

**Compliance burden of VAT caused by exempt educational supplies in higher education  
and a suggested alternative**

by

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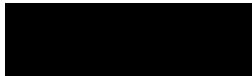
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## DECLARATION

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Date:

28 November 2024

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## **ABSTRACT**

When the VAT Act 89 of 1991 (hereinafter referred to as the VAT Act) was enacted in South Africa, educational services were exempted, however, since the inception of the VAT Act, the nature and quantum of income streams for higher education institutions have changed, each requiring different VAT treatments, resulting in a complex compliance environment. Using a mixed-methods approach, the study investigates what processes and principles informed the decision to recommend the treatment of educational services and whether these principles remain relevant in the current context. It explores the complexities this decision has introduced for higher education institutions, with a specific focus on the requirements of the VCR (VAT class ruling). To recommend an alternative treatment, the study reviews best practices recommended by the Organization for Economic Cooperation and Development (OECD), which advocates for minimal exemptions and commends New Zealand's VAT model, where educational services are standard-rated. Given that the initial model for implementing VAT in South Africa was based on this model, the study examines how New Zealand implemented its model and what its legislation requires. An analysis of the current higher education landscape is reviewed to provide context to the recommendation, where both public and private education institutions offer higher education. In addition, the decision to standard-rate medical services and medicines, when these supplies are generally exempted globally, is analysed.

The study finds that the current treatment of educational services creates significant challenges for the higher education sector and supports the standard-rating of educational services to reduce this burden, similar to the model implemented in New Zealand. While this is likely to be a contentious decision, the study recommends that there should be an extensive education campaign before this recommendation is implemented, and an effective electronic subsidy administered through NSFAS could assist in achieving this. Lastly, the study highlights notable structural and operational differences between public and private higher education institutions. Unlike their public counterparts, private institutions face fewer compliance challenges under the current VAT framework. This disparity further strengthens the case for standard-rating educational services to streamline compliance and foster equity across the sector.

### **Keywords**

Higher Education Institutions, Educational Services, Value-added Tax, VAT, Apportionment, Healthcare, Private Education

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## LIST OF DEFINITIONS

- C-efficiency - is defined as a measure of “a country’s VAT performance as the ratio of the revenue actually collected to the potential revenue found by applying the standard rate,  $\tau$ , to final consumption expenditures (net of VAT) shown in national accounts. (Cnossen, 2015:1088)
- Merit good - is created to address the perceived regressivity of VAT and includes goods or services of an educational nature. It is believed that the taxation of educational goods and services would be tantamount to the taxation of knowledge ((PWC, 2005)
- VRR - stands for the VAT Revenue Ratio and measures the difference between the VAT revenue actually collected and what would be raised if the standard VAT rate were applied to the entire tax base. Therefore, VRR is the ratio of actual tax revenue to the ratio of maximum possible tax revenue. (Bunn et al., 2021:12)

## LIST OF EXTRACTS FROM THE VAT ACT

s7(1)(a) – Imposition of value-added tax - 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 - 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; (SAICA, 2022:383)

s(7)(1)(c) - Imposition of value-added tax - 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— on the supply of any imported services by any person on or after the commencement date, (SAICA, 2022:383)

s(7)(2) - Except as otherwise provided in this Act, the tax payable in terms of paragraph (a) of subsection (1) shall be paid by the vendor referred to in that paragraph, the tax payable in terms of paragraph (b) of that subsection shall be paid by the person referred to in that paragraph and the tax payable in terms of paragraph (c) of that subsection shall be paid by the recipient of the imported services. (SAICA, 2022:383)

s11(1) - Where, but for this section, a supply of goods would be charged with tax at the rate referred to in section 7(1), such supply of goods shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero percent. (SAICA, 2022:391)

s41B - VAT class ruling and VAT ruling.—(1) The Commissioner may issue a VAT class ruling or a VAT ruling and in applying the provisions of Chapter 7 of the Tax Administration Act, a VAT class ruling or a VAT ruling must be dealt with as if it was a binding class ruling (SAICA, 2022:421)

## **LIST OF ABBREVIATIONS/ACRONYMS**

|         |   |
|---------|---|
| BBLR    | Broad-based low-rate                                      |
| CeSTII  | Centre for Science, Technology and Innovation Indicators  |
| DHET    | Department of Higher Education and Training               |
| GST     | Goods and Sales tax                                       |
| HASA    | Hospital Association of South Africa                      |
| IIE     | Independent Institute of Education                        |
| IMF     | International Monetary Fund                               |
| IRD     | Internal Revenue Department                               |
| NSFAS   | National Student Financial Aid Scheme                     |
| OECD    | The Organization for Economic Cooperation and Development |
| PWC     | PricewaterhouseCoopers                                    |
| SARS    | South African Revenue Services                            |
| SETA    | Sector Education and Training Authority                   |
| STATSA  | Statistics South Africa                                   |
| USAF    | Universities of South Africa                              |
| VAT     | Value-added tax   |
| VAT Act | VAT Act 89 of 1991  |
| VATCOM  | VAT Committee appointed by the Minister of Finance        |
| VCR     | VAT class ruling  |

# CHAPTER 1

## INTRODUCTION AND OVERVIEW

### 1.1 Introduction

This chapter introduces the study on the difficulties the higher education sector is experiencing with the exemption of educational services and the resultant compliance difficulties that have risen as a result. It provides context, including the study's background, objectives, research questions, and significance.

### 1.2 Background of the study

Governments worldwide have implemented some form of value-added tax (VAT) or goods and services tax (GST). These consumption taxes have gained popularity over several years and are seen as one of the most reliable and successful sources of revenue for governments. Most of the countries that had significant tax reforms included some kind of VAT or GST model in their new tax structures, with the number of countries that implemented this tax growing from 2 in 1967 to 36 in 1985 (Agha and Haughton, 1996) and accounting for 32.3 percent of the total revenue in 2019 from countries in the Organization for Economic Cooperation and Development (OECD) (Bunn et al., 2021). The primary constructs of this tax are that it is a broad-based tax applied to most of the population and, in theory, applies a single rate to ensure its effectiveness in collecting the maximum amount of tax (OECD, 2017). It is a tax on consumption where imports are taxed and exports are zero-rated (Agha and Haughton, 1996), considering the destination where the good or service is consumed as one of its core principles (OECD, 2017). In addition, it offers the added benefit of reducing tax evasion due to its operational mechanics, requiring each supplier to provide the purchaser in the value chain with an invoice so that the purchaser can claim the VAT. This is a significant improvement from some of the earlier GST models, where the base was narrower, and tax evasion was problematic. Collecting tax from all entities within the value chain, rather than solely from the retailer at the end of the process, has also significantly contributed to increased tax revenues for these governments (Agha and Haughton, 1996).

The historical VAT model was known as the 'traditional model' or 'European model' (Agha and Haughton, 1996) because it was introduced and gained popularity in Europe (Maples and

Sawyer, 2017). This model drifted away from the initial broad-based, single-rate model, and many countries implemented reduced rates or concessions due to political pressure to address the perceived regressivity of the tax. This has resulted in unnecessary complex tax policies and ineffective tax base design, resulting in distorted consumption patterns and higher VAT rates to accommodate these reduced rates (Bunn et al., 2021).

The modern VAT model was implemented by New Zealand in 1986 (Muir, 1993) and is based on the original broad-based single-rate model. While many countries have implemented a VAT policy since New Zealand, most have based their models on some variant of the modern VAT model, usually following a single rate, however, most have also implemented concessions. None have fully implemented the New Zealand model, although New Zealand demonstrated that taxing all goods and services with no concessions was achievable, contrary to prior belief (De la Feria and Krever, 2013).

