kollapen J, Mathopo J, Mhlantla J, Theron J and Tshiqi J concurring):

Introduction

[1] The writing of this judgment was assigned to me following the unfortunate indisposition of our Colleague, Van Zyl AJ, who was present at the hearing and was to

have written the judgment. The Court expresses its regret for any resultant delay this has caused.

[2] This case raises questions about the interpretation and application of section 16(3)(c) of the Value-Added Tax Act[1] (Act). These questions arise on an application by the applicant, Capitec Bank Limited (Capitec), for leave to appeal a judgment of the Supreme Court of Appeal, in which the latter Court upheld an appeal by the present respondent, the Commissioner for the South African Revenue Service (SARS), against a decision of the Tax Court in Capitec's favour.

[3] Lending money to customers is part of Capitec's business. To understand the value-added tax (VAT) issues in this case, it is convenient, upfront, to note some uncontentious features of the VAT regime insofar as they bear on the business of lending money. In terms of section 7(1)(a), VAT must be levied on goods or services supplied by a vendor "in the course or furtherance of any *enterprise* carried on" by the vendor (my emphasis).[2] Lending money is the "supply" of "services" within the wide definition of those terms in the Act. The expression "taxable supply" is defined as meaning a supply chargeable with VAT under section 7(1)(a).

[4] Whether a supply is made in the course or furtherance of an "enterprise", and is thus chargeable with VAT as a taxable supply, takes one to the Act's definition of "enterprise". The definition is lengthy. It is necessary to mention only two aspects:

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[1] 89 of 1991. The relevant part of section 16(3)(c) is quoted in [13] below.

[2] Section 7(1)(a) reads:

> "(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;"

(a) The enterprise must be an enterprise or activity in the course or furtherance of which goods or services are supplied "for a consideration, whether or not for profit".[3]

(b) Any activity, to the extent to which it involves the making of "exempt supplies", shall not be deemed to be the carrying on of an enterprise.[4]

[5] "Consideration" is widely defined to include everything that would commonly be regarded as consideration, whether in money or kind.[5]

[6] An "exempt supply" is defined as a supply that is exempt from VAT under section 12. In section 12(a), the supply of "financial services" is stated to be an exempt supply. In terms of section 1, "financial services" mean the activities deemed by section 2 to be financial services. In terms of section 2(1)(f), the provision of credit at a cost to the recipient is a "financial service".[6] This is subject to the proviso that this activity shall not be deemed to be financial services "to the extent that the consideration

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[3] Para (a) of the definition. Para (a) states the following as a meaning of "enterprise":

> "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;"

[4] Para (c)(v) of the definition. This item, in the form of a proviso, states:

> "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;"

[5] "Consideration" is defined as including, in relation to the supply of goods or services to any person—

> "any payment made or to be made (including any deposit on any returnable container and tax), 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, but does not include any payment made by any person as a donation to any association not for gain: Provided that a deposit (other than a deposit on a returnable container), whether refundable or not, given in respect of a supply of goods or services shall not be considered as payment made for the supply unless and until the supplier applies the deposit as consideration for the supply or such deposit is forfeited;"

[6] More fully, section 2(1)(f) describes this financial service as "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;"

payable in respect thereof is any fee, commission, merchant's discount or similar charge, excluding any discount cost".

[7] The net amount of VAT payable by a vendor in respect of a VAT period is the total "output tax" on the supplies made by it to its customers less the amount of "input tax" and other deductions permitted by the Act. "Input tax" is the VAT which the vendor has been charged on supplies it has acquired to enable it to make taxable supplies to its customers.[7] If acquired supplies are used by a vendor for dual purposes, taxable and exempt, the amount of VAT on those supplies deductible as input tax requires an apportionment of the VAT. This is regulated by section 17.

[8] When Capitec lends money, it charges interest and initiation and service fees. In the case of unsecured loans, and based on loans with durations of 36, 60 and 84 months, the fees make up between about 5% and 13% of the total consideration Capitec receives from the borrower, the rest being interest.[8] In general terms, therefore, Capitec's activity of lending money to unsecured borrowers is an exempt financial service to the extent of the interest it charges. That same activity, however, is the carrying on of an "enterprise", in which taxable supplies chargeable with tax under section 7(1)(a) are supplied, to the extent of the fees Capitec charges. In line with this, Capitec does not charge VAT on interest and does not claim input tax deductions attributable to the

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[7] Section 1 defines "input tax" as meaning, in relation to a vendor—

> "(a) tax charged under section 7 and payable in terms of that section by—
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> (i) a supplier on the supply of goods or services made by that supplier to the vendor; or
>
> . . . ;
>
> 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;"

[8] These percentages are derived from the "rate stack up model" which was adduced during Mr Retief's evidence. This was a costing model based on past experience. Since Capitec grants loans for shorter periods than 36 months, and since the proportion of income constituted by fees grows as the period of the loan shrinks, it may be that the average proportion of income derived from fees for all loans is somewhat higher than the figures suggested by the rate stack up model.

charging of interest, whereas it does charge VAT on the fees it levies and it claims input tax deductions attributable to the charging of fees.

[9] To protect itself against the risk that unsecured borrowers might be unable to repay loans upon retrenchment or death, Capitec – in the period with which we are concerned – took out insurance, initially with Channel Life Limited, later with Guardrisk Life Limited (insurers). In terms of the policies issued by these insurers, the "insured" was Capitec and the "insured life" was a Capitec borrower meeting certain criteria. The "insured event" was "the retrenchment or death of an insured life". The policy specified, among other things, the premiums payable by Capitec to the insurer and the policy benefits payable by the insurer to Capitec on the happening of an insured event.

[10] In turn, Capitec's standard unsecured lending contract with its customers made provision for "loan cover". Clause 13 provided in that regard as follows:

> "13.1 If your loan is for six months or more and you die or are retrenched, the amount owing to us will be covered to a maximum of R264 000 except that if you are retrenched within three months from taking the loan only half of the amount owing to us may be covered.
>
> 13.2 The cover must be claimed by you or your deceased estate within 12 months, with proof to our satisfaction of your retrenchment or death.
>
> 13.3 We do not warrant or guarantee the cover. You or your estate must claim the cover from us. You or your estate remain indebted to us unless and until the full amount owing to us is paid by the cover.
>
> 13.4 We do not charge any fees for the cover".

[11] The amount of cover in clause 13.1 matched the cover which Capitec had with the insurer on the happening of an insured event. It was also slightly more than the maximum capital sum which Capitec would lend unsecured borrowers at the time.

[12] In arriving at the VAT payable by it in its VAT return for November 2017, Capitec deducted an amount of R71 520 812. This was the "tax fraction",[9] namely $\frac{14}{114}$, of the amount Capitec had paid to customers as loan cover in terms of clause 13.[10] Capitec claimed to be entitled to make this deduction by virtue of section 16(3)(c).

[13] Section 16 deals with the calculation of VAT payable by a vendor. Section 16(3) sets out the amounts which a vendor, in arriving at the net amount of VAT payable, may deduct from the output tax charged on supplies made by it. In relevant part, section 16(3)(c) provides 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, . . . , 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;
>
> . . ."

