THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case no: 1025/2017

In the matter between:

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

and

RESPUBLICA (PTY) LTD **RESPONDENT**

Neutral citation: *CSARS v Respublica (Pty) Ltd* (1025/2017) [2018] ZASCA 109 (12 September 2018)

Bench: Ponnan, Wallis, Mbha and Makgoka JJA and Mokgohloa AJA

Heard: 23 August 2018

Delivered: 12 September 2018

Summary: Value-Added Tax Act 89 of 1991 – whether the supply of a building and related goods and services to an educational institution for use by its students under a written agreement amounts to the supply of 'commercial accommodation' as defined in section 1.

ORDER

On appeal from: Gauteng Division, Pretoria (Semenya AJ sitting as court of first instance):

1. The appeal is upheld with costs, including the costs of two counsel.
2. The order of the court a quo is set aside and replaced by:
   'The application is dismissed with costs, including the costs of two counsel.'

JUDGMENT

Ponnan JA (Wallis, Mbha and Makgoka JJA and Mokgohloa AJA concurring):

[1] This matter concerns the proper characterisation, for value-added tax (VAT) purposes, of the supply of a building and related goods and services to an educational institution under a written agreement, more particularly, whether that supply amounted to the supply of 'commercial accommodation' as defined in s 1 of the Value-Added Tax Act 89 of 1991 (the Act).

[2] With the leave of this court, the appellant, the Commissioner for the South African Revenue Service (SARS) appeals against a judgment of the Gauteng Division of the High Court, Pretoria (per Semenya AJ) granting the respondent, Respublica (Pty) Ltd (Respublica), declaratory relief as follows:

'1. . . .[T]he letting of accommodation by Respublica to TUT in terms of the lease agreement comprises of a taxable supply of commercial accommodation for value-added tax purposes and Respublica is obliged to levy and account for VAT in accordance with the Value-Added Tax Act 89 of 1991 on the rental payments it receives as consideration.

2. Respublica is liable to account for VAT on only 60% of the rental it receives in accordance with section 10(10) of the VAT Act.'

[3] The facts are not in dispute. Respublica owns immovable property situated within the Tshwane Metropolitan Municipality. The immovable property consists of 6 buildings configured into a number of furnished apartment-style living units suitable for student accommodation, as well as communal areas and facilities. On 9 December 2011 Respublica (as lessor)[1] concluded an agreement of lease with Tshwane University of Technology (TUT) (as lessee) in respect of the immovable property (the lease agreement).[2] The lease period was five years, renewable for an indefinite number of further periods of five years each. Provision was made in the lease agreement for the following:

(i) The premises were let to TUT for the sole purpose of allowing it to offer student accommodation to its students and for no other purpose.[3] TUT was also permitted to use the premises to accommodate holiday groups during university vacations.

(ii) TUT would allow students to occupy the leased premises pursuant to valid lease agreements contemplated in clause 9.2. Clause 9.2 envisaged TUT issuing a letter to students confirming their allocation to the residence for the academic year, without which a student might not occupy the accommodation. Presumably the terms upon which TUT admitted its students to the residence, including the costs thereof, were contained in agreements concluded directly between those students and TUT.

(iii) Respublica played no role in the selection and placement of students at the residence. Nor did it select the holiday visitors. This was done by TUT.

(iii) TUT undertook to take all necessary measures to control and ensure the proper discipline of the students accommodated on the leased premises, including ensuring strict compliance with the house rules.

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[1] Respublica was previously known as Midnight Storm Investments 399 (Pty) Ltd t/a Urban Nest. The original lease thus reflected Midnight Storm as the lessor.

[2] Although clause 3 of the lease stated that Respublica lets the leased premises to TUT, which is defined as the buildings situated at the immovable property, it is plain from the lease as a whole (e.g. the preamble, clause 2 and clause 18.1) that what is let is both the leased premises and the immovable property.

[3] Clause 10.2 of the lease agreement provided that TUT shall not use the premises for any other purpose, or permit any student or other person to do so, without the written consent of the respondent.

(iv) TUT undertook to ensure that each student vacated the premises by no later than the date on which he or she ceased to be a student or the date on which his or her right to reside there was terminated.

