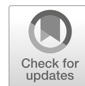
Interaction between Fringe Benefits Values and VAT



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Abstract The main objective of this study was to seek certainty regarding the interaction between the value-added tax (VAT) implications of fringe benefits and their impact on the taxable values of such taxable fringe benefits for income tax purposes. Hence, the study investigated whether VAT should be included or excluded when the taxable value of fringe benefits for income tax purposes are determined. In 2019, a minor amendment was made to the opening words of section 23C(1) of the Income Tax Act (No. 58 of 1962), a section that links the VAT consequences of a fringe benefit to that of determining its taxable value for income tax purposes. However, the actual words applied in the Amendment Act do not align with the National Treasury's intention as described in its Explanatory Memorandum. This misalignment is the problem that the study aimed to address, highlighting the two possible approaches of interpretation: literal versus purposive. The methodology adopted was nested in the paradigm of interpretivism, whereby a qualitative research approach was employed by means of doctrinal research, supplemented by a basic comparative analysis of two different approaches of interpretation. The outcome of the study highlight an anomaly in the income tax consequences triggered by the application of section 23C(1), causing an unintended change in policy that has a negative impact on the taxable value of taxable fringe benefits. The paper makes recommendations to be considered by the legislator to rectify the identified anomaly, which could aid in providing certainty regarding the interaction between fringe benefit values and VAT.

Keywords Cash equivalent · Fringe benefit value · Income tax · Market value · Section 23C · Value-added tax

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1 Introduction

From a tax policy perspective, the most useful definition of a "fringe benefit" is that it constitutes a voluntary employer expense in the form of non-cash compensation (Turner, 2009). The term "fringe" could be defined as "on the edge", "at the border of" or "not part of the main", while the term "benefit" is described as "an advantage or a profit gained from something" (Tonkin, 2021, para. 2). Therefore, a fringe benefit should be understood as a non-cash benefit or advantage gained by an employee that does not form part of such employee's primary remuneration package.

Where an employer (or associated institution in relation to such employer) decides to grant a non-cash benefit or an advantage to its employee, such a supply could trigger income tax implications in the hands of the employee who receives such benefit. However, before such benefit could be subject to income tax, it first needs to qualify as a "taxable benefit" as defined and described in terms of paragraph 1, read with paragraph 2, of the Seventh Schedule to the Income Tax Act (No. 58 of 1962) (hereafter referred to as "the Act"). A taxable benefit constitutes a benefit, or an advantage, granted by an employer to an employee by virtue of such employee's employment at such employer, or for services rendered (or to be rendered) by such employee to its employer (Republic of South Africa, 1962).

Furthermore, it is important to note that any benefit received in the form of cash is specifically excluded from the scope of a taxable benefit and could therefore not trigger an income tax liability in terms of the Seventh Schedule to the Act. Even though employment benefits received for services rendered in the form of cash, such as cash salaries and cash allowances for travel and subsistence, will be excluded from taxable benefits, these will still be taxable, as they still qualify for inclusion in an employee's gross income in terms of special inclusion paragraph (c) of "gross income" as defined in section 1(1) of the Act (Republic of South Africa, 1962). Cognisance should be taken of the fact that instances do exist where a "no value" needs to be placed on a specific fringe benefit. However, all no value fringe benefits fall outside the scope of this paper, as they will have no output tax effect due to their value of supply being nil for value-added tax (VAT) purposes.

Special inclusion paragraph (i) under "gross income", as defined in section 1(1) of the Act, makes any fringe benefit taxable (irrespective of it being capital in nature or not) by regulating that its cash equivalent needs to be included in the employee's gross income (Republic of South Africa, 1962). The value of the cash equivalent of any type of taxable benefit will, in general, be determined by the application of the following formula: the private value of the benefit or advantage granted, reduced by any consideration given by the employee to the employer for such private use (South African Revenue Service, 2013). The value to be placed on "the value of private use" for application under the cash equivalent formula will however differ depending on the type of benefit or advantage that is being granted as a taxable benefit. Table 1 contains an overview of the different types of benefits or advantages that could be granted by an employer to its employee. Each of these is specifically

Table 1 Overview of the different types of fringe benefits regulated within the scope of the Seventh Schedule to the Act