Within Africa, at least 42 countries have implemented a VAT consumption tax (PWC, 2023), with South Africa replacing its previous Goods and Services Tax (GST) Act with the Value Added Tax Act in 1991. South Africa, too, based its model on the New Zealand model and, similar to other countries, also introduced concessions. When considering the implementation of VAT, the Minister of Finance appointed a panel of experts, the VAT Committee (VATCOM), to review and make recommendations on any changes to the VAT Bill before it was enacted. One of the areas the committee deliberated on was the treatment of educational services. The Bill initially indicated that these services should be exempt from VAT. After deliberations, VATCOM also recommended exempting education services to simplify institutional administration in its final recommendations to the Minister of Finance (VATCOM, 1991).

This decision has primarily impacted public higher education institutions, where tuition and residence fees meet the definition of educational services and are therefore exempt. South Africa has 26 public higher education institutions and 125 private institutions, totalling 151 higher education institutions (DHET, 2024b). Only public higher education institutions receive funding from the government via a block grant (Treasury, 2023). In addition to this, they also generate tuition fees from the public and research grants from donors and government. Private higher education institutions fund their operations via tuition fees.

Since the implementation of the VAT Act 89 of 1991 (hereinafter referred to as the VAT Act),

there have been no substantive amendments to accommodate the changes in higher education institutions and the market in which they operate. Over the years, these institutions have expanded their operations beyond generating income from tuition and residence fees. Although research income has always been a component of the revenue streams of public higher education institutions, the nature of research has changed. It now includes varied research activities, each of which has to be assessed, which can result in different VAT treatments, such as exempt, standard-rated, or zero-rated. Revenue streams may also include income from other sources, such as consulting and venue hire (SNG Grant Thornton, 2022).

Managing these income streams from a VAT perspective requires more complex (Smith, 2019) and sophisticated ERP systems, as well as appointing staff with the necessary experience and qualifications, often supplemented by hiring external consultants at a high cost. In addition, it may result in implementing a VAT apportionment method, as required by the VAT Act. Apportionment occurs when an institution has multiple income streams with different VAT treatments (Nelson, 2016). If costs incurred straddle multiple income streams, an apportionment ruling is required from SARS. Compliance with these rulings is administratively burdensome and adds to the requirement for expertise to manage effectively. The industry has taken initiatives to address this, including submitting to the Davis Tax Committee. However, there have been no further amendments to the Act (SNG Grant Thornton, 2022).

Higher education institutions are in a challenging and costly position in managing compliance difficulties, resulting primarily from exempting educational services.

### **1.3 Problem statement**

When educational services were initially exempted under the VAT Act, following a recommendation by VATCOM, the decision was likely driven by significant factors, notably the ease of administrative management due to the specific nature of institutional income at the time the Act was established (Smith, 2019). However, the higher education sector has since transformed, and today, the VAT environment in these institutions has become complex. The VAT system, initially designed for simplicity, has evolved into an administratively burdensome framework (SNG Grant Thornton, 2022).

Since the VAT Act's inception, there have been no substantial changes to the VAT treatment of educational services. Given the additional compliance burdens imposed by the various VAT statuses that higher education institutions must manage (SNG Grant Thornton, 2022), does it

still make sense to maintain the exemption for these services? Are the original factors that led VATCOM to recommend exemption still relevant? Should educational services now be assigned a different VAT status, perhaps standard-rated or zero-rated?

This study explores the rationale behind the original exemption of educational services and examines the unintended compliance burdens associated with multiple VAT statuses. Given the compliance complexities introduced in these institutions, the analysis considers whether exempt supplies should remain a VAT status and proposes an alternative VAT treatment for educational services.

#### **1.4 Research objectives**

1. To understand why educational services were exempted for VAT purposes
2. To examine the impact of current multiple VAT statuses on higher education institutions
3. To understand the global view of exemptions for VAT purposes
4. To explore an alternative treatment of educational services for VAT purposes to assist in reducing the administration of compliance.

#### **1.5 Research questions**

1. Why were educational services exempted for VAT purposes?
2. How do current multiple VAT statuses impact higher education institutions?
3. What recommendations do global role players make regarding exemptions for VAT purposes?
4. What alternative VAT treatment of educational services can be implemented to reduce the administration burden of compliance?

#### **1.6 Significance of the study**

This study intended to understand what informed the decision to exempt educational supplies and the consequences of this on higher education institutions. The suggested alternative treatment will draw on examples from other countries and sectors within South Africa. If

implemented, the recommendation will reduce the administrative difficulties experienced by higher education institutions, the risk of non-compliance, and the financial costs of avoiding interest and penalties.

### **1.7 Scope of the study**

Higher education institutions within South Africa are the focus of this study, with greater attention on the 26 public higher education institutions. This is because they face the most significant challenges with the apportionment difficulties highlighted in the study. The research scope extends beyond South Africa to examine the global perspective on exempting supplies and justify the recommendation of standard-rating educational services.

### **1.8 Summary and organisation of dissertation**

This chapter provides the background to the study, explaining the difficulties that public higher education institutions experience in complying with the VAT Act. These difficulties are primarily due to the exemption of educational services. This provides input for the problem statement, which outlines the study's intent and provides guidance for creating the study's objectives and the research questions. Information on the study's scope, limitations, and significance are also provided, focusing on public higher education institutions.

The dissertation is structured as follows:

#### **Chapter 1 - Introduction**

This chapter provides background to the compliance challenges arising from the VAT Act, particularly regarding the exemption of educational services. The chapter establishes the research questions and objectives of the study, along with setting the boundaries for the study.

#### **Chapter 2 - Literature review**

This chapter outlines the theoretical framework which informs the research. The empirical literature review will examine the difficulties experienced by higher education institutions and industry in general in complying with the VAT Act and understand what researchers theorise as the reason for the compliance burden, including recommendations to remedy the additional administration.

### **Chapter 3 - Research methodology**

This chapter describes the research methodology, justifying the chosen research philosophy and design. The research study follows a pragmatism philosophy, using a mixed methods approach, and will use a narrative review to assess secondary data using a systematic approach. A content analysis approach, including qualitative and quantitative methods, is used to analyse the data. The chapter offers more insight into the data used and assesses their credibility.

### **Chapter 4 - Data analysis**

This chapter analyses the relevant literature, including articles, journals, books, and conference proceedings. The analysis will review the legislature, guidance, and rulings from SARS. Opinions from industry experts, statistics, financial data, and annual reports will also assist in understanding the problem. The intention is to understand best practices and what is recommended as an alternative to the current exempt status of educational supplies. An assessment of the current higher education environment will be undertaken.

The data analysis establishes the following to address the objectives of the study:

1. Obtain an understanding of what informed making educational supplies exempt in the first place.
2. Examine the legislation, guidelines, and rulings relevant to educational services and explain how these contribute to creating a complex compliance environment.
3. Investigate global perspectives on the treatment of exempt supplies and what recommendations have been made regarding this VAT status. The section explores the recommendation for implementing a standard rate for all supplies.
4. Analyse New Zealand's approach to standard-rating educational services
5. Review South Africa's decision to standard-rate medical supplies and assess whether similar reasoning applies to educational services.
6. Evaluate the current higher education and training environment to determine the most appropriate VAT treatment to reduce compliance burdens.

### **Chapter 5 - Summary, conclusion, and recommendations**

This chapter summarises and interprets the findings, providing recommendations and drawing conclusions based on the analysis.

## CHAPTER 2

### LITERATURE REVIEW

#### 2.1 Introduction

In the previous chapter, the background of why the current treatment of educational services in public higher education institutions is problematic was explained. The research objectives and questions were established, and the scope and significance of the study were outlined. This chapter considers the theoretical framework that drives the discussion on whether the treatment is fair and equitable. After that, the empirical literature review will explore and understand why educational services were exempted and the current compliance burden that the VAT Act has caused by having multiple VAT statuses. This section examines the existing literature on the compliance burden of VAT exemptions on educational supplies in higher education, highlighting the challenges and gaps in current research.

##### 2.1.1 Background to VAT and exemptions in higher education

VAT is a consumption tax that taxes goods and services in a value chain. The final consumer ultimately bears the full cost of the tax at the consumption stage. The producers and retailers in the value chain pay their portion of additional tax. The next stakeholder in the chain then deducts this input tax from the sales or output tax owed to the tax authority (VATCOM, 1991). The efficiency and neutrality of the tax make it successful in collecting a large amount of tax. However, some countries have implemented the tax with concessions (OECD, 2017). The concessions take the form of a zero-rating or exempting a good or service from VAT.