(v) TUT was liable to pay a monthly rental in respect of the leased premises, calculated by reference to a minimum number of beds to be provided in the leased premises. The rental was payable by TUT irrespective of whether or not the minimum beds were actually occupied.

(vi) TUT undertook, on termination of the lease, to restore the premises in good order and condition and not to make alterations or additions to the premises without consent or cause or permit damage to the premises or the commission of any nuisance on the leased premises.

(vii) Respublica provided agreed furnishings and amenities (such as internet connectivity and entertainment areas with televisions) as part of the leased premises, laundry facilities[4] and utilities (water and electricity) to the leased premises.

(viii) Respublica was responsible for the routine maintenance and repair of the premises and provided management services, including security and cleaning.

(ix) Respublica was entitled to enter the leased premises at all reasonable times for specified purposes.

(x) TUT was liable to pay holding-over rental if, on the expiry of the lease, it failed to ensure that all students and other persons immediately vacated the immovable property and the leased premises.

[4] Respublica's performance under the lease agreement was a taxable supply for purposes of the Act, with VAT chargeable at 14% of the value of the supply, unless one of the exemptions, exceptions, deductions or adjustments contained in the Act applied (s 7). Respublica contended that the provisions of s 10(10) of the Act applied and that it was only obliged to charge VAT on 60% of the total consideration received from TUT under the agreement. That section provides:

[4] In terms of clause 7.12 of the lease agreement, TUT was also responsible for the cost of water and electricity consumed by the laundry.

'Where domestic goods and services are supplied at an all-inclusive charge in any enterprise supplying commercial accommodation for an unbroken period exceeding 28 days, the consideration in money is deemed to be 60 per cent of the all-inclusive charge.'

[5] Section 10(10) of the Act in its current form was introduced by s 152(1)(a) of the Second Revenue Laws Amendment Act 60 of 2001. The amendments to the definitions in s 1 of the Act consisted of the insertion of a new definition for 'commercial accommodation' and the deletion of the definitions of 'commercial rental establishment' and 'residential rental establishment'. According to the relevant explanatory memorandum issued by the South African Revenue Service:[5]

'These proposed amendments, together with the amendment of s 10(10) and 12(c), are intended to simplify the provisions of the Value-Added Tax Act relating to the supply of accommodation in hotels, boarding houses, retirement homes and similar establishments. In the 2001 Budget Review it was announced that these provisions would be revised.

The Act provides that short-term stays in accommodation establishments are taxed at the full value of such supplies, while only 60% of such value is taxed where the accommodation constitutes the dwelling of the occupant. The reason for this is that persons resident in their own or rented dwellings are not subject to VAT on the full cost thereof. Mortgage interest and municipal rates, or alternatively, rent are exempt from VAT. The South African VAT base is roughly 60 per cent of GDP. Natural persons living in accommodation establishments should be taxed at an equivalent rate.

It should be borne in mind that most people living in boarding houses, retirement (old age) homes and homes for children or handicapped persons do not stay there as a matter of choice, but of financial or other necessity. . . .'

[6] Section 10(10) finds application, inter alia, where a vendor supplies 'commercial accommodation', which is defined as:

'(a) lodging or board and lodging, together with domestic goods and services, in any house, flat, apartment, room, hotel, motel, inn, guest house, boarding house, residential establishment, holiday accommodation unit, chalet, tent, caravan, camping site, houseboat, or similar establishment, which is regularly and systematically supplied and where the total annual receipts from the supply thereof exceeds R60 000 per annum or is reasonably expected to

[5] www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2001-01-ExplanatoryMemorandumRevenueLawsAmendmentBill2001.pdf accessed 28 August 2018.

exceed that amount in a period of 12 months, but excluding a dwelling supplied in terms of an agreement for the letting and hiring thereof:

(b) lodging or board and lodging in a home for the aged, children, physically or mentally handicapped persons; and

(c) lodging or board and lodging in a hospice.'

[7] The first, and perhaps, decisive question is whether Respublica can be said to have provided lodging to TUT. The dictionary meaning of 'lodging' is 'a temporary place of residence'[6] or 'a temporary residence; sleeping accommodation,'[7] whilst a 'lodger' is 'a person who pays rent in return for accommodation in someone's house'.[8] As it was put in *Koffman v Hercules Municipal Council*[9] at 88:

'A lodger is a person who occupies a room in the house of another of which room that other person retains control'.

