Materiality in VAT disputes

The Tax Court in Johannesburg recently handed down judgment in a dispute between a vendor and SARS in which SARS, after making a substantial refund including interest, sought to reclaim the interest because of omissions from the VAT return which would have reduced the amount of the refund.

In Case Number VAT1712, there had been two issues. The first related to the claim made by the vendor in respect of input VAT for purchases of gold in a micro-refining enterprise and the second related to interest that SARS had paid to the vendor when making a VAT refund payment. Two separate judgments were issued. We discuss here the judgment relating to SARS' attempt to recover the interest that it had paid together with a refund.

The VAT returns rendered by the vendor for the months from December 2015 to March 2016 resulted in SARS being indebted to the vendor in an amount of approximately R71m. SARS conducted a limited scope audit in June 2016 and determined that the refund was indeed payable. However, based on certain risks it identified, it passed the matter to the Investigative Audit Unit for further consideration.

In September 2016, the vendor sought an order in the Johannesburg High Court to compel SARS to pay its refund together with interest. SARS did not oppose the application, and an order was granted. Payment was made of the tax due together with interest in December 2016.

In the course of the audit, it was discovered that the vendor had not accounted for output VAT on the use of a motor vehicle by its member during three of the months in an amount of R200.36 per month. It issued assessments for the amounts in question. The vendor's objection was disallowed, and, in the response, SARS claimed that it was entitled to repayment of the interest that it had paid in respect of the refunds for those periods.

The vendor appealed to the Tax Court, and judgment was given on 29 April 2020.

The law

Windell J had no difficulty in finding that the assessment to VAT in respect of the fringe benefit granted to the member by the vendor was properly made and that the vendor was liable for the amounts so assessed. The law on this issue is not discussed further.

The critical issue was whether the vendor was liable to make repayment to SARS of interest that had been paid to it by SARS in December 2016.

Section 45(1) of the Value-added Tax Act provides:

> '(1) Where the Commissioner does not within the period of 21 business days after the date on which the vendor's return in respect of a tax period is received by an office of the South African Revenue Service refund any amount refundable in terms of section 44 (1), interest shall be paid on such amount at the

prescribed rate (but subject to the provisions of section 45(A) and calculated for the period commencing at the end of the first-mentioned period to the date of payment of the amount so refundable: Provided that—

(i) where such return made by the vendor is incomplete or defective in any material respect the said period of 21 business days shall be reckoned from the date on which—

(aa) the vendor rectifies the return and satisfies the Commissioner in writing that the incompleteness or defectiveness of the return does not affect the amount refundable; or

(bb) Information is received by the Commissioner to enable him to make an assessment upon the vendor reflecting the amount properly refundable to the vendor;'

SARS' case was that the vendor had filed defective returns and that the defect only became evident when the investigative audit was undertaken, and therefore any interest that related to the period prior to the identification of the defect was not lawfully payable and was required to be repaid by the vendor.

The judgment

It was determined in the judgment that the vendor was liable to pay the additional VAT of R600.09.

The vendor's argument was that the additional amount of VAT that was assessed was a trifling amount and that it could not sustain a conclusion that the returns filed were 'incomplete or defective in any material respect'.

Windell J summarised SARS' position at paragraph [20] of the judgment:

'SARS's contention is the following: [the vendor's] failure to declare the fringe benefit amounted to non-compliance with the provisions of section 18(3) of the Act and constitutes an "error". The "error" is material to SARS and non-compliance with the relevant provisions of the tax Acts could simply not be condoned. The Commissioner is tasked with collecting all the taxes due to the fiscus, regardless of how "immaterial" they may seem to be. If the "error" was so immaterial, this could have easily prompted [the vendor] to declare the output tax before it was caught by SARS.'

In considering this aspect, Windell J considered the application of the concept in insurance law and at paragraph [22] quoted the following passage from Qilingile v SA Mutual Life Assurances Society 1993 (1) SA 69 (A) at 74:

'… what has to be ascertained is whether the result likely to have been caused by the misrepresentation is material. Materiality is not a relative concept; something is either material or it is not. Etymologically the word "material" ("wesenlik" in Afrikaans) denotes substance, as opposed to form. In legal parlance it bears a correspondent meaning: "Of such significance as to be likely to influence the determination of a cause … ." (The Shorter Oxford English Dictionary Vol 2 at 1289.)