Regulation provisions: Paragraph numbers	Description of type of benefit or advantage (fringe benefit)
2(*a*) & 5	Acquisition of an asset at less than its actual value
2(*b*) & 6	Right of use of any asset (other than residential accommodation or any motor vehicle)
2(*b*) & 7	Right of use of a motor vehicle
2(*c*) & 8	Meals, refreshments and meal and refreshment vouchers
2(*d*) & 9	Residential accommodation
2(*e*) & 10	Free or cheap services
2(*d*) & 10A	Residential accommodation treated as a low-interest loan
2(*f*) & 11	Benefits in respect of interest of debt
2(*g*), 2(*g*A) & 12	Subsidies in respect of debt
2(*i*) & 12A	Contribution to benefit fund
2(*j*) & 12B	Incurral of costs relating to medical services
2(*k*) & 12C	Benefits in respect of insurance policies
2(*l*) & 12D	Valuation of contributions made by employers to certain retirement funds
2(*m*) & 12E	Contribution to bargaining council
2(*h*) & 13	Payment of employee’s debt or release of employee from obligation to pay a debt
16	Benefits given to relatives of employees and others

Source: Authors’ compilation deduced from Seventh Schedule to the Act (Republic of South Africa, 1962)

regulated by different paragraphs contained under the Seventh Schedule to the Act as to what “value of private use” needs to be placed on it.

Apart from the income tax consequences that could be triggered in the hands of employees who receive a taxable fringe benefit granted by their employer (as indicated in Table 1), such a supply of a taxable fringe benefit could also trigger VAT implications in the hands of the employer if such employer is a registered VAT vendor. As section 23C of the Act plays a crucial role in linking the VAT consequences of a fringe benefit to that of determining its taxable value to be applied for income tax purposes, a review of the purpose of section 23C of the Act, as well as a historical review of the amendments that had been affected to section 23C of the Act, is presented next.

2 Literature Review

The purpose of section 23C of the Act is to prevent a double deduction for an income taxpayer who is also a VAT vendor. Section 23C ensures that the VAT (input tax) that has already been allowed to be claimed under section 16(3) of the VAT Act

cannot be claimed again as a deduction for income tax purposes (National Treasury, 2001a).

Before 1 October 2001, section 23C of the Act only referred to the "cost" of an asset or "expenditure incurred" by a taxpayer, being silent on the scenario where, for example, a deduction in respect of an asset is not based on "cost", but rather on "market value". Uncertainty prevailed on whether VAT will be included or excluded from the "market value" if such market value is to be applied as the value of such asset for income tax purposes. To remove the latter uncertainty, section 23C of the Act was amended effective from 1 October 2001 to extend its application by the inclusion of the term "market value" within the ambit of this provision (National Treasury, 2001b). The Explanatory Memorandum that supported the latter amendment also clarified that if VAT (input tax) was allowed to be claimed upon the acquisition of such asset, the claimed VAT needs to be excluded from the market value of such asset.

After the former amendment, section 23C of the Act had been amended once more. Before its final amendment in terms of the Taxation Laws Amendment Act of 2019, the opening words of section 23C(1) of the Act read as follows: "*Where for the purposes of applying any provision of this Act*, regard is to be had to the cost to the taxpayer or the market value of any asset acquired by him . . ." (emphasis added) (National Treasury, 2019b, p. 30). Hereafter, the opening words of section 23C(1) of the Act were replaced, and currently still read as follows: "*Notwithstanding the Seventh Schedule*, where regard is to be had to the cost to the taxpayer or the market value of any asset acquired by him or her . . ." (emphasis added) (National Treasury, 2019b, p. 30).

The Explanatory Memorandum on the objects of the Tax Administration Laws Amendment Bill (TLAB) of 2019 set out the policy objectives which the TLAB aimed to achieve (National Treasury, 2019b). Under clause 26 of the Explanatory Memorandum on the 2019 TLAB (National Treasury, 2019b), the rationale and motivation for the 2019 amendment to section 23C(1) of the Act were provided as follows:

> In 2015, *Regulations dealing with "determined value" in paragraph 7(1) of the Seventh Schedule on retail value in respect of right of use of motor vehicle* came into effect. The proposed amendment in subsection (1) seeks *to align the policy intention as outlined in the Regulation* and clarify that VAT is to be included in the "*determined value*" used to calculate the fringe benefit arising in the employee's hands (emphasis added) (p. 56).

The phrase "to align the policy intention as outlined in the Regulation", encapsulated in the description of the rationale and motivation furnished by the National Treasury under clause 26 of the Explanatory Memorandum on the 2019 TLAB (National Treasury, 2019a, p. 56) in support of the reason why the proposed amendment to the opening words of section 23C(1) is required, effectively refers to the regulations as contained in Government Regulation 362.