On the ordinary meaning of the word, a 'lodger' is a natural person who actually takes up temporary accommodation. If so, lodging cannot be provided to a juristic person that has 'no body to kick and no soul to damn'.[10] The notion that Respublica provides 'lodging' to a juristic person such as TUT, which is by its nature incapable of living in accommodation, is therefore inconsistent with the ordinary meaning of the word as used in the Act.

[8] What is more, there may be a distinction between a 'lodger' and a tenant under a conventional agreement of lease.[11] In *S A Breweries Ltd v Rent Control Board*[12] at 71-72, Hathorn JP, writing for the majority, explained:

'. . . there is ordinarily no contract of letting and hiring between a hotel keeper and a person who occupies a room in a hotel. I will call him a lodger. It follows that a lodger is not a sub-lessee, and consequently the second essential is absent here because the premises are not occupied as a human habitation by the lessee in terms of the lease . . . or by a sub-lessee. .

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[6] Oxford South African Concise Dictionary.
[7] Collins English Dictionary.
[8] Collins English Dictionary.
[9] *Koffman v Hercules Municipal Council* 1948 (1) SA 85 (T).
[10] *CIR v Richmond Estates Ltd* 1956 (1) SA 602 (A) at 606.
[11] *Koffman v Hercules Municipal Council* (supra) at 88.
[12] *S A Breweries Ltd v Rent Control Board* 1943 NPD 64. Carlisle J concurred in the judgment of Hathorn JP. Although Selke J arrived at the same conclusion, his reasons differed in some respects from the majority.

. . The result is exactly in accord with the object of the Act, which was designed to protect lessees and sub-lessees. It was not designed to protect lodgers.'

Later, the learned Judge President added (at 73-74):

'. . . [W]hen one thinks of the extensive rights which a lessee acquires under a lease and compares them with the limited rights of a lodger in a hotel it seems to me to be obvious that the contracts are not the same. Thus, it is clear to me that a lodger has no right to make drastic alterations in the position of the furniture in the room he occupies. Nor has he the right to call in artisans to paint or to attend to the water supply or to the lighting in the room. These are matters for the hotel keeper. In short, the hotel keeper retains control of the room and gives to the lodger a very limited right of use, which, although it be an exclusive one, is not comparable to the extensive rights of a lessee under a contract of letting and hiring. There appears to be little authority in our law on the subject but the view I have expressed is supported by the case of *Pay v Morton* 18 CTR 819 . . . Morton was a monthly boarder. Maasdorp J, who decided the case, took the view that the contract was of a special nature, to which none of the authorities before him applied. These authorities were authorities on letting and hiring. It is clear, therefore, that the learned Judge was of opinion that a contract for board and lodging, even if it was by the month, was not a contract of letting and hiring.'

[9] We need not decide here whether the distinction drawn between a contract of letting and hiring and one for the provision of board and lodging is correct. The matter was not dealt with in detail in argument and the view expressed by Hathorn JP was in part based upon the English concept of a licensee, which is not known in our law. The judgment highlights the fact that the provision of board and lodging is a very personal one and, if it is a lease, is one subject to stringent terms not normally encountered in a conventional lease. The relationship between TUT and Respublica bears little resemblance to conventional arrangements for the provision of board and lodging.

[10] That, however, is not the end of the matter. Respublica contends that its supply to TUT met the definition of commercial accommodation, because the accommodation supplied by it was used by the students, who, so the contention goes, were in truth the 'lodgers'. In my view Respublica's approach is analytically unsound. It fails to take proper account of the nature of the contractual arrangements and conflates two distinct supplies. I accept for present purposes that it may well be theoretically possible for A to

conclude an agreement with B for the provision of lodgings to C. On the facts outlined above, however, it is apparent that two distinct legal relationships were contemplated. The first, between Respublica and TUT and, the second, between TUT and its students and holiday visitors. In terms of the first, there was a 5-year renewable lease of immovable property by Respublica to TUT, together with an undertaking to provide specified services and utilities to the property. The second contemplated numerous shorter term agreements between TUT and its students and holiday visitors in terms of which the former provided accommodation to those persons. There was no contractual relationship between Respublica and the students or holiday visitors for the lease of the premises or the provision of accommodation. The students looked to TUT for a place in the residence, which the latter hired from Respublica. TUT made a separate supply of accommodation to its students. That supply, 'being a supply necessary for and subordinate and incidental to the supply of [educational services] [and] supplied for a consideration in the form of . . . payment for board and lodging', was exempt from VAT by virtue of s 12(*h*)(*ii*) of the Act.