South Africa introduced the VAT Act into law in 1991. The VAT Act 89 of 1991 states that an exempt good or service is not required to pay VAT on or deduct VAT for its goods or services (SAICA, 2022). This status, therefore, prevents the neutrality mentioned in the previous paragraph from occurring. This traps the VAT in the system, making the producer or retailer who produces or provides the exempt services responsible for its payment (VATCOM, 1991). In section 12(h) of the VAT Act, educational services and services related to educational services are exempt (SAICA, 2022), which, in a higher education institution, includes revenue such as tuition fees and government grants. The authors in the empirical review generally recommend zero-rating educational supplies. The zero-rating of supplies is covered in section 11 of the VAT Act (SAICA, 2022) and is very beneficial in that it allows the vendor to deduct

the input tax and pay no VAT on the output tax, thereby generally creating a refund for the vendor.

## **2.2 Theoretical framework**

### **2.2.1 The distributive justice theory**

The distributive justice theory is concerned with justice and, in this study, the justice of tax, in other words, the fair collection and equality in tax distribution. The concept of tax is important in this theory, which is defined as a legal payment collected to address public demands (Ribeiro, 2006) where there is an inherent agreement to pay these by citizens as they receive the benefits of these payments in services from government. Revenue collection is important, as maintaining society has costs (Farrelly, 2004). Equality in the collection of taxes is another important concept. It is a recent development in the management of taxes, progressing towards implementing a fairer tax policy, which considers the financial situation of those being taxed (Ribeiro, 2006; Kurupparachchi et al., 2023). Although neutrality is essential, it must be tempered with equality to ensure that citizens do not unfairly share a more significant tax burden than they can pay (Sugin, 2011). Kurupparachchi et al. (2023) expanded on this, noting that the more vulnerable are exposed to greater regressivity when considering the impact of indirect taxes; however, there needed to be compliance with tax policy, but it should be mindful of the living standard of taxpayers.

Ribeiro (2006) explained further that there are two requirements for distributive justice in tax to exist. The first is the state's sovereignty; in other words, the state must have the power to collect taxes, and secondly, there must be a unified political community where citizens are willing to pay taxes. There must be an interest in society to fairly share in the burden of maintaining society, which infers that the distribution may sometimes not be equal but will be fair (Farrelly, 2004). This theory requires decision-makers to be free of bias when they intend to make decisions for the good of society, ignoring their values, culture, or social, political, or religious standing. This requirement is referred to as the 'veil of ignorance' and is criticized as a shortcoming of this theory, as decision-makers are affected by these aspects, so the possibility of them not affecting decisions is unlikely (Ray, 2021). Similarly, Ray (2021) also notes that the theory requires decisions to be rational and reasonable, which requires that decisions are made for the betterment of society and are not driven by selfish interests, and decision-makers can apply their minds. This may not always be the case when one considers

people with disabilities or those with other health difficulties. Saleem (2021) notes that there is sometimes a misunderstanding of the difference principle, interpreted as continually funding the least advantaged to establish equality. Instead, the equality principle intends to consider these individuals when making decisions, ensuring that this is done by still driving economic stability. Despite the criticisms of this theory, it still has value as it is simple, supports the principles of equality, and drives liberty (Saleem, 2021).

Consumption or indirect taxes such as VAT are often criticised as not meeting the equality requirement in distributive justice theory. Conceptually, VAT is regressive, as it taxes all equally without considering their financial situations and capacity to pay VAT (Kurupparachchi et al., 2023). Governments have introduced concessions or preferential rates to address this requirement and accommodate the burden on lower-income groups. However, Kaiser and Spahn (1989) noted that these concessions, often created for efficiency, are not effective in addressing the regressivity of VAT, as the goods for which the concessions are granted are used to a greater extent by the more affluent, which is counterintuitive to the point of the concession.

The continual use of concessions and, in the context of this study, the exemption of educational services fits well within this theory. It is vital that when data are reviewed and recommendations made, the equality of the recommendations is considered so that no further unnecessary burden is placed on the most vulnerable. However, the integrity and effectiveness of the status quo must be questioned, always within the tenets of distributive justice theory, that alternative recommendations to the existing VAT treatment of educational services must be just and fair.

### **2.2.2 The social contract theory**

The social contract theory relates to the relationship between a government and an individual, where the government enters a social contract to protect the rights of its citizens in return for those citizens giving up some of their rights for the protections that the government provides. Zhang (2020) indicated that there are variations in the theory, including the view of Thomas Hobbs that a social contract is necessary with the government to protect men against their greed and selfishness, versus John Locke, who believed that citizens would voluntarily enter into this social contract with the government as they understood the value and the will of the state should not be more important than that of individuals. Gauthier (1977) explained it as a contract

between these parties to establish a political society.

Within this society, a coercive authority forces compliance, as there is an underlying trust and belief that the result of compliance will be better than noncompliance (Gauthier, 1977). This underlying contract with the belief that the entity will benefit from the arrangement with the government makes this theory relevant to this study. There must be a belief that the government works for its citizens' benefit in response to the freedoms and rights they give up. The theory is relevant in the context of tax policy in that there is a belief that the right to income is in the best interest of the political society in which we operate.

This aspect is highlighted explicitly by Smith (2020) in the context of Croatia, where there was inherent distrust by the government of the citizens to comply with tax requirements, as well as from citizens towards the government who were angered by the additional tax compliance requirements that had to be adhered to avoid penalties, thereby compromising the social contract between these parties.

This inherent trust is essential when creating tax policy, as citizens should not feel threatened or unfairly disadvantaged. In the context of this study, while there may have been a good reason to make the decisions around the treatment of educational services in the VAT Act at the time those decisions were made, that is no longer the case. The argument for continuing with the status quo needs to be reviewed, as it is currently disadvantaging the stakeholders it was trying to protect, thereby compromising the social contract between these institutions and the government. The social contract theory is, therefore, critical in this study.

### **2.2.3 Tax incidence theory**

The tax incidence theory is an economic theory that deals with the distributional effects of tax and who eventually pays the tax, even though, theoretically, the tax payment may be the responsibility of another. One explanation of the theory is that “incidence is concerned not with him who pays in the beginning, but him who pays at the end” (Kendrick, 1937:5); another is who ultimately bears the burden of the tax (Holden, 1940). The theory includes the impact of the changes in pricing caused by taxes and on the demand for goods and services, which could place a heavier burden on the producer if they cannot transfer this cost. This situation may have knock-on implications for the producers of these products, possibly impacting their ability to produce them (Kendrick, 1937). One of the most significant concerns with this model is its symmetry. Benzarti (2024) questioned the model's simplicity, noting that there may be more

impacting the transfer of this cost than just demand and supply, and pointed out that the transfer of costs may not be proportional to the tax cut or increase. Kosonen et al. (2017) similarly questioned this aspect, noting the impact of the proportional effects lasted for many years. They also stated the model assumes a level of rational behaviour, which they questioned, as there may be other aspects which affect spending behaviour in addition to a change in the VAT rate. Despite these variables, there is still value in the theory, as it deals with distribution.

Taxes that do not tax income proportionately, as would be the case with VAT, affect prices and impact production (Mieszkowski, 1969). Bhatia (1982) specifically focused on the effect of this theory in the context of VAT and explained that, theoretically, if VAT is applied in line with its original intent at equal rates in every industry, it will not impact prices; this talks to the neutrality principle of VAT. However, based on the decisions of many governments to implement lower rates, neutrality is not seen as the most critical driver in the creation of tax policy. The introduction of differing VAT rates for different services and industries disturbs this neutrality and shifts the responsibility or burden for this tax to others in the value chain. While the tax incidence theory is primarily a statistical theory, the underlying principles are important in this research study.