This regulation was issued, and became effective on 1 March 2015, to assist in clarifying the uncertainties that prevailed regarding the value to be used as the "determined value" in determining the value to be placed on the "right of use of a

motor vehicle" fringe benefit in different scenarios. Government Regulation 362 (National Treasury, 2015) clarifies that where any motor vehicle is manufactured, obtained or acquired or the right of use of any motor vehicle is obtained by the employer, the retail market value thereof for the purposes of items (a) and (c) of the definition of "determined value" in paragraph 7(1) of the Seventh Schedule to the Act will constitute, in respect of any year of assessment commencing on or after 1 March 2018, an amount equal to the "dealer billing price", which will represent an amount inclusive of VAT (National Treasury, 2015).

As the National Treasury's formulated policy objective to rationalise the reason behind the amendment of the opening words of section 23C(1) refers to the term "determined value" and uses the phrase "to align the policy intention as outlined in the Government Regulation", it seems that the legislator's intention behind this amendment was to only supersede the "right of use of a motor vehicle" fringe benefit above that of the provisions of section 23C. Hence, it seems as if the provisions of section 23C should only be subject to that of the taxable benefit regulated under paragraph 7 of the Seventh Schedule to the Act, and not to the rest of the taxable benefits as contained under the Seventh Schedule to the Act.

Therefore, it is questionable whether the National Treasury's rationale and motivation (as directly quoted above) in support of the need to amend the opening words of section 23C(1) of the Act are truly reflected in the outcome obtained when the new opening words of section 23C(1) (as introduced in terms of the latest amendment made to section 23C) are interpreted based on a literal approach of interpretation in comparison to the outcome it intended to derive based on a purposive approach of interpretation. Where different outcomes are derived from the interpretation of legislation based on a literal, as opposed to an interpretive approach of interpretation, such differences aid in creating and causing uncertainty among taxpayers in terms of how to correctly interpret and apply such legislation.

3 Research Question, Objectives and Contribution

The main aim of this study was to seek certainty regarding the interaction between the VAT implications triggered by the supply of fringe benefits and their impact on determining the taxable values of such taxable fringe benefits for income tax purposes. Therefore, the following research question was formulated for this study: Should VAT be included or excluded when the taxable value of fringe benefits is determined for income tax purposes?

In support of answering the research question, the following research objectives were set for the study:

1. To conduct a doctrinal analysis of the current legislation regulating both the VAT and the income tax treatment of taxable fringe benefits when granted by an employer (a registered VAT vendor) to its employee

2. To conduct a basic comparative analysis to illustrate two possible outcomes that could be derived from employing two different approaches of interpretation, namely the literal approach of interpretation (Case 1) as opposed to the purposive approach of interpretation (Case 2), to section 23C, which serves as the provision linking the VAT consequences of a fringe benefit to that of determining its taxable value for income tax purposes.

The study undertook to contribute by making a recommendation, based on the findings of the doctrinal and basic comparative analysis of different interpretations, that could provide better certainty regarding the interaction between fringe benefit values and VAT. More specifically, this recommendation could assist the legislator to address the anomaly on whether VAT should be considered when determining fringe benefit values in the hands of employees.

The remainder of this paper is structured as follows: First, the research methodological criteria employed in this study as the strategy for conducting the research are framed and motivated. This is followed by the doctrinal investigation to conceptualise and explain the working and requirements of the legislative provisions that are applicable on the supply and receipt of a fringe benefit under both the VAT Act (more specifically, sections 18(3) and 10(13)) and the Income Tax Act (more specifically, the provisions contained within some of the paragraphs under the Seventh Schedule to the Act) as well as section 23C of the Act, which serves as a link between the VAT Act and the Act. The latter will address Research objective 1. Next, to address Research objective 2, the findings deduced from the doctrinal analysis under Research objective 1 were applied to conduct a basic comparative analysis based on two different approaches of interpretation. The comparative analysis attempted to establish how the income tax implications triggered by the interpretation and application of the opening words of section 23C(1) of the Act, based on a literal approach of interpretation, compare to the income tax implications that were aimed to be achieved under the policy objective set by the National Treasury, which motivated the need for the opening words of section 23C(1) to be amended. Finally, the paper concludes by summarising the main findings in the context of both research objectives to answer the research question, make recommendations, acknowledge the limitations of the research, and suggest an area for further research.

4 Methodology

This study was nested in the interpretivist paradigm. Research positioned in the paradigm of interpretivism is a holistic approach towards research where analysis and evaluation of phenomena in its entirety endeavour to create new knowledge about the topic under investigation (Zuber-Skerritt, 2001). Henning et al. (2004) recommend that more than one research instrument be applied in the interpretive paradigm to create multiple dimensions of what is being investigated. Therefore, this

research was based on the theoretical foundation of seeking to explain phenomena deduced from theory (described by Saunders et al., 2009 and (Stronach & MacLure, 1997) by doctrinally analysing the relationship between section 23C of the Act and the VAT Act to determine its impact on fringe benefit values for normal tax purposes based on two different approaches of interpretation. A qualitative research approach was employed by means of a doctrinal analysis and supplemented by a basic comparative analysis of two hypothetical cases. Each hypothetical case aided in highlighting and explaining the anomaly under investigation.