[11] Here, Respublica supplied the immovable property and leased premises to TUT under an agreement of lease. It handed over possession and occupation of the property to the latter for the duration of the lease period and in return received a specified monthly rental. The lease contained a full range of terms typically found in a property lease. It is so that Respublica was required in terms of the lease agreement, in addition, to provide TUT with residential management services on the premises. These supplies were plainly ancillary to the lease. They did not detract from the core basis for TUT's occupation of the premises, namely a lease of immovable property.

[12] Respublica's approach is contrary to the general principle (as recognised in other VAT jurisdictions) that the VAT consequences of a supply must be assessed by reference, first and foremost, to the contractual arrangements under which the supply is made. In New Zealand, whose Goods and Services Tax (GST) legislation influenced our own, *Rotorua Regional Airport Limited v Commissioner of Inland Revenue* held:

'[t]he nomenclature used by the parties is not decisive. Nor are the economic or other consequences. What is crucial is the ascertainment of the legal rights and duties which are actually created by the transaction into which the parties entered'.[13]

The issue in *Rotorua* was whether an airport operator had to charge GST on a 'development levy' paid by departing passengers. The operator argued that it was not so obliged because the levy was not consideration for a supply, and was used to fund future facilities. The court however found that because the passengers had to pay the levy to the operator in order to take flights from the airport, the levy was consideration for the use of the airport. It also held that (para 53): 'because the focus is on the legal relationship between [the operator] and passengers . . . the use to which the funds are in fact put is not relevant'.

[13] A similar approach has been adopted in English law, where the majority of the Supreme Court in *Airtours Holidays Transport Limited v Commissioner for Her Majesty's Revenue and Customs*[14] para 47 observed: 'when assessing the VAT consequences of a particular contractual arrangement, the court should, at least normally, characterise the relationship by reference to the contracts and then consider whether that characterisation is vitiated by [any relevant] facts'. Likewise, in the context of European VAT jurisprudence, the European Court of Justice has stated 'a supply of services is effected for consideration . . . only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance.' [15]

[14] So viewed, one cannot legitimately attribute to Respublica's supply, governed as it was by its own contractual terms, the characteristics of an altogether different supply of accommodation to third parties under separate contracts, with whom it had no contractual nexus. The test for whether Respublica supplied lodging cannot be whether the end-use of the property under the second set of supplies by TUT was temporary in nature or constituted the supply of lodgings to the students. The relevant contractual rights and obligations were those as between Respublica and TUT, and did not involve

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[13] *Rotorua Regional Airport Limited v Commissioner of Inland Revenue* (High Court, Wellington) CIV-2008-485-2524 para 50, relying on a number of Court of Appeal authorities.

[14] *Airtours Holidays Transport Limited v Commissioner for Her Majesty's Revenue and Customs* [2016] UKSC 21; [2016] 4 All ER 1 (SC).

[15] *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* Case C-16/93 para14.

the supply of temporary accommodation. The fact that TUT supplied temporary accommodation in the form of lodging to its students is *res inter alios acta* and is irrelevant. Accordingly, as the supply by Respublica to TUT does not meet the first requirement of the 'commercial accommodation' definition that suffices to determine the appeal against it. It is thus unnecessary to consider whether the other requirements have been met. Nor, is it necessary to consider whether the supply by Respublica is 'a dwelling supplied in terms of an agreement for the letting and hiring thereof', because counsel were agreed that the exclusion did not find application and accordingly need not detain us.

[15] In the result:

1. The appeal is upheld with costs, including the costs of two counsel.
2. The order of the court a quo is set aside and replaced by

'The application is dismissed with costs, including the costs of two counsel.'

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V M Ponnan

Judge of Appeal

APPEARANCES:

For Appellant:	MW Janisch SC (with him TS Sidaki)
	Instructed by: Mothle Jooma Sabdia Inc., Pretoria Symington De Kok Attorneys, Bloemfontein
For Respondent:	AR Sholto-Douglas SC (with him PA Swanepoel)
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