[14] SARS disallowed the deduction, which it gave effect to by issuing an additional assessment. Following SARS' disallowance of Capitec's objection to the additional assessment, Capitec noted an appeal to the Tax Court.

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[9] The expression "tax fraction" is defined in section 1 as meaning:

> "the fraction calculated in accordance with the formula:
>
> $$\frac{r}{100 + r}$$
>
> in which formula 'r' is the rate of tax applicable under section 7(1);"

Capitec made loan cover payments of R582 383 754 in the relevant period.

[10] The loan cover payments were made over the period November 2014 to November 2015. SARS made no point of the fact that the deduction was only claimed in November 2017.

Litigation history

Tax Court

[15] In terms of the Tax Court Rules then applicable,[11] the pleadings comprised a statement by SARS of the grounds of assessment and grounds for opposing the appeal (rule 31 statement), followed by a statement by Capitec of its grounds of appeal (rule 32 statement). In its rule 31 statement, SARS pleaded that the loan cover payments did not qualify for "input tax deduction" in terms of section 16(3)(c), because the supply of the loan cover did not constitute a "taxable supply". This was alleged by SARS to be so for two reasons, namely (a) that the loan cover was provided for no "consideration" and accordingly the supply of the loan cover had no "value"; and (b) that the loan cover constituted, alternatively was in respect of, an exempt supply.

[16] At the hearing of the tax appeal, Capitec adduced the evidence of Mr A C Retief. By the time he testified, his position was Manager: Special Projects, but from 2002 to 2016 he was Capitec's Management Accountant reporting to the Chief Financial Officer. After Mr Retief's testimony, Capitec closed its case. SARS did likewise without tendering evidence.

[17] The Tax Court (per Sievers AJ, sitting with assessors) found in favour of Capitec and upheld the appeal. As to SARS' first pleaded basis for opposing the appeal, the Court reasoned that, although Capitec made no distinct charge for the loan cover, the cost of such cover was recovered at least in part through the service fees which Capitec charged. Those fees constituted consideration for the cover. The unsecured lending business was thus an "enterprise".

[18] The Court seems to have considered, however, that, even if there was no consideration for the loan cover, this would not disqualify the provision of such cover

[11] Rules promulgated under section 103 of the Tax Administration Act, 2011 (Act No. 28 of 2011), GN 550, *GG* 37819, 11 July 2014.

from being a taxable supply. The Court referred in that regard to SARS' Interpretation Note 70, issued in 2013,[12] where SARS stated:

> "[VAT] incurred on marketing efforts, including certain promotional supplies made for no consideration, may be deducted if the expenses can be directly attributed to specific taxable supplies made for a consideration, or generally, for the purpose of promoting the vendor's other taxable product offerings."[13]

[19] The provision of loan cover gave Capitec, the Court held, a competitive and marketing advantage. This advanced Capitec's lending business, in which both interest and fees were earned. The provision of the loan cover was thus made in the course and furtherance of an "enterprise" that involved the making of taxable supplies.

[20] As to SARS' second ground for opposing the appeal, the Tax Court regarded it as artificial to treat the provision of credit and the activities which earned the fees as distinct and separate transactions. Customers did not contract or receive any benefit above the loan and the loan cover. The fees were simply part of the consideration payable for the provision of credit. It was inconsistent with Mr Retief's evidence to view the loan cover as exclusively advancing the making of exempt supplies.

[21] Without further ado, the Tax Court concluded that the requirements of section 16(3)(c) were satisfied and upheld the appeal.

Supreme Court of Appeal

[22] The Supreme Court of Appeal upheld SARS' appeal against the Tax Court's order, replacing the latter order with one dismissing Capitec's appeal to the Tax Court with costs, including the costs of two counsel, and confirming SARS' assessment.[14]

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[12] South African Revenue Service *Interpretation Note: No. 70 Supplies Made for No Consideration* (14 March 2013). Issue 2 of this Note was issued on 10 November 2021. In the respects relevant to this case, there are no material differences between the two versions.

[13] Id at para 5.2.2.

[14] *Commissioner for the South African Revenue Service v Capitec Bank Limited* [2022] ZASCA 97; [2022] 3 All SA 641 (SCA) (SCA judgment).

[23] The Supreme Court of Appeal agreed with Capitec's contention that, because it carried on a single business of offering credit from which it earned interest (an exempt activity) and fees (a taxable activity), and because the loan cover was supplied as part and parcel of Capitec's credit offering business, there was a direct link between the supply of the loan cover and the supply of credit. However, so the Supreme Court of Appeal continued, one could not ignore that Capitec was in the business of providing credit, not providing insurance. The provision of credit was an "exempt supply".

[24] The question that arose, according to the Supreme Court of Appeal, was thus whether, because a "minor component" of the business took the form of fees and was thus a taxable supply, the "entire business activity" of Capitec should be treated as a taxable supply.

[25] The Court quoted from its judgment in *Tourvest*,[15] which also dealt with financial services in which only part of the consideration received by the vendor consisted of taxable fees and commissions. The Court in *Tourvest* said that in such circumstances "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", but that this "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". The proviso in the definition of "financial services" "creates a mixed supply out of an identified activity", and merely "add[s] a taxable element to what is, and at its core remains, an exempt financial service", turning the activity "into a partly exempt and a partly taxable supply".[16]

[26] The Supreme Court of Appeal in the present case concluded that carving out the taxable component did not convert what was in essence an exempt supply into a taxable

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[15] *Commissioner for the South African Revenue Services v Tourvest Financial Services (Pty) Ltd* [2021] ZASCA 61; 2021 (5) SA 86 (SCA); 84 SATC 62 (*Tourvest*).

[16] Id at paras 15-6.

supply. This led to the question whether the fees charged by Capitec were charged on the supply of the loan cover to its customers. No, answered the Court, referring to the express terms of the loan contract and to the fact that the initiation and service fees permissibly chargeable in terms of the National Credit Act[17] were regulated separately from the cost of credit life insurance. The cost of credit life insurance, if consideration was charged for it, would have required separate disclosure.[18]

[27] The Supreme Court of Appeal rejected Capitec's argument, made with reference to section 10(23), that a service may be supplied for a consideration of nil. This "valuation rule", in the Supreme Court of Appeal's opinion, did not have the effect of changing the character of a non-taxable supply for no consideration into a taxable supply.

[28] Because the loan cover was provided for no consideration, its supply, according to the Supreme Court of Appeal, "did not qualify as an 'enterprise' as envisaged in section 1 of the VAT Act". That definition required there to be a consideration for the goods or services supplied. On this basis alone, Capitec could not invoke section 16(3)(c).

[29] Then, in an excursus not foreshadowed in the pleadings or in the Tax Court or in written argument in the Supreme Court of Appeal, that Court offered an analysis which connected the loan cover that Capitec provided to its customers with the insurance policy between Capitec and the insurer. There was, in the Supreme Court of Appeal's view, "only one real ordinary insurance contract", namely the contract between Capitec and the insurer, but it benefited two parties – Capitec and the borrowers. And "notably", in the Supreme Court of Appeal's view, the insurer levied VAT on the premiums paid

[17] 34 of 2005.