Concessions recommended by VATCOM to accommodate various merit goods and as a result of stakeholder representations resulted in the implementation of multiple rates in the VAT Act. The impact of this decision is that even though the understanding is that these concessions provide benefits to those industries to which they relate, they have a knock-on effect on the economy as a whole. The fiscus still requires a certain revenue level from the collection of VAT. If the tax is not equally collected from the entire economy, then the tax burden shifts onto other sectors to accommodate this higher income demand.

Ultimately, concessions impact the standard rate of VAT, resulting in other industries funding these lower rates to meet government demands. Higher education is one area that has been given this concession and would, therefore, benefit from the reduced rates. However, the original intention of this concession has not unfolded as expected, resulting in higher costs to manage this concession and to accommodate the multiple rates created by the VAT Act. These concessions, therefore, do not achieve their intent and result in additional costs to ensure compliance.

## **2.3 Empirical review**

### **2.3.1. Exemption of educational supplies**

The decision to exempt educational services was deliberated on by the VATCOM before making a final recommendation to the Minister of Finance (Smith, 2019). Jugdhaw (2018) provided insight into some key elements that drove VATCOMs decision to exempt educational supplies. These include the fact that the government primarily funded this sector at the time, so exempting these services seemed reasonable. The importance of education would have also been a consideration in the treatment of this supply. Jeewa (2016) expanded on the drivers by explaining that the exempt supply would have benefited higher education institutions, as they would not have been required to register for VAT, thereby reducing the risk of non-compliance with the requirements of the VAT Act.

Smith (2019) also noted that there was no distinction between the different levels of education at the time, differentiating between primary, secondary, and tertiary education. Instead, VATCOM assessed the educational services as relevant to the sector without considering the different variables that may have impacted each of the levels and what individual impact the exempting of educational supplies may have had on these sectors in the future.

Although the authors (Jeewa, 2016; Jugdhaw, 2018; Smith, 2019) highlight some reasons why VATCOM recommended that educational services remain exempt, a deeper analysis would assist in assessing whether the decision was reasonable and guide the discussion on whether the variables are still relevant in the current context within which higher education institutions operate.

### **2.3.2 The burden of VAT compliance in higher education**

Tuition fees, residence fees, and government grants are usually the most significant income streams for higher education institutions, and they are exempt in terms of section 12(h) of the VAT Act (SAICA, 2022). In addition to tuition fee income, these institutions have many other income streams, each requiring an assessment to establish their VAT treatment. Many income streams with multiple VAT statuses result in a complex environment for ensuring compliance. SNG Grant Thornton (2022) further explores this environment's complexity and highlights the difficulties higher education institutions face in ensuring compliance with the VAT Act. They note that historically, higher education institutions' main driver of income was tuition fees.

However, due to declining subsidies, higher education institutions are now compelled to increase their non-educational revenue to meet operational needs. These varied income streams result in more VAT statuses and complexities in establishing how to treat supplies for VAT purposes. In addition, managing the recent changes in the treatment of VAT on imported goods and electronic services results in a complex VAT environment for higher education institutions (SNG Grant Thornton, 2022).

The VAT environment of higher education institutions is one of the more complex, and the VAT system created for ease is now administratively burdensome and difficult to manage (SNG Grant Thornton, 2022). In addition, there have been no substantive changes in the VAT Act since its inception. Smit (2009) recommended that SARS provide a ruling on revenue streams in higher education institutions due to uncertainty in the treatment of certain income streams. These can be difficult to analyse, as they require an in-depth knowledge of VAT and the nature of the income streams, skills that higher education institutions would not necessarily have in-house.

SARS issued a VAT class ruling multiple times, with the most recent ruling in 2022. Nelson (2016) considered the tax apportionment method applied by institutions per this ruling and whether other methods could alleviate the administrative burden this caused. The study highlighted the need to consider the VAT Act's implications on higher education institutions and recommends that the practicalities of implementing it in its current form be considered and adjusted.

Jeewa (2016) also considered the current treatment of educational services per section 12(h) of the VAT Act and whether this is still relevant in the current context of universities. The research concluded that the government needs to assess the evolution of higher education and adjust the VAT Act to consider this. The Act should also provide clarity in terms of what constitutes educational services. These uncertainties create a risk for non-compliance, resulting in penalties and interest.

Applying a doctrinal approach, authors (Jeewa, 2016; Nelson, 2016) noted the complex environment in which higher education institutions operate, which appears to be a theme in most literature on VAT in higher education institutions. The difficulties, which include interpreting revenue streams for VAT purposes and implementing a binding class ruling, are just some of the issues these institutions face. Subsequent to these publications, submissions

were made to the Davis Tax Committee to consider changing the treatment of educational services. However, the report shows that no specific consideration was given to the treatment of educational services other than noting that it is a merit good and, therefore, exempted (Davis and Woolard, 2018).

While the authors' (Jeewa, 2016; Nelson, 2016) analysis is insightful, a more comprehensive exploration of these difficulties is needed to fully comprehend the challenges the higher education sector is experiencing in complying with the full array of VAT legislation that affects it.

### **2.3.3 The burden of VAT compliance globally**

When considering compliance challenges, it is essential to understand that this is not just a higher education issue. The problem with VAT compliance is international and experienced across many industries.

Considering the difficulties experienced by other industries, Ritchie (2015) focused her research on the challenges encountered in the retail sector in managing the apportionment of input tax and assessed different countries to try and ascertain best practices. Using a mixed methods approach combining qualitative and quantitative methods, the conclusion reached was that the apportionment of input VAT is generally problematic.

The apportionment problem is also experienced in other countries. Mascagni et al. (2023) demonstrated this by considering Rwanda, where VAT, conceptualised as an efficient consumption tax, has instead become costly and complex to administer. The study demonstrated that the practical implementation of VAT differs substantially from its theoretical conceptualisation. Zu et al. (2020) explored the compliance burden imposed by VAT in the UK. Their focus was primarily on the situation where special regimes were adopted to simplify VAT, but this has had the opposite result, instead increasing the compliance burden.

A similar case could be made for higher education institutions that have to implement a VAT class ruling, making compliance more difficult. The authors noted that compliance problems arise from policy. They recommended that policymakers take a more holistic approach when deciding on policy changes, specifically those designed to simplify VAT and consider the potential additional compliance burden for taxpayers (Zu et al., 2020).

In India, using a qualitative and quantitative approach, with more weighting on the quantitative, Vishnuhadevi (2021:194) estimated that “the proportion of VAT compliance costs relative to VAT revenue ranges between 2 percent and 10 percent”. The article concluded that VAT compliance incurs the highest costs compared to other taxes. These costs were primarily due to the record-keeping requirements and the external expertise required to comply. The size and complexity of the VAT requirements and the differential rates played a role in this cost. There was a direct correlation between VAT complexity and associated compliance costs. Governments should assess this correlation further when they change VAT policy (Vishnuhadevi, 2021).

Further investigation was undertaken to quantify this hidden compliance cost of taxation in India more effectively. Mukherjee and Badola (2022) reviewed the existing literature and compiled information related to expenses incurred by enterprises on VAT-related activities, then identified those component costs explicitly associated with VAT and termed these TSCs (total selected costs). They estimated that “the average compliance cost is 4.35% of average annual total operating cost and 3.87% of average annual turnover of sample enterprises” (Mukherjee & Badola, 2022, p.421). These are significant costs that relate only to the cost of compliance and do not include the actual tax payment, which enterprises would need to incur on top of this cost.

Evans et al. (2018) supported the conclusion that the number of VAT statuses increases complexity. They used a diagnostic tool to survey compliance issues in forty-seven countries, including those with very low and high compliance burdens. The tool used a mixed methods approach encompassing a doctrinal literature review, qualitative analysis, and quantitative surveys. Their results once again confirmed that the complexity of VAT policy appears to be the most significant factor that impacts the compliance burden in most countries, compared to the administration framework and the capabilities of the revenue services, which were not as substantial.