A doctrinal analysis was considered an appropriate research method for this study, as legislation is one of the typologies of legal research being described as a possible research paradigm in taxation research (Hutchinson, 2005; McKerchar, 2008). In addition, in the field of taxation, doctrinal research is commonly applied as a research method (Frecknall-Hughes, 2016; Viviers, 2021). A qualitative research approach supports the researcher in exploring the complexity of the research question to create a better interpretation or understanding (McKerchar, 2008).

The research was inductive in nature, as it applied both a literal and a purposive approach of interpretation. The literal approach of interpretation is described as the strict, or the letter-of-the-law interpretation, also referred to as the "black letter law" approach (Knight & Ruddock, 2008, p. 29). The "black letter law" approach is synonymous with doctrinal research and is typified by the systematic process of identifying, analysing, organising and synthesising statutes, judicial decisions and commentary (Hutchinson & Duncan, 2012). In support of the literal approach of interpretation, it was indicated in the English case *Cape Brandy Syndicate v IRC*, 1921(1) KB 64 that when interpreting a tax Act, one should merely consider what is clearly said. There is no room for any intendment or presumption, and nothing is to be read in or implied, as one can only look fairly at the language used by the Act.

In turn, Goldswain (2008) describes the purposive approach as the act of seeking and ascertaining the intention of the legislator by reading an Act as a whole and by placing it in the context of what is sought to be achieved (i.e. the policy objectives behind the legislation) and the relationship between the individual provisions of the Act. In terms of the latter approach, the researcher (and ultimately the taxpayer) is enabled to realistically question the interpretation of legislation where it is perceived to be unfair in circumstances where the result of its application does not seem to match the true intent of the legislator.

From judgements laid down in previous cases, it is evident that courts have departed from the ordinary effect of the words of the legislation to avoid the element of absurdity (such as an anomaly encapsulating uncertainty, inconsistency and ambiguity) and to give effect to the "true intention of the legislature" (Farrar's Estate v CIR, 1926 TPD 501; *M v COT*, 21 SATC 16; *Venter v R*, 1907 TS 910). By applying the "intention of the legislature" rule under the purposive approach of interpretation it is pivotal to clearly determine the legislature's policy objective (s) behind the enactment of a specific provision(s) and to ensure that its interpretation and application do not contradict such policy objective(s) (Glen Anil Development Corporation Ltd v SIR (1975) 37 SATC 319).

Where a mismatch is discovered between the result of the literal as opposed to the purposive approach of interpretation, an anomaly in the legislation exists. In other words, an anomaly occurs where the strict or literal interpretation and application of a specific provision(s) results in a deviation from what was to be expected when measured against the policy objective(s), true intent and rationale behind its legislative introduction. This deviation has been referred to in Shaler v The Master and Another, 1936 AD 136 (1936, p. 143) as the resulting "absurdity" because of ambiguities, inconsistencies and uncertainties that arise in the process of trying to interpret legislation.

5 Doctrinal Analysis

This section encompasses a doctrinal analysis of the legislative provisions of both the VAT Act and the Income Tax Act that could be trigged when an employer grants a taxable fringe benefit to its employee.

5.1 VAT Act Provisions

5.1.1 Section 18(3)

Section 18(3) of the VAT Act (Republic of South Africa, 1991) deems the granting by an employer (who is a registered VAT vendor) of a benefit or advantage consisting of the supply of goods or services to an employee (as contemplated in paragraph (i) of the definition of "gross income" in section 1(1) of the Act, read with the Seventh Schedule to the Act) to constitute a supply of goods or services made by such employer (vendor) that is deemed to be carried out in the ordinary course of its enterprise. However, the proviso to section 18(3) of the VAT Act determines that no deemed supply will be triggered to the extent that such advantage or benefit granted qualifies as (i) an exempt supply (as regulated under section 12 of the VAT Act), (ii) a zero-rated supply (as regulated under section 11 of the VAT Act) or (iii) entertainment (as defined in section 1 and regulated under section 17(2)(*a*) of the VAT Act).

Table 2 shows an evaluation of the different types of fringe benefits regulated under the Seventh Schedule to the Act to identify and justify which of these fringe benefits will not be subject to VAT (i.e. output tax) when they are supplied by an employer (vendor) to an employee.