[18] Section 101(1)(e) read with section 106 of the National Credit Act and the Regulations promulgated thereunder, National Credit Regulations, GN R489 *GG* 28864, 31 May 2006, as amended up to and including 2015. With effect from 6 May 2016, the Regulations were amended. As a result, Capitec changed its business model. In the present case, we are concerned with the position prior to 6 May 2016.

by Capitec and was entitled to a section 16(3)(c) deduction in respect of the amounts it paid out to Capitec.

[30] Capitec, in turn, the Supreme Court of Appeal said, was entitled to an input tax deduction in respect of VAT on the premiums it paid to the insurer and was required to pay output tax on any indemnity payments it received from the insurer. When the insurer made an indemnity payment under the policy, Capitec was deemed in terms of section 8(8) to have supplied a service to the insurer and had to pay output tax on the deemed supply:

> "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, . . . 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."[19]

[31] Furthermore, so the Supreme Court of Appeal said, the insurance policy issued by the insurer insured Capitec against the "outstanding loan amount", which was the capital amount of the credit provided "and the capitalised amount of interest and fees". Fees charged by Capitec were payable monthly on accrual. If not paid immediately, they were capitalised and added to the balance of the loan, rendering them exempt, because the capitalisation of the fees amounted to additional credit granted by Capitec to the customer. The insurance policies did not cover the earning of fees but the recovery of credit. Because the provision of credit was an exempt financial service, the loan cover was supplied in the course of making an exempt supply. SARS' Interpretation Note 70 did not change this, because the Note explicitly stated that no input tax deduction was allowable in respect of exempt supplies made for no consideration.

[19] SCA judgment above n 14 at para 33.

[32] The Supreme Court of Appeal then turned to the question of apportionment, although its conclusions up to this point had rendered apportionment irrelevant. The Court rejected Capitec's argument that section 17 does not apply to the apportionment of an amount deductible in terms of section 16(3)(c). Section 17, the Court said, governed the apportionment of "notional input tax". Because Capitec had not pleaded apportionment, there was no basis for allowing an apportionment, and SARS was right to have disallowed the entire deduction.

Submissions in this Court

Capitec

[33] Capitec disputes the Supreme Court of Appeal's conclusion that a supply made for no consideration can never be a taxable supply. Such a supply, if made in the course or furtherance of an enterprise in which taxable supplies for consideration are made, is itself a taxable supply with a deemed consideration of nil, as provided for in section 10(23). Capitec continues to invoke Interpretation Note 70 in support of this argument.

[34] Capitec argues that the provision of the loan cover was not gratuitous. It was linked to the provision of credit, for which interest and fees were charged. But even if the supply of the loan cover was for no consideration, that is not conclusive. The loan cover was nevertheless supplied in the course or furtherance of the business of providing credit, and part of that business was the non-exempt "enterprise" of providing credit in return for taxable fees.

[35] The Supreme Court of Appeal thus erred, in Capitec's submission, in finding that the provision of the loan cover was made exclusively in the furtherance of making exempt supplies. The single supply of credit was a mixed supply, partly exempt and partly taxable. This accords, submits Capitec, with *Tourvest*.

[36] The Supreme Court of Appeal's invocation of capitalisation in the present case was, according to Capitec, plainly wrong. With reference to *Oneanate*,[20] Capitec argues that the unpaid fees do not lose their character as such simply because they have been debited to the customer's account and in that sense capitalised. The Supreme Court of Appeal's contrary finding has grave consequences for all providers of financial services. If unpaid fees are written off as irrecoverable, the vendor is entitled in terms of section 22(1) to reclaim from SARS the amount of VAT accounted for on the irrecoverable fees. However, if the debiting of the fees to the customer's account causes them to lose their character as fees and become an exempt supply of credit, this mechanism would not be available to the vendor.

[37] Capitec submits that its policies with the insurers were not legally relevant to the characterisation of Capitec's own supply of loan cover to its customers. The two are legally distinct contracts. According to Capitec, the Supreme Court of Appeal's analysis of the policy issued by the insurers was based on something which the Court itself raised for the first time during SARS' replying argument. Capitec's counsel objected that this was new. The nature of the supply made by the insurer to Capitec had never been an issue in the case.

[38] The Supreme Court of Appeal's analysis was in any event wrong, so Capitec contends. The insurers were long-term insurers registered in terms of the Long-Term Insurance Act.[21] In terms of section 2(1)(l) of the VAT Act, the supply of a long-term insurance policy is an exempt supply, so the VAT treatment of the premiums charged by the insurers and of the indemnity payments made by them was not the treatment which the Supreme Court of Appeal supposed.

[39] Finally, Capitec argues that section 17 finds no application in the case of section 16(3)(c). Section 17 deals only with the apportionment of amounts deductible

[20] *Standard Bank of South Africa Ltd v Oneanate Investments (Pty) Ltd (in liquidation)* [1997] ZASCA 94; 1998 (1) SA 811 (SCA); [1998] 1 All SA 413 (A) (*Oneanate*).

[21] 52 of 1998.

as "input tax". Section 16(3)(c) is not "input tax", and there is no such thing – so Capitec argues – as "notional input tax". According to Capitec, a vendor is entitled to a deduction in full in terms of section 16(3)(c), provided that the supply of the loan cover pertained to the making of taxable supplies, even if it did not pertain exclusively to taxable supplies. Alternatively, and if this Court were to find that there is a statutory basis for apportionment, Capitec asks that the matter be referred back to SARS for further examination and assessment.

SARS

[40] SARS supports the Supreme Court of Appeal's reasoning. It submits that the supply of the loan cover was made in the course of the exempt activity of supplying credit. The cost of providing the loan was "built into the interest rate". Furthermore, SARS supports the Supreme Court of Appeal's conclusion on capitalisation. The capitalisation of unpaid fees constitutes an advance of additional credit by Capitec to the customers. The loan cover related to the credit advanced, which would include capitalised fees.

[41] SARS also relies on the Supreme Court of Appeal's conclusion that the loan cover was provided for no consideration and was thus not a "taxable supply", and supports that Court's rejection of Capitec's reliance on section 10(23). However, SARS submits that the finding to this effect was *obiter* (in passing) and in any event a factual finding, so that an appeal in respect of this aspect should not be permitted.

[42] SARS rejects Capitec's submission that its contract with the insurer on the one hand and its provision of loan cover to borrowers on the other should be interpreted and treated as separate and independent. "Context and purpose" are said by SARS to be important. Capitec's approach is criticised as narrow legalistic formalism. The Supreme Court of Appeal did not, as claimed by Capitec, conflate the loan cover with the insurance policies, but "interpreted the transaction in accordance with its commercial substance".