The literature highlights several issues often similar to difficulties that higher education institutions struggle with. They are essential in understanding this problem and providing an international context to the research.

#### **2.3.4 Alternatives to exempting supplies, specifically educational services**

While there is limited recent literature on exempting supplies related to educational services,

various authors have considered the validity of exempt supplies for VAT purposes more generally.

Agbo and Nwadiolor (2020) considered the current treatment of services in Nigeria using qualitative surveys, specifically in light of a recent substantial increase in VAT the government enacted. The article provides insight into the creation and purpose of VAT in Nigeria and a projection of its future within the country. They recommended reviewing and minimising exempt services but emphasised retaining the exemption for educational services. However, they did not consider the overall impact on the higher education industry and whether this is still the best fit.

Cnossen (2015) offered a counter view, recommending that all supplies be standard-rated as far as possible. Standard-rating all supplies would increase revenue to the fiscus and allow simpler VAT administration. It would also limit the need for legal opinions, allowing the resources previously expended on VAT interpretations to be redirected to other priorities. As mentioned before, the cost for the appointment of experts is one experienced in the higher education environment as well, and they would also benefit from diverting these funds to more pressing needs.

Cnossen (2020) continued this counter-recommendation by highlighting the substantial cost of supplies exempt in the Netherlands. The study recommended a single VAT rate that would foster economic growth and noted that “VAT exemptions distort input choices, stimulate uneconomical self-supply and complicate administration and compliance” (Cnossen, 2020:1).

In a separate article, he considered the effect of the different VAT rates, specifically in the context of the contribution to the VAT policy gap from a Dutch perspective. He noted that this contribution was significant, generated substantial welfare costs (Cnossen, 2022), and considered three options to modernise EU VAT. One of these recommendations is again to include additional exempted supplies in the standard-rated net and, if that is not appealing, to zero-rate them. Again, he highlights the benefits, including reducing opportunities to manipulate input choice and bias and lowering the administration burden, even though it could worsen competitive advantage. He specifically considered the treatment of merit goods and argued that even if these supplies were subject to VAT, the shortfalls could be addressed without distorting input choices and outsourcing activities, and discriminating against private education providers (Cnossen, 2022).

Using a mixed methods approach, Kowal and Przekota (2021) found that the more variations there are in VAT policy, the greater the complexity of compliance. The research indicated that a tax system with fewer rates and preferably with a single lower rate is the least susceptible to fraud and more straightforward to comply with. The authors recommended one VAT rate with modifications for people experiencing poverty, which does not worsen their situation. Ultimately, these are valuable recommendations as they address the critical issues around the unintended consequences of exempt supplies and assist in considering alternative VAT treatments. The conclusion is that multiple VAT rates create administration and compliance challenges. Several authors have explored alternatives to the current VAT status for educational services in higher education.

Jeewa (2016) recommended that the government consider including higher education institutions under the 'welfare organisations' concession in the VAT Act or consider zero-rating educational supplies, similar to the system implemented in Australia. This solution would assist in dramatically reducing the administration burden. In a study, Nelson (2016) considered the tax apportionment method applied by institutions per the VAT ruling and whether other methods could alleviate the administrative burden this caused. The recommendation in the study by Nelson (2016) was to consider changing the VAT rate from exempt to zero-rated, highlighting the financial and administrative benefits this would allow these institutions if the VAT Act is amended.

Using a doctrinal approach, Jugdhaw (2018) suggested a new VAT method primarily to address the funding shortfalls within the higher education environment, but it would also assist in alleviating the challenges faced with VAT compliance. Similar to Nelson (2016), the recommendation was to consider making tuition fees zero-rated. This VAT rate would allow these institutions to claim VAT on expenditures incurred for tuition fees, resulting in substantial refunds and a welcome boost to assist with higher education institutions' current funding crisis. The thesis, however, noted that this benefit would also extend to private higher education institutions (Jugdhaw, 2018). Even with this outcome, there would still be significant benefits in the management of VAT, as it is likely that the apportionment issues would be significantly reduced if this recommendation was implemented.

Smith (2019), applying a doctrinal approach, also questioned the benefit to private institutions should a zero-rated VAT supply status be afforded to educational services and recommended that it may be preferable that educational services remain exempt per the VAT Act. However,

this approach would not resolve the existing administration and compliance challenges. He also considered whether allocating a status of standard-rated to educational supplies would make sense but noted that there may be a problem with public perception. The final recommendation is to differentiate between public and private educational services, allocating a zero-rated supply to the public and a standard-rated supply to private educational services (Smith, 2019). These recommendations are worth noting and examining, but understanding the compliance difficulties first is critical to establishing whether it is worth changing the rate, even if this may have unintended benefits for private institutions.

The authors (Jeewa, 2016; Jugdhaw, 2018; Nelson, 2016; Smith, 2019) theorise that the solution is to reduce the number of VAT rates, but the question remains: What VAT rate would be best and, in the context of this study, what would be best for a higher education Institution? Most authors have recommended a zero-rated VAT rate, but few have explored the benefits of standard-rating educational services and why this may be a reasonable alternative

## **2.5 Research gap**

The literature review highlights to a limited extent that educational services were exempted due to a recommendation from VATCOM (Smith, 2019), which believed it would limit administration (Jugdhaw, 2018) and as a result of the importance of education (Jeewa, 2016). However, there is a significant compliance burden that higher education institutions must manage. The situation is exacerbated by introducing an apportioned VAT status, even with the assistance of a VAT binding class ruling, which is complex and more challenging to administer and often results in additional costs due to the need to appoint expensive consultants to assist (Nelson, 2016).

The literature also highlights the challenges industry and other countries commonly face regarding VAT compliance. The initial intention of implementing VAT was to create a simple consumption tax; however, the difficulties in ensuring compliance have resulted in it not being simple to administer with a high cost of compliance. In addition, risks such as the potential for manipulation and errors are also concerning. Generally, the authors (Agbo and Nwadiolor, 2020; Cnossen, 2020; Kowal and Przekota, 2021) recommend fewer VAT treatments. For higher education institutions, implementing fewer VAT rates, for example, a standard- or zero-rating, would reduce VAT compliance costs and assist in managing the risks associated with implementing multiple VAT statuses. The benefits and challenges of the different VAT rates

are noted below -

**Table 2.1: Challenges and benefits of VAT rates**

| <b>VAT Rates</b> | <b>Benefits</b>  | <b>Challenges</b>   |
|------------------|--|---|
| Standard rated   | Revenue and expenses are vatable and are therefore included in the VAT calculation. This should place the institution in a VAT-neutral state.  | Record keeping and administration would be required, along with the submission of VAT returns.  |
| Zero-rated       | VAT on zero-rated goods and services would be deductible, while revenue would have a zero percent VAT rate, resulting in no output VAT. This would generally result in a refund, which is why this rate is often sought after. | As noted above, record keeping and administration would still be required, along with submitting VAT returns.   |
| Exempt           | Exempt goods and services result in the charge of no VAT and would, therefore, require no VAT payments and no registration for VAT submissions if all goods and services relate to an exempt VAT status.                       | If an institution provides goods and services that are both vatable and exempt, then a VAT apportionment may be required, which makes the administration and compliance requirements onerous. |

*Source: Researcher's own construction (2025)*

While authors (Jeewa, 2016; Jugdhaw, 2018; Smith, 2019) have considered at a basic level the reason VATCOM exempted educational services, this research study focused on obtaining a more in-depth understanding of these reasons and the impact of the exempt status of educational supplies has on increasing the complexity of administration in higher education institutions and ensuring compliance with the VAT Act. In addition to unpacking these difficulties, the study understood the global view of exempting supplies from VAT and investigated what other countries have done concerning educational supplies. Reviewing what the literature recommended helped establish a basis for allocating different VAT statuses to similar supplies, and understanding the current landscape in which higher education institutions operate assists in providing an argument for what VAT rate is best fit for educational supplies, specifically in higher education institutions.