Only those fringe benefits identified in Table 2 that could be subject to output tax upon their supply by an employer (vendor) to its employee (i.e. triggered by a deemed supply under section 18(3) of the VAT Act) formed part of the investigation under review in this study, which was aimed at seeking certainty regarding the interaction between fringe benefit values and VAT.

Table 2 Fringe benefits that will be subject to VAT upon their supply

Types of fringe benefits	Supply subject to output tax?	Reason why no output tax is levied upon its supply
Acquisition of an asset at less than its actual value	Yes	N/A
Right of use of any asset (other than residential accommodation or any motor vehicle)	Yes	N/A
Right of use of a motor vehicle	Yes	N/A
Meals, refreshments and meal and refreshment vouchers	No	Qualifies as "entertainment" as defined, hence input tax denied
Residential accommodation	No	Qualifies as the supply of a "dwelling", which is an exempt supply under section 12
Free or cheap services	Yes	N/A
Residential accommodation treated as a low-interest loan	No	Qualifies as a "financial service" as defined, hence an exempt supply under section 12
Benefits in respect of interest of debt	No	Qualifies as a "financial service" as defined, hence an exempt supply under section 12
Subsidies in respect of debt	No	Supply of money is not a supply subject to VAT
Contribution to benefit fund	No	Qualifies as a "financial service" as defined, hence an exempt supply under section 12
Incurral of costs relating to medical services	Yes	N/A
Benefits in respect of insurance policies	No	Qualifies as a "financial service" as defined, hence an exempt supply under section 12
Valuation of contributions made by employers to certain retirement funds	No	Qualifies as a "financial service" as defined, hence an exempt supply under section 12
Contribution to bargaining council	No	Qualifies as a "financial service" as defined, hence an exempt supply under section 12
Payment of employee's debt or release of employee from obligation to pay a debt	No	Qualifies as a "financial service" as defined, hence an exempt supply under section 12

Source: Authors' compilation deduced from Seventh Schedule to the Act (Republic of South Africa, 1962) and the VAT Act (Republic of South Africa, 1991)

5.1.2 Section 10(13)

Section 10(13) of the VAT Act determines that the value of a deemed section 18(3) supply constitutes the amount equal to the cash equivalent (as determined

under the Seventh Schedule to the Act) of the benefit or advantage granted to the employee. These cash equivalent values may need to be determined by applying the "market value" of such taxable benefits or the cost of such taxable benefits, depending on what type of fringe benefit the employee enjoys, as the Seventh Schedule applies different value rules to different fringe benefits.

The term "market value" is not formally defined in section 1(1) of the Act; however, it is generally accepted that the market value of an asset will represent the fair consideration that would apply between independent persons dealing at arm's length. In a VAT context, the term "open market value" is formally defined in section 1(1), read with section 3, of the VAT Act. Under section 1(1) of the VAT Act, it is indicated that the "open market value" in relation to the supply of goods or services means the open market value thereof determined in terms of section 3 of the VAT Act. In turn, section 3(1)(*b*) of the VAT Act states that the "open market value" of a supply of goods or services for VAT purposes shall include any tax charged (i.e. output tax) in terms of section 7(1)(*a*) of the VAT Act.

5.2 *Income Tax Act Provisions*

5.2.1 Provisions under the Seventh Schedule to the Act

The Seventh Schedule to the Act regulates the taxable value, which is referred to as "cash equivalent", to be placed on different types of benefits or advantages derived by an employee by reason of employment or the holding of any office. In essence, the granting of a fringe benefit by an employer to an employee could give rise to a taxable benefit in the employee's hands, which could make such employee liable for income tax on such benefit received. In terms of special inclusion paragraph (i) under "gross income" as defined in section 1(1) of the Act, the cash equivalent of any taxable benefit (as defined and determined by applying the various provisions of the Seventh Schedule to the Act) needs to be included in an employee's gross income for income tax purposes (Republic of South Africa, 1962).

5.2.2 Section 23C

Section 23C of the Act deals with the reduction of the cost or market value of certain assets. In terms of the taxability of fringe benefits, section 23C acts as the provision that interlinks the VAT consequences of an employer (vendor) on the supply of a fringe benefit to that of its value taxable in the hands of the employee receiving such benefit for income tax purposes.