[43] As to the VAT consequences of the policies issued by the insurers, SARS argues that Capitec is not necessarily right that the policies are long-term insurance, arguing that, to the extent that the policy insured Capitec in respect of retrenchment of borrowers, it was a short-term insurance policy. Conversely, to the extent that the policies issued by the insurers were long-term insurance policies, the loan cover would have a similar character, and would then not qualify for deduction. To the extent that the policies had a mixed character, apportionment was not pleaded.

[44] At best for Capitec, so SARS contends, the loan cover was supplied in the course of making mixed supplies which were partly exempt and partly taxable and thus subject to apportionment in terms of section 17. Since Capitec chose not to plead or prove apportionment, it is not entitled now to invoke apportionment. SARS rejects Capitec's submission that in terms of section 16(3)(c) it suffices, for a deduction in full, that the loan cover was supplied in part, though not exclusively, in the furtherance of the taxable activity of earning fees. The taxable activity was only a minor part of Capitec's provision of credit.

Condonation

[45] Capitec's application for leave to appeal was filed 10 court days late, for which it has sought condonation. There is a satisfactory explanation and SARS does not oppose condonation which should therefore be granted.

The issues

[46] The threshold questions, as always, are whether the matter engages this Court's jurisdiction and, if so, whether it is in the interests of justice to grant leave to appeal.

[47] If these threshold questions are answered affirmatively, the following issues arise on the merits:

(a) Was the loan cover provided free of charge?

(b) If so, does this lead to the conclusion that the provision of the loan cover was not a "taxable supply"?

(c) If the answers to questions (a) and (b) lead to the conclusion that the provision of the loan cover could in principle be a taxable supply, was it made exclusively in the course or furtherance of an exempt activity?

(d) If the loan cover was not made exclusively in the course or furtherance of an exempt activity but partly in the course or furtherance of the "enterprise" activity of earning taxable fees, does it matter that the unpaid fees were "capitalised" by being debited to the borrower's account and that the loan cover related to the total indebtedness of the borrower?

(e) If the answer to question (d) is not dispositive against Capitec, does section 16(3)(c) entitle Capitec to a deduction of the full amount contemplated in that section, even though the loan cover was also provided in the course or furtherance of the exempt activity of earning interest?

(f) If the answer to question (e) is no, is Capitec entitled to raise the question of apportionment, having not pleaded this in the Tax Court?

(g) If Capitec is entitled to raise apportionment, does section 17 apply? And if not, is there any other basis for apportionment?

(h) What is the relevance, if any, of the policies issued by the insurers and their VAT treatment?

[48] The case was conducted on the basis that the loan cover involved the supply by Capitec to the borrower of a "contract of insurance" for purposes of section 16(3)(c).[22] No argument to the contrary was advanced and I express no opinion on the matter. For

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[22] "Insurance" is defined in section 1 as meaning:

> "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;"

In terms of section 2(1)(i), "the provision, or transfer of ownership, of a life insurance policy" and "the provision or transfer of ownership of reinsurance in respect of any such policy" constitutes the provision of "financial services".

purposes of this case, we must proceed on the basis that the loan cover involved the supply of a contract of insurance.

Jurisdiction and leave to appeal

[49] Capitec invokes the general jurisdiction conferred on this Court by section 167(3)(b)(ii) of the Constitution. In terms of that provision, this Court may decide a matter that "raises an arguable point of law of general public importance which ought to be considered" by this Court. This Court's approach in assessing whether it has general jurisdiction under this provision is set out in the oft-cited *Paulsen* case.[23]

[50] This case raises several points of law of general public importance. These include, among others, the correct characterisation of supplies made free of charge; the legal significance, if any, of the fact that unpaid fees, the earning of which would ordinarily be an "enterprise" activity, have been capitalised; the proper interpretation of section 16(3)(c) in circumstances where the supply of an insurance contract is made in the course or furtherance of an activity which is partly exempt and partly of an "enterprise" character; and whether apportionment in any form is available in such circumstances. These questions transcend Capitec's interests and indeed the interests of banks. They are also arguable, as will appear.

[51] The importance of the questions and Capitec's prospects of success are weighty factors in favour of granting leave to appeal. There are no factors militating against granting leave, which should thus be granted.

[23] *Paulsen v Slip Knot Investments 777 (Pty) Limited* [2015] ZACC 5; 2015 (3) SA 479 (CC); 2015 (5) BCLR 509 (CC) (*Paulsen*) at paras 16-28. See also, for example, *Shiva Uranium (Pty) Limited (In Business Rescue) v Tayob* [2021] ZACC 40; 2022 (2) BCLR 197 (CC); 2022 (3) SA 432 (CC) at para 27 and *Big G Restaurants (Pty) Limited v Commissioner for the South African Revenue Service* [2020] ZACC 16; 2020 (6) SA 1 (CC); 2020 (11) BCLR 1297 (CC) at paras 11-5. In the latter case, this Court took into account that the Supreme Court of Appeal had reversed a well reasoned judgment of the Tax Court, even though in the event the Supreme Court of Appeal's decision was upheld.

The relevance and VAT treatment of the policies issued by the insurers

[52] The policies issued by the insurers and Capitec's provision of loan cover to the borrowers are separate contracts. Capitec could have obtained insurance against the risk of default by its customers without providing loan cover to the borrowers; and, conversely, Capitec could have provided loan cover to the borrowers without taking out insurance from the insurers (indeed, a small part of the loan cover was not matched by insurance).[24]

[53] No questions of interpretation of the insurance policies or the loan cover clause were debated in the litigation. If such questions had arisen, the loan contract could not have been interpreted with reference to the insurance policies, because the borrowers were not parties to the insurance policies and there is nothing to show that they ever saw the policies.

[54] The Supreme Court of Appeal erred in finding the VAT treatment of the insurance policies to be relevant. That question was not raised by the parties themselves. The late stage in which it arose in oral argument in the Supreme Court of Appeal created the risk that the Court might go awry in its analysis. In this Court, Capitec submits that the Supreme Court of Appeal indeed went wrong. Although this was the subject of cursory submissions in this Court, it is not appropriate for us to address it. We do not have the benefit of the Tax Court's assessment on the issue and this part of the Supreme Court of Appeal's judgment was not based on full argument. The question as to how the insurers and Capitec in fact dealt with the policies for VAT purposes could have been the subject of evidence, had it been relevant.

[24] According to Mr Retief, the amount in the relevant period not covered by Capitec's insurers was R3.9 million, less than 1% of the total loan cover payments. He testified that Capitec gave loan cover for loan contracts of six months or more, whereas the insurers only covered loans with a term of 12 months or more. In the period under consideration, there were 394 clients with loans of less than 12 months in respect of which Capitec paid loan cover, hence the amount of R3.9 million.

Was the loan cover provided free of charge?

[55] It is no doubt so that Capitec would not have provided loan cover to its unsecured borrowers unless the interest and fees it expected to earn from the provision of credit to the borrowers covered all its costs, including the cost of premiums payable to the insurers, and left a satisfactory return on capital. Economically, therefore, one might say that the provision of the loan cover was not "free".