Conformably, its meaning in insurance law is significant in relation to the determination of the risk.'

At paragraph [23] of the judgment Windell J clarified that section 45(1) is clear in its purpose in making SARS liable to interest on refunds such that:

'SARS was thus obliged, on first principles, to make payment thereof within 21 days after the date on which [the vendor's] returns were received. It failed to pay make payment and was liable to pay interest, except if the returns were incomplete or defective in any material respect.'

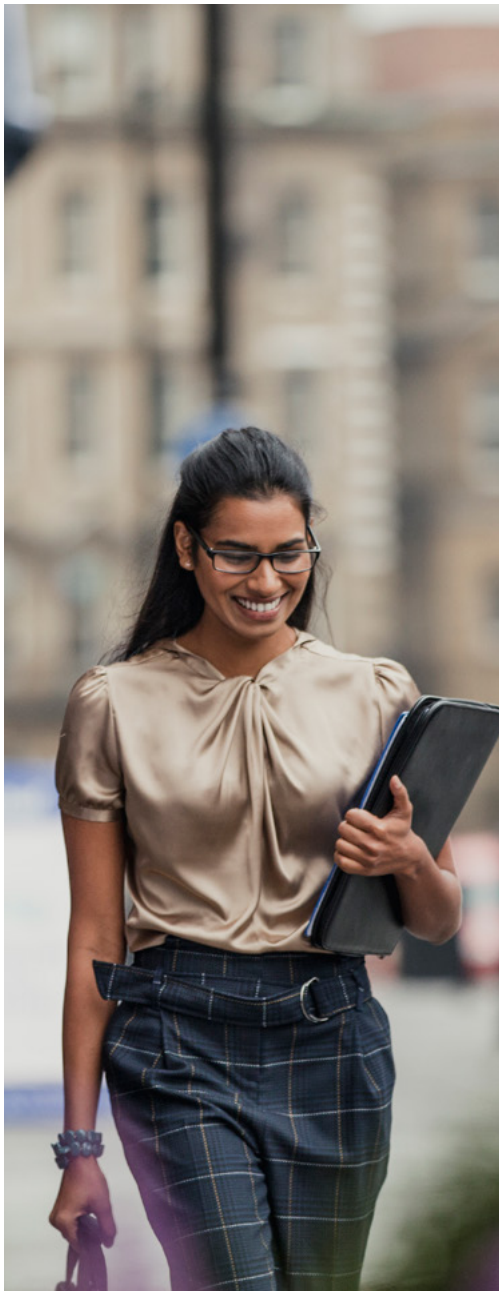
The assertion by SARS that any omission from a return is 'material' was roundly rejected. Windell J found that the provisions of section 45(1) did not support such a finding. She held at paragraph [25]:

'Section 45 is a pragmatic provision not concerned with principle but with materiality. It recognises the fact that vendors may render returns that are incomplete or defective. If it were a matter of principle then any defective or incomplete return would carry the consequence of SARS not having to pay interest. But, the Legislature, in its wisdom, determined that expedience trumps principle insofar as the payment of interest by SARS is concerned.'

In the case under consideration the defect related to some R600 in relation to a refund of R71m, a ratio of 1:180 000 or 0.0006%. Windell J therefore concluded, at paragraph [26]:

'This fraction does not satisfy the materiality test that the Legislature included in section 45 of the VAT Act. In the premises the attempt to rely on the fringe benefit errors is a transparent attempt for SARS to ex post facto wriggle out of its obligations vis-à-vis [the vendor]'

Judgment on this issue was given in favour of the vendor and SARS was ordered to pay the costs of arguing this issue.



The takeaway

The ability to defer the date from which interest is payable is peculiar to the VAT Act, and the provisions of section 45(1) apply, notwithstanding that there are provisions in the Tax Administration Act which regulate the payment of interest by SARS.

The Tax Administration Act (TAA) confers on SARS the right to defer the payment of a refund pending the outcome of a verification, inspection or audit of a refund. Unfortunately, the provisions of the TAA which determine the date from which interest shall be reckoned in respect of a variety of circumstances have not yet been brought into effect.

It appears that it is intended that section 45(1) will nevertheless continue to govern the payment of interest on VAT refunds even after the specific provisions are promulgated.

Vendors should examine carefully any refunds where interest paid does not appear to run from the due date of payment.

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