## **2.6 Chapter summary**

This chapter outlined the theoretical framework, drawing on distributive justice, social

compact, and tax incidence theories to establish a foundation for the study. The empirical literature review explored the challenges experienced by higher educational institutions, along with recommendations from authors on alternative VAT treatments, and justified that this study will further examine the implications of the exemption of educational services for higher education institutions and support the recommendation to standard-rate this supply. The research methodology applied in this study will be considered in the next chapter, and the research philosophy and design will be justified. More insight into the data used and its credibility is offered.

## CHAPTER 3

### RESEARCH METHODOLOGY

#### 3.1 Introduction

This chapter outlines the research methodology used to conduct the research. The research philosophy is explained, and the design is justified in relation to the nature of the study. The methods used to achieve the research objectives are also linked to the overall approach. The data sources are explained, and a quality assessment is conducted to ensure that the data is from reputable sources. Finally, data extraction and synthesis are described, and ethical considerations are explored.

#### 3.2 Research philosophy

It is necessary to understand the historical drivers that informed the decision to exempt educational services, along with the legislation and financial data that impact institutions that deliver educational services today. This requires reviewing existing data to answer the research questions. This was important to provide a comprehensive understanding and assessment to address the study's objectives effectively. These factors drove the philosophy and the approach applied in this research study.

Defining a research philosophy is essential, as understanding the assumptions that drive personal value can assist in conducting and planning the research. It allows the selection of appropriate methodologies and methods so that work is not duplicated or performed unnecessarily (Crossan, 2003).

As noted above, the current research study reviews legislation, literature, and statistical data to provide insight into why the VAT treatment of educational services should be changed. It, therefore, follows a pragmatism philosophy using a mixed methods approach applying both qualitative, including a doctrinal review and quantitative methods.

Pragmatism is a philosophy that employs both qualitative and quantitative methods to meet the study's objectives and answer the research questions (Shan, 2022). It is often criticized as applying two opposing methods; however, Maarouf (2019) argues that the philosophy integrates both these methods to provide a complete assessment, as the philosophy approaches the study from the two points based on the methodology, using the strength of both methods,

depending on the data being reviewed. This allows for a more comprehensive understanding and more robust evidence to support the study (Maarouf, 2019)

### **3.3 Research design and approach**

The research follows a descriptive research design via a desktop review using applied research. This historical research approach is appropriate as it assists in constructing a historical account of literature to contextualise and interpret current research. It may also help in deriving lessons that provide policy enhancement recommendations (Lamb, 2003). In the context of this research, the desktop review is the most relevant design as it accesses a wide array of literature from reputable sources to consider the historical context in which educational services were exempt for VAT purposes. In addition, it provides insight into whether this exemption is still relevant in the current context, what alternatives are better options, and why. The advantage of this design is that it relies on a reputable foundation on which to make a credible assessment.

The study uses a narrative review to assess secondary data sources to support the aim and objectives of the study. It follows a mixed-use method, using both a qualitative, doctrinal research methodology through the review of legislation and research literature in this area and a quantitative method through the assessment of statistics and financial information from credible sources. The advantage of this method is that it was identified as the approach used by authors during the literature review. Secondly, this method triangulates the information from various sources, corroborating the conclusions and ensuring the veracity of the recommendations made at the study's conclusion.

### **3.4 Data sources and quality assessment of the documents**

A systemic data review approach is followed, which involves a comprehensive analysis of available research and data. Terms were inputted into the search function of the databases/internet to obtain the necessary data. The terms used included “educational services”, “higher education”, “higher education institutions”, “value-added tax”, “VAT”, “goods and services tax”, “GST”, “New Zealand GST”, “VAT apportionment”, “public higher education”, “private higher education”, “medical services and medicines”, “healthcare”, “public healthcare” and “private healthcare”.

Data were sourced from the UKZN database, Google Scholar, and the internet. Government publications and textbooks were obtained from the UKZN library. Several data types were

reviewed in the research study, including peer-reviewed journal articles and books, government reports, approved theses, and book chapters. Internet searches were primarily performed on webpages of local and international government organisations, experts in the field of VAT, and the webpages of large suppliers of private medical services and private education. The data were therefore obtained from reputable sources and are of a high standard, giving credibility to the information accessed from them.

Data for the data analysis were collected based on the research questions they addressed. Given the historical context of questions one and two, which questioned why educational services were exempted for VAT purposes and how current multiple VAT statuses impact higher education institutions, data was sourced from 1991 to 2024. A total of 29 research publications were reviewed. Publications and data were included in the study if they included the historical drivers for the decision, the treatment of education services, and the treatment of VAT in a higher education context. Data addressing funding incentives, the impact of the VAT rate change on merit goods, the effect of changes to the Act, SARS approval processes, analyses of other industries, and interpretation of educational services in different countries were excluded. In addition to research publications, data, including legislation from government and industry expert websites and publications, were reviewed and included in the study, where they addressed the research question. A doctrinal review of legislation and rulings was used to address question 2. A total of 21 sources were used, including 2 books, 1 report, 5 thesis, 1 article, and 12 websites.

In addressing the third question relating to what recommendations global role players make regarding exemptions for VAT, 25 research publications were reviewed for the period 2015 – 2024 to ensure more recent publications were accessed. Research publications were reviewed and included if they addressed exemptions for VAT purposes at a general or global level, which may be relevant to higher education institutions. Publications related to transfer pricing implications, difficulties related to other taxes, specific act and administration recommendations, cost of compliance, interpretation of educational services, and industry-specific challenges were excluded. In addition, data from government and industry expert websites and publications were reviewed, and recommendations from global roleplayers such as the OECD and IMF were reviewed and included in the research study if they addressed the research question. A total of 12 sources were used, including 2 reports, 7 journals, and 3 websites.

Several research publications were reviewed to address the fourth research question. Research publications related to this question, which considered alternative VAT treatment of educational services to reduce the administration burden of compliance, included data related to three broad areas.

Firstly, given that the study indicates that the New Zealand model was one of the most successful, research on the GST model implemented in New Zealand was reviewed, where research publications were extracted from 1993 – 2024, and a total of 21 publications were reviewed; given its historical nature, it was essential to go back to understand the model. Along with this, legislation was reviewed on New Zealand government websites. Data was included where it addressed the research questions and specifically where it considered the implementation of the New Zealand GST model and legislation related to educational services. Publications were excluded where they related to models in other countries and the impact of the New Zealand model on those countries, specific changes to the New Zealand legislation, administration difficulties, the morality and effectiveness of VAT, and other taxes. A total of 12 sources were used, including 1 book, 1 book chapter, 6 journal articles, and 4 websites.

In relation to the second area, which addressed the treatment of medical services for VAT purposes as a basis for considering a different treatment of educational services, the report from VATCOM was used to explain the decision. Thereafter, publication data was extracted from 2007 – 2024, while other data, including financial data and legislation, was extracted from 1997 – 2024. A total of 24 publications were reviewed. Publications were included, which informed the decision to make medical services standard-rated and the impact of that decision on the healthcare industry. Publications related to healthcare funding, the impact of the VAT rate increase, collection and administration of VAT, equity in healthcare in other countries, and justification for VAT on specific types of healthcare services were excluded. A total of 19 sources were used, including 1 report, 2 thesis, 9 journal articles, and 7 websites.

Thirdly, the growth in the private higher education sector was considered, where research publications were extracted from 2014 – 2024. Data was reviewed on government and private education websites. A total of 20 research publications were reviewed. Publications related to the growth in the higher education sector and the research produced by this sector were included, either globally or at a sub-Saharan level. Publications related to private education in

specific countries, internationalization, improving access, funding, curriculum design, and survival strategies for higher education institutions were excluded. A total of 23 sources were used, including 1 book, 7 journal articles, and 15 websites.

Keywords include higher education institutions, educational services, value-added tax, VAT, apportionment, healthcare, and private education.