[56] However, the contracts with the borrowers were explicit in stating that there was no charge for the loan cover. This was seemingly done by Capitec to ensure compliance with the National Credit Act. In these circumstances, it is not permissible, in my view, to allocate some unspecified part of the interest and fees as a notional charge for providing the loan cover, even if it were possible to find a rational basis for doing so. I thus consider that the case must be approached on the basis that the loan cover was provided free of charge.

Is a free-of-charge supply disqualified from being a "taxable supply"?

[57] A "taxable supply" is a supply as contemplated in section 7(1)(a). The supply contemplated in section 7(1)(a) is the supply by a vendor of goods or services "in the course or furtherance of any enterprise" carried on by the vendor. Section 7(1)(a) does not itself impose a requirement that the supply must be for consideration. In order, however, for the supply to fall within the scope of section 7(1)(a), it must be supplied in the course or furtherance of an "enterprise".

[58] The definition of "enterprise" requires that the enterprise or activity must be "carried on continuously or regularly" and must be one in the course or furtherance of which goods or services are supplied to another person "for a consideration, whether or not for profit". It expressly includes any enterprise or activity carried on in the form of a commercial or financial concern.

[59] The definition of "enterprise" does not require that *all* goods or services supplied in the course of that activity must be supplied for a consideration. The requirement is that the activity must be one in which goods or services are supplied for a consideration. It is not unusual for a for-profit business to supply some goods or services free of charge. The business may do so for marketing or advertising purposes. A retailer may offer shoppers an extra item free if a purchase is made or may hand out free samples to shoppers. A business may offer prizes to lucky customers. The goods thus supplied are undoubtedly supplied by the vendor in the course or furtherance of the enterprise, even though they are supplied free of charge.

[60] Contrary to the Supreme Court of Appeal's view, section 10(23) is relevant. It provides that, save as otherwise provided in section 10, "where any supply is made for no consideration the value of that supply shall be deemed to be nil". The Act thus envisages that a supply may be made for no consideration. The Supreme Court of Appeal is right that section 10(23) cannot convert a non-taxable supply into a taxable supply, but that is because section 10(23) is not concerned with whether the supply is taxable or non-taxable; that is determined by other factors. What section 10(23) makes clear is that any supply, whether taxable or non-taxable, may be a supply for no consideration, and it is then assigned a value of nil for any purposes relevant to the Act.

[61] What flows from this is that if a vendor, in order to advance the interests of its enterprise in which goods are sold for consideration, offers shoppers a free item as a marketing ploy, the free item, although it is a taxable supply, has a nil value, and so the VAT on that supply in terms of section 7(1)(a) is also nil. It is nevertheless important for such items to be classified as taxable supplies, because on this depends the vendor's right to deduct, as input tax, the VAT it had to pay in acquiring the goods which it supplied free of charge. In terms of section 17(1), the vendor is only entitled to a deduction as input tax to the extent that such goods were consumed, used or supplied "in the course of making taxable supplies".

[62] European VAT law appears to differ materially from ours in the respects relevant to this case.[25] However, the following passage from the United Kingdom's Upper Tribunal (Tax and Chancery Chamber) in *Tesco Freetime*[26] reflects the economic reality when free-of-charge supplies are made to promote a vendor's business. The Tribunal was addressing the argument that it would distort the VAT system if the vendor could deduct input tax but no VAT was payable by the customers who consumed the free supply:

> "[T]o the extent that this point was framed as a broader argument that 'the appropriate analysis under VAT law should produce a result where the tax does stick', we consider that it is met by an argument broadly similar to that set out by the FTT at paragraphs 85 to 94 of the Decision. Ms Foster QC's argument involves, as she put it, pulling back the camera so as to see the wider picture. If that is done, she submitted that the critical feature which emerges is the Clubcard member's consumption of (as the case may be) a free pizza or trip to the cinema. But why stop there? If the camera is pulled back to encompass the entire Tesco Clubcard programme, then the picture presented is one in which, while the cost of the programme is borne by Tesco in the first instance, it is merely one component of its overall business costs, all of which costs are factored into the prices at which its goods are offered to the public. Thus the apparently free gift, either by way of redemption goods and Rewards, is in economic reality paid for by Tesco's customers as a whole. Tesco accounts for the output tax received on such payments. Accordingly, taking this broad view of the Tesco Clubcard programme, there is sticking tax in the sense that VAT is accounted for by Tesco on the totality of the payments received from customers by Tesco as consideration for the totality of the goods and services supplied (directly or indirectly) by it to its customers."[27]

[25] In Interpretation Note 70 of 2013, above n 12, SARS observed, in a section of the Note dealing with the international characteristics and principles of VAT, that "there is a great deal of inconsistency in the VAT treatment of supplies made for no consideration" – para 3.3 at p 6. The national legislation of members of the European Union is based on the *Sixth Council Directive on the Harmonisation of the Laws of the Member States relating to Turnover Taxes – Common System of Value Added Tax: Uniform Basis of Assessment* (77/388/EEC), 17 May 1977 as amended, later updated and recast as the *Council Directive on the Common System of Value Added Tax* (2006/112/EC), 28 November 2006, as amended.

[26] *Revenue and Customs v Tesco Freetime Ltd* [2019] UKUT 18 (TCC); [2019] STC 1188.

[27] Id at para 56.

[63] It follows that Capitec's supply of the loan cover was not disqualified from being a "taxable supply" merely because it was supplied free of charge, and the Supreme Court of Appeal erred in finding otherwise.

[64] The Tax Court and the Supreme Court of Appeal referred in their judgments to SARS' Interpretation Note 70, as did the parties in argument. Although the conclusion I have reached is consistent with Interpretation Note 70 in both its 2013 and 2021 iterations, it is unnecessary to express a view as to what use if any may be made of such Notes when interpreting fiscal legislation, outside of the provisions of the Tax Administration Act[28] dealing with a "practice generally prevailing".[29]

Was the loan cover supplied exclusively in the course or furtherance of an exempt activity?

[65] Capitec does not contend that the free loan cover was offered exclusively in relation to the "enterprise" activity of earning taxable fees. Capitec recognises that, by providing free loan cover, it was making its overall credit offering more attractive, the credit offering being one in which Capitec earned exempt interest and taxable fees. Capitec's argument is that this mixed character does not affect the extent of the deduction to which it is entitled in terms of section 16(3)(c). That is a separate question, to which I return later.

[66] SARS, however, contends that the free loan cover was offered exclusively in relation to the exempt activity of earning interest. As I have already foreshadowed, the terms of the insurance policies are irrelevant in answering this question. It is perfectly true that the insurance policies provided cover to Capitec for the full amount outstanding by the borrower, subject to the monetary cap on policy benefits. The amount outstanding by a borrower would typically include unpaid capital, interest and fees. The

[28] 28 of 2011.

[29] See sections 5 and 99(1) of the Tax Administration Act. Although Capitec advanced an alternative argument based on a practice generally prevailing, the conclusions I have reached on Capitec's main case have made it unnecessary to consider the alternative argument.

fact that this is what the insurance policy as between Capitec and the insurer covered tells one nothing as to why Capitec, in a separate contract, offered loan cover to the borrower.