An example of where an asset, or the right to use an asset, could be acquired at a value for income tax purposes equal to the market value of such asset is where a fringe benefit is received by an employee and where the Seventh Schedule determines that the value to be placed on such fringe benefit should be either the "cost to

the employer" or the "market value" of such asset (e.g. the acquisition of an asset at less than actual value under paragraph 5(2) of the Seventh Schedule to the Act). As mentioned earlier in this paper, although the term "market value" is not formally defined in section 1(1) of the Act, it would generally represent the fair consideration that would apply between independent persons dealing at arm's length. Furthermore, uncertainty prevails regarding whether the market value of assets (and fringe benefits) for income tax purposes will include or exclude VAT.

In the context of fringe benefits, section 23C of the Act aims to clarify to taxpayers how the VAT consequences triggered in terms of the VAT Act upon the acquisition and/or supply of goods and services in the hands of the employer (vendor) will have an impact on the taxable value of such goods and/or services in the hands of an employee for income tax purposes. The latter argument is deduced from the current opening words of section 23C(1) of the Act, which read "Notwithstanding the Seventh Schedule" (Republic of South Africa, 1962).

The term "notwithstanding" is not formally defined in the Act. In ordinary English language, synonyms used for the term "notwithstanding" are "despite" or "in spite of", and its meaning could be further described as "not considering, or not being influenced by" (Cambridge Advanced Learner's Dictionary & Thesaurus, 2023). In a legal context, the term "notwithstanding" is commonly used in statutes and regulations to indicate that a specific provision or rule is not affected, or limited, by any other provisions or rules that may be contained in that same section or Act. Hence, the term "notwithstanding" is used to indicate that a specific provision or rule is intended to override, supersede or be given priority over that of other provision (s) or rule(s). Therefore, if, for example, clause 1 of a contract reads as follows: "Notwithstanding clause 2 . . .", it effectively means that clause 1 sets out the normal rule, while clause 2 of the contract creates the exception that will take precedence over that of the normal rule (Hossein, 2020).

Interpreting the former in the context of the regulation of the cost or market value of assets under section 23C of the Act, read with the provisions of the various paragraphs under the Seventh Schedule that regulate the determination of the taxable value (i.e. the cash equivalent) of various fringe benefits, it is deduced from the opening words of section 23C(1), "Notwithstanding the Seventh Schedule", that the provisions of the Seventh Schedule to the Act take presence above the value reduction rules for assets as contained under section 23C. Therefore, based on a literal approach of interpretation, it is concluded that the opening words of section 23C(1) are found to have an impact on the value of all taxable fringe benefits. This effectively means that the "cost" or "market value" of all assets, or the right to use such assets, granted by and employer (vendor) to its employee as a taxable fringe benefit will always include VAT, irrespective of what the actual VAT consequences of such assets were in the hands of the employer who granted such fringe benefit.

6 Basic Comparative Analysis

To explain and conceptualise the income tax consequences triggered by the current wording of section 23C of the Act for taxable fringe benefits (see Table 1) that are also subject to output tax (see Table 2) upon its supply by an employer (vendor) to its employee, two hypothetical cases of interpretation were analysed and compared. This comparative analysis aimed to highlight the anomaly caused by the interpretation and application of the current wording of section 23C regarding the taxability of a fringe benefit based on a literal approach of interpretation (Case 1), as opposed to a purposive approach of interpretation (Case 2).

The "acquisition of an asset at less than its market value" fringe benefit, as regulated under paragraph 2(*a*) read with paragraph 5 of the Seventh Schedule to the Act, was selected to form the basis of the scenario for the purposes of the basic comparative analysis between cases 1 and 2. This selection was deduced from the contents of Tables 1 and 2, in identifying a single fringe benefit that qualifies as a taxable benefit (deduced from Table 1) and that will also be subject to output tax (deduced from Table 2) upon its supply by an employer (vendor) to its employee.

6.1 Scenario

An employer (a registered VAT vendor making only taxable supplies) acquired a new computer at a fair consideration of R23 000 (including VAT) 3 years ago, which was used solely for purposes of its trade over the previous three-year period. The computer was then sold by the employer to one of its employees (a non-vendor) at a consideration of R4 600 (inclusive of VAT) at a time when the computer's market value amounted to R6 900 (inclusive of VAT). The advantage granted to the employee to acquire the computer at less than its actual market value was granted by virtue of the employee's employment at the employer.

6.1.1 VAT Analysis for Cases 1 and 2

For VAT purposes, the employer (vendor):

- would have been allowed to claim input tax upon the acquisition of the computer 3 years ago amounting to R3 000 (i.e. R23 000 × 15/115) (section 16(3) of the VAT Act); and
- will, upon the supply of the advantage to the employee, be deemed to make a supply to the employee (section 18(3) of the VAT Act) and must levy output tax on such supply based on the cash equivalent of the advantage granted to the employee (section 10(13) of the VAT Act). For the determination of the cash equivalent value of each case, see the separate income tax analysis of each case indicated below.