Locally, the webpages accessed were the ADvTECH Group, Department of Science and Innovation (DSI), Department of Higher Education and Training (DHET), Exeo Capital, Hospital Association of South Africa (HASA), Independent Institute of Education (IIE), Life Healthcare Group, Netcare Limited, National Student Financial Aid Scheme (NSFAS), PricewaterhouseCoopers (PWC), South African Revenue Services (SARS), SNG Grant Thornton, Statistics South Africa (StatsSA), TaxCom, Treasury, Sector Education and Training Authority (SETA). The international web pages accessed were the International Monetary Fund (IMF), the New Zealand Inland Revenue Department, the OECD iLibrary, and the Victoria University of Wellington.

### **3.5 Data extraction, synthesis and analysis**

A content analysis methodology was employed to extract relevant data through a systematic review of selected sources. Content analysis, as defined by Krippendorff (1989), involves a careful examination of textual material to identify and interpret significant themes, patterns, and salient points while maintaining sensitivity to the contextual meanings embedded within the content. In this study, different analytical approaches were applied based on the nature of the material reviewed.

A doctrinal research method was utilized which included legal materials, including statutes, judicial rulings, and official guidance documents. This method involves the critical evaluation and synthesis of legal texts to determine their scope, implications, and applicability.

A qualitative analytical approach was adopted, including academic and theoretical literature, such as peer-reviewed journal articles, scholarly books, and academic theses. This involved an in-depth thematic review aimed at understanding conceptual frameworks, methodological approaches, and key findings within the existing body of knowledge.

Conversely, empirical financial data was examined using a quantitative analytical framework. This included the analysis of numerical data such as financial statements, trends, ratios, and other relevant statistical indicators to identify patterns, relationships, and economic implications.

### **3.6 Ethical considerations**

Ethical clearance (application no. 00027690) was obtained from the University of KwaZulu-Natal (UKZN) for the research study. No further approval was required, as secondary data obtained were freely available from the data sources.

### **3.7 Chapter summary**

This chapter expanded on the methodology used, indicating that a pragmatism research philosophy was applied when the study was conducted. The study used a descriptive research design via a desktop review using applied research. A mixed-methods approach, using qualitative and quantitative methods, was considered most appropriate. The data were obtained from reputable sources and extracted and assessed using a content analysis approach. Ethical clearance was obtained from UKZN for the study, and no further approval was required as freely available secondary data sources were used. In the next chapter, the data collected will be analysed and presented for further assessment and review.

## CHAPTER 4

### ANALYSIS OF RESULTS

#### 4.1 Introduction

In Chapter 3, the research methodology that informs this study was unpacked, and justification was provided for the research philosophy, design, and methods. Information on data sources, extraction, and synthesis was also provided.

In this chapter, the data analysis is conducted. The chapter is constructed first to consider the historical precedence that VATCOM established, which will assist in addressing the study's first objective. Thereafter, the impact of this decision on the higher education sector is explained, which will address the second objective. To address the third objective and identify an alternative recommendation for exempting educational services, a global view is considered, where the New Zealand model is held as the most progressive model currently available. An assessment of this model is therefore conducted to make a recommendation. The treatment of medical services and medicines is a misnomer in VAT, as most other countries exempt this supply. Understanding what drivers VATCOM applied when allocating a different VAT status further supports the standard-rating of educational services. Finally, an assessment of the current higher education landscape is reviewed to consider whether private and public institutions should be treated the same. These final three sections will assist in addressing the fourth objective of this study.

#### 4.2 Reasons for the exemption of educational services for VAT purposes

This section explores the principles and drivers that VATCOM applied in deciding to exempt educational services.

##### 4.2.1 Framework that informed exempting educational services

The VAT Act became effective on 30 September 1991 in South Africa. Prior to this, the government published the draft Value Added Tax Bill on 18 June 1990, inviting representations and comments on the bill. The bill was to replace the GST enforced by the Sales Tax Act of 1978. It was based on a model implemented in New Zealand but adjusted to accommodate the socio-economic issues faced by South Africa. The purpose of the new bill was to address the shortcomings of the Sales Tax Act, which allowed for significant tax evasion and taxed a

narrower base of taxpayers. The new tax would be based on the destination principle, which states that products or services are taxed where they are consumed (VATCOM, 1991).

The Minister of Finance appointed a panel of 16 experts from the public and private sectors to review the comments and make recommendations to the Minister (Jugdhaw, 2018). This panel was called the Value-Added Tax Committee (VATCOM). After the report from VATCOM, a report on the treatment of merit goods and services, drafted by PWC, was issued by Treasury (PWC, 2005).

VATCOM received written and verbal representations from the public, which they considered to establish whether further adjustments should be made to the Bill. The recommendations made by the committee were based on several fundamental principles. Primary amongst these was that the number of reduced rates should be kept to a minimum, where the only reasons for allowing these reduced rates was to improve the circumstances of people with low incomes, where services are difficult to tax, or where groups lobbied for reduced rates on merit goods (VATCOM, 1991).

According to PWC (2005), this view of fewer reduced rates was growing increasing support, including from the IMF, which was also of the opinion that there should be minimal concessions for lower VAT rates and that simplicity and efficiency should rank higher than equity, which should instead be addressed by other interventions from government. It was understood that this was the approach that VATCOM would be driving. Preece (1991) noted that VATCOM intended to keep the concessions to a minimum, with the view that these were ineffective in assisting people experiencing poverty and targeted initiatives should instead be used to do so.

VATCOM applied specific objectives when they considered how tax policy should be drafted. These included the following:

**Neutrality** – Sales Tax did not tax all goods and services, but the new VAT system would. The Act would allow the final consumer to pay the VAT to the fiscus without penalising those in the value chain.

**Equality** – VAT taxes all equally, despite its regressivity. Other mechanisms should be used to address socio-economic consequences. PWC (2005) explained this as the fairness of tax policy based on two tenets: first, the ability of taxpayers to pay, and, secondly, if

taxpayers enjoy the benefits of government services, they should pay for them.

**Efficiency, Productivity and Simplicity** – The tax should collect a large amount but do so efficiently and simply. Silke et al. (2023) explained simplicity as being easy to understand and efficiency as designed so that it does not influence economic decisions. PWC (2005) expanded this definition to include simplicity, minimal administration, matching of tax impact and incidence, broadening the tax base, flexibility, moderate rates of progression, reducing the burden, and increasing revenue.

The committee also concluded that VAT should not require substantially more compliance requirements than GST (Jeewa, 2016). The following essential consequences were noted when considering the exempt status of supplies afforded in the Bill. First, the vendor should be treated as the final consumer in the VAT chain; the vendor should not be in a position to claim back the VAT, so in a case where a supplier would have usually excluded the cost of the VAT on a product or service, as this was recoverable via a VAT claim, a supplier of exempt services would not be in a position to do so. The supplier was forced to build this into the product or service cost (VATCOM, 1991).

The second consequence noted by the committee was that the exempt status would require substantial administration (VATCOM, 1991). PWC (2005) noted the problem with any exemption is that it reduces the income available to the fiscus, which it would then need to recover elsewhere. This concern should support the view that taxing, where possible, should be indulged unless there is a compelling argument against it. VATCOM established a strong foundation based on which to assess the representations they received from the industry on the treatment of several different supplies. Given the implications of these supplies, the principle of minimal concessions was at the forefront of the VATCOM thinking. As noted by PWC (2005), concessions erode the income available to the fiscus, which would need to be replaced elsewhere, placing an additional burden on the government. They also understood that, generally, these supplies resulted in extra administration and increased the compliance burden (Jeewa, 2016).

The objectives of policy construction were considered when they applied their minds to any recommended changes that should be made to the VAT Bill. As outlined above, these objectives included neutrality, equality, efficiency, productivity and efficiency. They would have driven VATCOM decisions in recommending changes (VATCOM, 1991).

#### **4.2.2 Reasons for exemption of educational services**

Several variables would have required consideration when deciding what VAT status to recommend for educational services. The Value Added Tax Bill recommended that educational supplies remain exempt, similar to how they were treated under the Sales Tax Act (Jeewa, 2016). Representations were made suggesting that educational supplies should be standard-rated; however, VATCOM felt that applying this status would yield no additional gain to the fiscus (VATCOM, 1991). The reason for this was that given that the government primarily funded higher education institutions at the time (Nelson, 2016), these funds would ultimately need to be recycled back into subsidies provided by the government.