[67] The evidence put up by Capitec was clear and undisputed. Free loan cover was provided because it made Capitec's loan offering to unsecured borrowers more attractive. It placed Capitec "in a good competitive position relative to other credit providers", it was a "marketing benefit", it ensured that "during the sales process of credit we are in a position that we can offer a solution as good as any of our competitors" – this was Mr Retief's testimony. In other words, it advanced Capitec's business of lending money to unsecured borrowers. And Capitec lent money to unsecured borrowers in order to earn exempt interest and taxable fees. The evidence also showed that, when borrowers concluded loan agreements, Capitec gained the further benefit of fees on the savings accounts which a large majority of customers took out with Capitec at the same time.

[68] SARS placed reliance on the statement, in Capitec's 2016 annual report, to the effect that the bank had insurance against bad debts, but did not charge its clients credit life or retrenchment insurance "as this is built into the interest rate we charge our clients". This again confuses the policy issued by the insurer and Capitec's contract with the borrower. It matters not from what pot of money – the interest or the fees – Capitec regarded itself as meeting the cost of the premiums it paid the insurer. In order to determine whether the loan cover is an exempt, taxable or mixed supply, it is the purpose of Capitec's provision of the loan cover to its borrowers that is important. The evidence on that question was clear.

[69] Although it does not matter, I should add that Capitec's business model at the time was, as Mr Retief testified, to charge the maximum fees permitted in terms of the National Credit Act. The interest rate was thus the flexible tool by which Capitec could ensure that all its costs were met and that it achieved its desired profit margin while potentially winning clients by lowering the interest rate. It was thus natural for Capitec

to say that the cost of insurance was built into the interest rate which it charged the borrowers. There was nothing to show, however, that the interest and fees did not go into a common fund from which all costs, including insurance premiums, were met. It is doubtful that money paid by Capitec to an insurer as premiums would be directly traceable to money received as interest rather than fees. Money from borrowers would become mixed upon receipt.

[70] According to Mr Retief's evidence, moreover, the money Capitec earned from initiation and service fees generally exceeded the costs Capitec incurred in performing the administration tasks which the National Credit Act associates with initiation and service fees respectively, thus generating surplus funds to cover other costs of the lending operation. He was asked whether the loan cover was equally related to taxable and exempt supplies. He replied:

> "No. I would say that the loan cover is to the extent that the revenue is fees and VAT-able the loan cover to that extent has been – is being recovered from fees and to the extent that the total revenue is from interest, the loan cover is being recovered from interest. So I'm saying the total cost of the bank plus the private return on equity is recovered by price structure which is a combination of VAT-able and exempt supplies and that in my mind goes, call it ratios would apply to the extent to which we recover the cost from the clients through income."

That seems to me to be about as accurate a description as is possible in the circumstances.

[71] Subject to the question of capitalisation, which I consider next, the conclusion I reach is that the loan cover was a mixed supply made in the course and furtherance of Capitec's exempt activity of lending money for interest and its enterprise activity of lending money for fees. These were not in truth separate activities; there was a single activity of lending money for consideration which consisted of both interest and fees. Nevertheless, the proviso to section 2(1) compels one to treat the single activity as

consisting of two notional components, the one an exempt activity, the other an "enterprise" activity.

The capitalisation of fees

[72] The Supreme Court of Appeal's reasoning on capitalisation, and SARS' support of that reasoning, were misdirected. The argument is that the fees, once capitalised, constitute further credit, and the loan cover covers the borrower's full indebtedness, including the capitalised fees – in other words, that the loan cover simply covers the capital indebtedness, which may include credit advanced by capitalising fees.

[73] Even if that analysis were sound, why would it make a difference? The question that has to be answered, in terms of section 16(3)(c), is whether the supply of the loan cover to borrowers was a taxable supply. That depends on whether it was made in the course or furtherance of an enterprise. And that depends, in turn, on whether the activity, in the course or furtherance of which the supply was allegedly made, qualified as an "enterprise" and, if so, whether as a fact the supply was made in the course or furtherance of that enterprise.

[74] The precise legal character of the borrower's debt in respect of which the loan cover indemnified the borrower tells one nothing about whether Capitec's activity was an "enterprise" and whether the loan cover was offered in the course or furtherance of that enterprise. The question is not what benefit the borrower obtained from the free cover, but why Capitec conferred the benefit of free cover on the borrower.

[75] If a vendor offers a lucky customer a free refrigerator, it is irrelevant that the customer will use the refrigerator at home in a private activity which is not an "enterprise". The relevant question is why the vendor offered a lucky customer a free refrigerator. If the free refrigerator was offered as a marketing ploy to advance the vendor's activity of selling appliances for consideration, the free refrigerator would be a supply in the course or furtherance of that enterprise.

[76] Once one has concluded, as I have, that the free loan cover was offered in the course and furtherance of Capitec's lending business of earning exempt interest and taxable fees, one knows what has to be known. Precisely what debt of the borrower benefited from the loan cover is neither here nor there. The loan cover is offered at the time Capitec concludes its loan contract with the borrower. It is then that the purpose of the supply of the loan cover is established. Many customers may ultimately never need to claim indemnity under the loan cover, because they will not be retrenched or die during the term of the loan. The precise composition of the debt of a borrower who does need to claim the indemnity will depend on that borrower's precise circumstances.

[77] Nevertheless, it is important to emphasise that unpaid fees debited by Capitec to borrowers' accounts do not lose their character as fees, any more than the debited interest loses its character as interest. *Oneanate*[30] makes this clear. In that case the Supreme Court of Appeal approved the following passage from the judgment of the trial court:

> "Words like 'capitalisation' are used to describe the method of accounting used in banking practice. However, neither the description nor the practice itself affects the nature of the debit. Interest remains interest and no methods of accounting can change that."[31]

[78] It is precisely for this reason that "capitalised" interest is still interest for purposes of the *in duplum* rule (the rule which precludes the recovery of unpaid interest exceeding the outstanding capital). This rule, which has been confirmed in this Court,[32] would be rendered nugatory if the above statement in *Oneanate* were not sound. The debits in respect of interest and fees are clearly identified as such in the loan statements which Capitec issued to the borrowers.

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[30] *Oneanate* above n 20.

[31] Id at 828F-G.

[32] *Paulsen* above n 23.

The extent of the deduction permitted by section 16(3)(c) and apportionment

[79] It is convenient to take the remaining issues together, as they are related. There are four possibilities where the supply of a contract of insurance is a mixed supply made in the course or furtherance simultaneously of an exempt activity and an "enterprise" activity:

(a) that the vendor is entitled to deduct the tax fraction of the full amount of payments made in terms of the insurance contract;

(b) that the vendor is entitled to no deduction at all;

(c) that the vendor can claim the tax fraction of a portion of the payments made in terms of the insurance contract, invoking the apportionment provisions of section 17; or

(d) that the vendor can claim the tax fraction of a portion of the payments made in terms of the insurance contract, invoking an apportionment implicit in section 16(3)(c), interpreted in the context of the scheme of the Act as a whole.