6.1.2 Income Tax Analysis for Cases 1 and 2

- The value to be placed on the "acquisition of an asset (computer) at less than its market value" fringe benefit shall be the market value thereof at the time the computer is acquired by the employee (paragraph 5(2) of the Seventh Schedule to the Act).
- However, now it is questionable whether the VAT is to be included in or excluded from the value of the fringe benefit for normal tax purposes of the item being supplied. Hence, should the value to be placed on the fringe benefit under the Seventh Schedule include or exclude VAT? The answer to this question is dealt with separately under each case below, as the answer is dependent on the type of approach of interpretation applied under each case.

6.2 Case Study 1

Analysis of the VAT implications and their related impact (if any) on the value of the fringe benefit for income tax purposes based on a literal approach of interpretation.

6.2.1 Income Tax Analysis

In applying the literal approach of interpretation to the opening words of section 23C (1), "Notwithstanding the Seventh Schedule" (Republic of South Africa, 1962), it means that section 23C(1) cannot be considered in establishing the fringe benefit value, as the entire Seventh Schedule is indicated to supersede (or to override) the provisions of section 23C.

This means that only the Seventh Schedule needs to be applied (and not section 23C) in addressing the question on whether the value to be placed on the fringe benefit for income tax purposes should include or exclude VAT. As the fringe benefit under scrutiny in this comparative analysis (namely the "acquisition of an asset at less than its actual value") is dealt with under paragraph 5 of the Seventh Schedule, the value according to paragraph 5(2) to be placed on this fringe benefit is the "market value" thereof as at the time it is acquired by the employee. However, the term "market value" is not formally defined for application in a Seventh Schedule context. Clause 33 of the Explanatory Memorandum on the Second Revenue Laws Amendment Bill (National Treasury, 2001a, p. 28) states: "It is contended that it is arguable that VAT should be included when determining market value, since it is usually included in the advertised price (see section 65 of the Value-Added Tax Act, 1991)."

Therefore, it is concluded that the cash equivalent value of the taxable benefit in the hands of the employee who receives the advantage by means of acquiring an asset (computer) at less than its market value will therefore be the market value

inclusive of VAT, namely R6 900. Effectively, the value of the fringe benefit that is taxable in the employee's hands is inflated. Hence, the literal approach of interpretation applied to section 23C(1) has a negative impact on the value of the fringe benefit, as a value inclusive of VAT results in a higher taxable value, which in turn will result in a higher income tax liability in the employee's hands.

6.2.2 VAT Analysis

As the cash equivalent of the advantage granted to the employee under Case 1 was concluded to be R6 900, it means that the employer must levy output tax on the fringe benefit deemed supply equal to R900 (i.e. R6 900 × 15/115) (section 18(3) read with section 10(13) of the VAT Act).

6.3 Case Study 2

Analysis of the VAT implications and their related impact (if any) on the value of the fringe benefit for income tax purposes based on a purposive approach of interpretation.

6.3.1 Income Tax Analysis

In applying the purposive approach of interpretation to the opening words of section 23C(1), the words "Notwithstanding the Seventh Schedule" (Republic of South Africa, 1962) are now interpreted in the context of supporting the National Treasury's explanation for amending the opening words of section 23C(1), namely that these opening words are to be interpreted to mean that section 23C is only superseded (or overridden) by a single fringe benefit, namely the "right of use of a motor vehicle" fringe benefit regulated under paragraph 7 of the Seventh Schedule. As the fringe benefit under scrutiny in this comparative analysis (namely the "acquisition of an asset at less than its actual value" fringe benefit dealt with under paragraph 5 of the Seventh Schedule) is not a paragraph 7 benefit, the provisions of section 23C must apply (rather than the entire Seventh Schedule as under Case 1) in addressing the question on whether the value to be placed on the fringe benefit for income tax purposes should include or exclude VAT.

Consequently, section 23C(1) determines that if the taxpayer is a vendor and an input tax deduction was claimed, the amount of the actual input tax must be excluded from the cost or the market value of the asset or the amount of the expenditure (Republic of South Africa, 1962). Furthermore, if the taxpayer is a non-vendor and no input deduction was allowed to be claimed, the VAT portion must be included in the cost (or the market value) of the asset or the amount of the expenditure (Stiglingh et al., 2023).

Therefore, the market value should in this instance exclude VAT and will be R6 000 (i.e. R6 900 × 100/115). Effectively, the value of the fringe benefit that is taxable in the employee's hands is lowered. Hence, the purposive approach of interpretation applied to section 23C(1) has a positive impact on the value of the fringe benefit, as a lower taxable value will result in a lower income tax liability in the employee's hands.