[80] Capitec says that (a) is the correct answer. This is instinctively unattractive, made more so by the facts of this case, where the enterprise activity (that is, the fee-earning component) is only 5% to 13% of the whole, the rest being an exempt activity (that is, interest-earning). The scheme of the Act in general is that deductions against output tax are only permitted in respect of inputs consumed, used or supplied in the course or furtherance of the taxable activity. Capitec's argument disturbs this scheme.

[81] The same objection can be raised against (b). And in fairness, neither SARS nor the Supreme Court of Appeal adopted (b) as their position. Both SARS and the Supreme Court of Appeal took the view that, if the loan cover had a mixed character (something they rejected for other reasons), (c) was the correct answer, namely apportionment in terms of section 17.[33] But SARS argued and the Supreme Court of

[33] Section 17(1) provides:

Appeal held that section 17 apportionment was not available in this case because Capitec had not pleaded it.

[82] While apportionment in terms of section 17 would yield an acceptable result, the language of the Act does not accommodate it. Section 17 applies to the apportionment of VAT on goods or services which the vendor has acquired partly in the course of making taxable supplies and partly for some other use (for example, making exempt supplies), so as to determine what portion of such VAT the vendor may deduct as "input tax".

[83] In the context of the free loan cover, Capitec did not acquire any goods or services which it consumed, used or supplied to the borrowers or on which it paid VAT. There is no question of a portion of VAT which Capitec paid out to suppliers being deductible as "input tax". Section 16(3)(c) is a special tailor-made deduction in the case of the supply of a contract of insurance. The amount which the vendor can deduct in terms of section 16(3)(c) is not "input tax".

[84] The introductory part of section 16(3) does not refer to "input tax". It introduces a list of amounts which a vendor can deduct from its output tax in arriving at the net amount of VAT payable to SARS. Some of the items in the list are indeed

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> "Where goods or services are acquired or imported by a vendor partly for consumption, use or supply (hereinafter referred to as the intended use) in the course of making taxable supplies and partly for another intended use, the extent to which any tax which has become payable in respect of the supply to the vendor or the importation by the vendor, as the case may be, of such goods or services or in respect of such goods under section 7(3) or any amount determined in accordance with paragraph (b) or (c) of the definition of 'input tax' in section 1, is input tax, shall be an amount which bears to the full amount of such tax or amount, as the case may be, the same ratio (as determined by the Commissioner in accordance with a ruling as contemplated in Chapter 7 of the Tax Administration Act or section 41B) as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services: Provided that— . . ."

I note, in passing, that section 17(1)(i) contains a *de minimis* provision (a provision concerning trivialities) in favour of a vendor insofar as input deductions are concerned: where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95% of the total intended use of such goods or services, goods or services may be regarded as having been acquired wholly for the purpose of making taxable supplies. So if goods or services are used to the extent of 5% or less in making exempt supplies, there does not need to be an apportionment, and the vendor can deduct the full amount as input tax. Similar provisions are found in sections 18(4) and 18A(1). There is, however, no converse rule. In other words, the Act does not say that if a supply has a non-taxable component of 95% or more, the vendor may not make any input tax deduction.

"input tax" – paragraphs (a), (b), (g) and (k). But paragraph (c), with which we are concerned, does not describe the deduction as "input tax" nor would that be an apt term to describe the deductible amount in question.

[85] The reference, in the opening part of section 16(3), to the deductions being subject to the provisions of sections 15 and 17, is understandable. Some of the items in the section 16(3) list are "input tax", so it was appropriate for the lawmaker to make those deductions subject, among others, to section 17.

[86] Since the wording of the Act does not permit an answer in terms of (c) above, this leaves the possibility of (d), apportionment on some other basis. Section 16(3)(c) requires that the supply of the contract of insurance should be a taxable supply in order to qualify for deduction. In the light of the proviso to section 2(1), the lawmaker requires one to view the supply of the contract of insurance as partly a taxable supply and partly an exempt supply. The scheme of the Act, in circumstances such as the present, thus itself suggests an apportionment.

[87] The fact that the Act makes no explicit provision for apportionment in this situation is not dispositive against apportionment. In *Rand Selections*[34] the Appellate Division dealt with a case where the legislature had "artificially split liquidation dividends into 'income' and 'dividend'". The taxpayer, a share-dealer, had spent £367 859 in acquiring the shares in a company, Lace. When Lace went into liquidation, the taxpayer received dividends totalling £336 434, of which £124 123 was exempt from income tax in terms of the definition of "dividend", the balance of £212 311 representing income in the taxpayer's hands. Section 11(2)(f) of the Income Tax Act then in force[35] entitled a taxpayer to deduct expenditure and losses incurred in the production of "income" while section 12(f) prohibited a deduction of

[34] *Commissioner for Inland Revenue v Rand Selections Corporation Ltd* 1956 (3) SA 124 (A) (*Rand Selections*).

[35] 31 of 1941.

expenses incurred in respect of amounts received or accrued which did not constitute "income".

[88] Centlivres CJ, who gave the majority judgment, said that the legislature had "artificially split" the liquidation dividends received by the taxpayer into "income" and "dividend". One provision allowed a deduction of expenditure in the production of the "income" while another provision prohibited the deduction of expenditure in the production of the "dividend". He continued (in this passage "Company" refers to the taxpayer):

> "Had it not been for the fact that the Legislature split liquidation dividends into two parts the whole of the liquidation dividends would in this case have been 'income' as the Company was a share-dealer . . . and the whole of the expenditure of £367 859 . . . would have been deductible, for the whole of that expenditure would have produced the 'income'. The amount produced by the expenditure is the same whether or not there is a splitting of the liquidation dividends into two component parts and this is the important point to emphasise. In the present case we must regard the liquidation dividends as consisting of 'income' and 'dividend' and it would be idle to contend that the expenditure of £367 859 . . . produced 'income' only and not 'income' plus 'dividend' and, that being so, it necessarily follows from sections 11(2)(a) and 12(f) read together that there must be an apportionment of that expenditure. . . . In the present case the Company alleges in effect that it spent £367 859 . . . in producing the 'income' alone: that allegation is contrary to the facts of the case.
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> It was contended on behalf of the Company that, as the Act itself does not direct an apportionment of the expenditure or tell us how to ascertain what portion of the expenditure may be deducted from the 'income', the whole of the expenditure is deductible from the 'income'. I do not agree with this contention. The silence of the Act on the point might even be used as a basis for the contention that no portion of the expenditure is deductible, . . . The Commissioner has conceded, and I think rightly so, that a portion of the expenditure attributable to the 'income' can be deducted under section 11(2)(a)".[36]

[36] *Rand Selections* above n 34 at 131A-G.

[89] A similar question arose in *Nemojim*,[37] where the taxpayer's share-dealing business had a dual purpose, the earning of income in the form of the proceeds of shares on resale and the earning of exempt income in the form of dividends. The question was whether the taxpayer's expenditure on acquiring shares was wholly or partly deductible in terms of section 11(a) of the Income Tax Act.[38] Corbett JA rejected the Commissioner's first argument, which was that the taxpayer's sole purpose in buying shares had been to earn tax-exempt dividends. That contention was contrary to the facts, since the taxpayer had had a dual purpose.