Leading South African tax textbooks (that are nationally prescribed by leading South African universities and widely used by tax students as well as tax practitioners) also apply the purposive approach of interpretation in their explanatory examples to illustrate to the textbook users how section 23C needs to be interpreted and applied practically (Stiglingh et al., 2023).

6.3.2 VAT Analysis

As the cash equivalent of the advantage granted to the employee under Case 2 was concluded to be R6 000, it means that the employer must levy output tax on the fringe benefit deemed supply equal to R782.61 (i.e. R6 000 × 15/115) (section 18(3) read with section 10(13) of the VAT Act).

6.4 Conclusions Deduced from the Findings of the Basic Comparative Analysis

Deduced from the outcomes of the basic comparative analysis derived from the interpretation of the opening words of section 23C(1), based on a literal approach of interpretation (see Case 1), as opposed to a purposive approach of interpretation (see Case 2), it is evident that an anomaly exits regarding the outcome achieved when compared to the outcome it was intended to achieve. This results in an unintended change in policy that has a negative impact on the certainty regarding the interaction between fringe benefit value and VAT. De Koker and Williams (2011) advocate that where an anomaly in tax a system prevails, such as an anomaly highlighted in this paper, it is the task of the legislature to address it through the enactment of appropriate amendments.

7 Conclusions and Recommendations

In the quest of seeking certainty regarding the interaction between the VAT implications triggered by the supply of fringe benefits and their impact on determining the taxable values of such taxable fringe benefits for income tax purposes, the research question that this study attempted to answer was: Should VAT be included or

excluded when the taxable value of fringe benefits is determined for income tax purposes?

Based on a qualitative doctrinal analysis, supplemented by a basic comparative analysis, an anomaly was found to exist, whereby the income tax consequences triggered based on a literal approach of interpretation of the opening words of section 23C(1) of the Act seem to be in contradiction with the income tax consequences it was intended to achieve based on a purposive approach of interpretation.

Deduced from the findings under Case 1, it is concluded that where a literal approach of interpretation is applied to the opening words of section 23C(1), the outcome results in a negative impact on the fringe benefit values, as a value (i.e. either cost or market value) inclusive of VAT (i.e. an inflated value) to be placed on the fringe benefit results in a higher taxable value, which in turn will result in a higher income tax liability in the employee's hands. It is submitted that it is highly unlikely that this negative impact could have been the true intention of the legislator when measured against the rationale provided for amending the opening words of section 23C(1).

In order to address this anomaly, and to prevent the negative and unintended impact the current opening words of section 23C(1) of the Act have on the taxable value of fringe benefits (similar to that proven under Case 1 of the comparative analysis), it is recommended that the opening words of section 23C(1) of the Act be amended by replacing them with the following words: "Notwithstanding the regulations under paragraph 2(b) and paragraph 7 of the Seventh Schedule to this Act." Such proposed replacement of the opening words of section 23C(1) of the Act (or something similar that will result in the same effect) is considered crucial in ensuring that the provisions of the Seventh Schedule to the Act only take precedence over the application of section 23C in respect of the "right of use of a motor vehicle" fringe benefit as regulated in terms of paragraph 2(*b*) read with paragraph 7 of the Seventh Schedule to the Act. Such replacement of words will assist in eliminating the current prevailing anomaly identified and will marry the outcome of the literal approach of interpretation to that of the outcome of the purposive approach of interpretation in the instance where the recommended new wording to replace the current opening words of section 23C(1) is to be interpreted. Another recommendation is to introduce a definition for the term "market value" to be applied in a Seventh Schedule context to all taxable benefits (other than those of paragraph 7 of the Seventh Schedule) to clarify whether in the instance where the value to be placed on any fringe benefit is to be the "market value", this "market value" should include or exclude VAT.

Finally, the proposed recommendations could aid in meeting the initially intended policy objective as was set by the National Treasury during 2019 when the opening words of section 23C(1) were amended, and could assist in providing certainty regarding the interaction between fringe benefit values and VAT.

8 Limitations and Suggestion for Further Research

It is acknowledged that this study was subject to limitations in terms of which its findings, interpretations and conclusions drawn are solely and inductively based on the views and interpretation of the researchers. Hence, this paper should be interpreted in the context of this acknowledged limitation.

It is submitted that a critical evaluation of the interpretation and application of section 23C of the Act, when measured against the fundamental principles of taxation, could aid in providing further certainty regarding the interaction between fringe benefit values and VAT. This is suggested as an area for further research.

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