[90] Corbett JA then considered the question of apportionment. After referring to *Rand Selections*, he said:

> "As pointed out in the *Rand Selections* case . . . , the Income Tax Act makes no provision for apportionment. Nevertheless, apart from the *Rand Selections* case, it is a device which has previously been resorted to where expenditure in a globular sum has been incurred by a taxpayer for two purposes, one of which qualifies for deduction and one of which does not . . . It is a practical solution to what otherwise could be an intractable problem and in a situation where the only other answers, viz disallowance of the whole amount of expenditure or allowance of the whole thereof, would produce inequity or anomaly one way or the other. In making such an apportionment the Court considers what would be fair and reasonable in all the circumstances of the case".[39]

[91] In my view, a similar approach is mandated in the context of section 16(3)(c) where the insurance contract is supplied only partly as a taxable supply. Section 72(1), could perhaps be called in aid to support this approach. That section empowers the Commissioner to decide how a particular provision should be applied or the calculation of tax done if, in consequence of the way in which a vendor conducts its business,

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[37] *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* 1983(3) SA 935(A) (*Nemojim*).

[38] 58 of 1962.

[39] *Nemojim* above n 37 at 951B-E.

"difficulties, anomalies or incongruities" have arisen or may arise in regard to the application of the provisions of the Act.[40]

[92] The next question is whether Capitec's failure to plead apportionment should result in Capitec being deprived of any deduction at all. When Capitec sought a deduction in full, SARS should – on the view I take of the law as applied to the facts of this case – have responded that it would permit a partial deduction, and it should have sought from Capitec the information required to determine a partial deduction. It was not correct for SARS to have disallowed the deduction in full.

[93] Capitec, having lodged an objection, in terms of rule 7, against the whole of the disallowance, appealed to the Tax Court against the whole of the dismissal of its objection. Capitec's failure to advance an alternative objection against only a part of the disallowance would not have precluded it from including this alternative in its appeal to the Tax Court. What the Tax Court Rules preclude is the raising of a new ground that constitutes a new objection against a part or amount of a disputed assessment that was not objected to under rule 7.[41] Since Capitec had objected to the

[40] Section 72(1) states:

> "If in any case the Commissioner is satisfied that in consequence of the manner in which any vendor or class of vendors conduct his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise in regard to the application of any of the provisions of this Act and similar difficulties, anomalies or incongruities have arisen or may arise for any other vendor or class of vendors of the same kind or who make similar supplies of goods or services, the Commissioner may make a decision as to—
>
> (a) the manner in which such provisions shall be applied; or
> (b) the calculation or payment of tax provided in this Act,
>
> in the case of such vendor or class of vendors or any person transacting with such vendor or class of vendors as appears to overcome such difficulties, anomalies or incongruities: Provided that such decision shall not—
>
> (i) have the effect of reducing or increasing the liability for tax levied under this Act; or
> (ii) be contrary to the construct and policy intent of this Act as a whole or any specific provision in this Act."

[41] Rule 10(3) provides that a taxpayer may not appeal "on a ground that constitutes a new objection against a part or amount of the disputed assessment not objected to under rule 7". Rule 32(3) states that an appellant in the Tax Court may not include, in its rule 32 statement, "a ground of appeal that constitutes a new ground of objection against a part or amount of the disputed assessment not objected to under rule 7".

whole of the disputed assessment, the alternative would not have involved an attack on a part of the assessment to which objection had not previously been taken.

[94] Capitec should nevertheless have pleaded the alternative, but the question is whether it should now be penalised for its failure to have done so. This judgment concludes that SARS should not have disallowed the objection in full. SARS, as an organ of state subject to the Constitution, should not seek to exact tax which is not due and payable.

[95] The fact that the evidence is not sufficient to enable this Court itself to make the apportionment does not stand in our way. In terms of section 129(2) of the Tax Administration Act,[42] the Tax Court may, on appeal to it, confirm an assessment or decision; or order the assessment or decision to be altered; or refer the assessment back to SARS for further examination and assessment; or make an appropriate order in a procedural matter. We can now make the order that the Tax Court should have made. This could include referring the assessment back to SARS for further examination and assessment, with a view to determining an appropriate apportionment.

[96] On the face of it, the appropriate apportionment would be based on the proportion that the taxable fees bore to the total consideration. The evidence points to the likelihood that this could be determined accurately and with relative ease.[43] In my view, therefore, we should remit the matter to SARS.

Costs

[97] The Supreme Court of Appeal, in upholding SARS' appeal, required Capitec to pay the costs of the litigation in the Tax Court. That order must have been an oversight. In terms of section 130(1) of the Tax Administration Act, the Tax Court may only make a costs order against a litigant in the circumstances listed in that subsection. Among

[42] Above n 28.

[43] The rate stack up model, adduced during the course of Mr Retief's evidence, provides a breakdown of fees and interest on loans of 36 months, 60 months and 84 months respectively.

others, costs may be awarded against SARS or the taxpayer if the grounds of assessment or grounds of appeal are held to be unreasonable. Neither side argued that the opposing litigant's grounds were unreasonable nor were they unreasonable. Indeed, the Supreme Court of Appeal's decision on an aspect which is no longer contentious, namely the remittal of penalties, shows that the Supreme Court of Appeal itself did not regard Capitec's grounds of appeal as unreasonable. It follows that the parties must bear their own costs in the Tax Court.

[98] As to the costs in the Supreme Court of Appeal, the appeal to that Court was against an order of the Tax Court which had allowed Capitec a deduction in full. This Court's decision is that the Supreme Court of Appeal should only have allowed SARS' appeal in part. That part, however, is very substantial, since on any approach to apportionment the allowable deduction would be modest, perhaps in the vicinity of 8% to 10%. SARS would thus still have achieved substantial success in the Supreme Court of Appeal and should have its costs in that Court.

[99] In this Court, Capitec is appealing against the decision of the Supreme Court of Appeal which deprived it of any deduction at all. The effect of our decision will be to grant Capitec some relief. Although such relief is likely to be modest in percentage terms, the monetary amount will not be trivial. For example, if the apportionment results in an allowable deduction of 8%, this will total about R5.72 million before taking interest into account. However, and although this might constitute substantial success for Capitec on appeal, it did not plead apportionment and has always run the case on the footing that it is entitled to a deduction in full. That is a battle which it has lost. I thus consider it fair to order the parties to bear their own costs in this Court.

Order

[100] The following order is made:

1. The late filing of the application for leave to appeal is condoned.
2. Leave to appeal is granted.
3. The appeal succeeds to the extent set out below.

4. The orders of the Tax Court and Supreme Court of Appeal are set aside.
5. The assessment for the applicant’s November 2017 value-added tax period is remitted to the respondent for examination and assessment in accordance with the principles set out in this judgment.
6. The parties must bear their own costs in the Tax Court.
7. The applicant must pay the respondent’s costs in the Supreme Court of Appeal, including the costs of two counsel.
8. The parties must bear their own costs in this Court.

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