There would also have been considerations regarding the taxation of education as a potential merit good. PWC (2005) noted that there was generally an argument not to tax merit goods, which comprised, among others, goods and services that were in the public interest, goods and services that were essential, goods and services of an educational nature that would amount to the taxation of knowledge and goods and services which from a political viewpoint should not be taxed.

It could be inferred that educational services fall within all the classifications of merit goods noted above and would, therefore, be considered explicitly for special concessions. Jeewa (2016) indicated that VATCOM was conscious of the importance of education at the time, so the considerations around treating educational supplies as a merit good would likely have featured in their deliberations around its treatment. Problems around too many concessions would have been assessed. PWC (2005) argued that there were only two reasons for concessions for VAT, either for social policy or where there is complex tax administration. However, generally, these concessions erode the neutrality objective of VAT, making it more difficult to administer and easier to evade tax.

Although VATCOM acknowledged that exemptions should be kept to a minimum (Preece, 1991) in line with the principles of neutrality, equality, efficiency, productivity and simplicity, as noted previously, the report shares minimal information about the engagement with these principles in their discussions around the treatment of educational services. However, they pointed out that the exemption status would not require these institutions to register for VAT (VATCOM, 1991), which would, at a minimum, comply with the principles of efficiency and

simplicity. At the time, this concession would have resulted in these institutions not having to implement the demanding requirements of the VAT Act, which included extensive recordkeeping and submission of returns.

As noted above, the recommendation by VATCOM was based on the fact that the government primarily funded these institutions at the time (Nelson, 2016). There is no indication in the report of any forethought around the evolution of this sector, specifically higher education institutions, which in their current form would completely contradict this recommendation and result in the administration burden that the recommendation was trying to avoid.

PWC (2005) considered the treatment of educational supplies worldwide at the time of their report. The sample they selected was 24 countries in Africa and 29 countries in Western Europe and the European Union, and all exempted educational supplies. While the treatment of this supply was unanimous as exempt in these countries, this was not the case with the balance of the regions and countries selected. In Eastern Europe, only one out of five countries sampled exempted these supplies, with the balance either standard-rating or using a reduced rate. Six of 12 countries in the Americas exempted educational services, while eight of 14 in Asia were exempt. PWC (2005) believed that based on these results, the international trend was to view educational services as a merit good, which was generally exempt.

It is understandable why VATCOM would recommend that educational supplies be exempt, as at the time and based on global trends, this appeared to be the norm. However, even then, some countries standard-rated this supply, which would have been against existing political pressure to define these supplies as merit goods and deserving of a concession, ultimately resulting in them being exempt. When VATCOM considered educational supplies, they also considered the industry in totality, referring to the 21000 educational institutions at the time (VATCOM, 1991), without differentiating between organisations that delivered primary, secondary, and tertiary education (Jugdhaw, 2018). These institutions are very different today, each with varying revenue streams, and should not be considered together when recommending VAT treatment.

VATCOM did not support the representations that educational supplies should be zero-rated. They believed this would place these institutions in a better position than under the Sales Tax Act, which was not the intention of the Act and would create a hidden subsidy that was beyond Parliament's control (VATCOM, 1991). VATCOM considered several other industries in their

deliberations. Two of these are worth considering further. First, the decision on how to treat medical services and medicines, and second, the treatment of welfare organisations.

The VAT Bill initially indicated that medical services and medicines should be exempt from VAT. PWC (2005) considered the treatment of medical services globally in their report, considering the treatment in over 80 countries. Most of these countries were exempting medical services then, so the initial recommendation to exempt these supplies seemed reasonable. There was widespread representation from the medical industry, which requested a range of VAT treatments when VATCOM considered the submissions, the most significant of these where suppliers highlighted the administrative difficulties and the compliance burden that would result from the exempt status (Hablutzel, 2021). VATCOM was diligent in its assessment and considered all aspects of the potential problems that would arise, ultimately recommending that all medical services and medicines be standard-rated (VATCOM, 1991).

Secondly, the supplies of welfare organisations were also considered. VATCOM recommended that these organisations be defined as welfare organisations in the VAT Act, with a similar definition to the one in the Sales Tax Act, but in addition, it recommended that they be registered in terms of the National Welfare Act. Institutions that provided exempt educational supplies were explicitly excluded from this definition (Jeewa, 2016), as they felt that including these organisations would negatively affect welfare organisations (VATCOM, 1991). VATCOM recommended that subsidies received by these organisations should be zero-rated or the subsidies received by these organisations should be subject to VAT but compensated for the VAT payable through increased subsidies from the government. VATCOM once again highlighted in its recommendation that the decision to address welfare considerations should not be made via tax concessions but through initiatives outside the tax system (VATCOM, 1991).

Overall, one can understand why VATCOM recommended that educational services remain an exempt supply as indicated in the VAT Bill. The critical drivers for this decision included the view by the government that given that it was funding these institutions at the time, it did not make sense to standard-rate the supply. The exempt status of their primary income streams would have granted these institutions the special allowance of not registering for VAT, thereby avoiding the cumbersome and demanding requirements of the Act, primarily where record keeping was concerned. The assessment as a merit good would also have been a consideration in their decision, as well as the political pressure of taxing such goods. Finally, given that most

of the world was exempting this supply, it made sense to recommend the same status.

In considering how VATCOM decided to exempt educational services, it is essential to note that they made a contrasting decision regarding the treatment of medical services and medicines. Although similar arguments can be made to those for educational services that these supplies should be exempt, VATCOM still recommended that they be standard-rated. The decision and consequences of this assessment are discussed later in the chapter.

The treatment of supplies by welfare organisations was also considered. VATCOM recommended that these supplies be either zero-rated or made vatable, with the VAT payable reimbursed to these organisations via increased subsidies. This decision is also contrary to similar considerations when supporting the exempt status for educational supplies (VATCOM, 1991).

### **4.3 Impact of current multiple VAT statuses on higher education institutions**

This section explores the impact of the current VAT treatment of the income streams in the higher education sector to provide insight into the compliance challenges the sector is dealing with.

#### **4.3.1 Exempt supplies in higher education institutions**

According to the SARS VAT Guide 404, exempt supplies relate to goods and services for which no VAT is charged and for which no VAT may be deducted. Businesses with only exempt supplies for VAT purposes cannot register as vendors as they do not carry on an enterprise (SARS, 2022a). If an organisation only provides exempt supplies, then the benefits of this status are substantial, as they do not need to register for VAT and comply with the requirements of the VAT Act. This benefit would be especially relevant to the onerous record-keeping requirements.

The Value Added Tax Act no. 89 of 1991 states the following concerning the exemption of educational supplies –

12. Exempt supplies —The supply of any of the following goods or services shall be exempt from the tax imposed under section 7(1)(a):
  - (h)(i) the supply of educational services—

- (aa) provided by the State or a school registered under the South African Schools Act, 1996 (Act No. 84 of 1996), or a public college or private college established, declared, or registered as such under the Further Education and Training Colleges Act, 2006 (Act No. 16 of 2006);
  - (bb) by an institution that provides higher education on a full time, part-time or distance basis and which is established or deemed to be established as a public higher education institution under the Higher Education Act, 1997 (Act No. 101 of 1997), or is declared as a public higher education institution under that Act, or is registered or conditionally registered as a private higher education institution under that Act; or
- (ii) the supply by a school, university, technikon or college solely or mainly for the benefit of its learners or students of goods or services (including domestic goods and services) necessary for and subordinate and incidental to the supply of services referred to in subparagraph (i) of this paragraph, if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for lodging or board and lodging; or (SAICA, 2022)

In the context of higher education institutions, as per section 12(h)(i) above, all tuition fees and some of the subsidies received will be exempt from VAT. In addition, per section 12(h)(ii), any costs required to and incidental to the supply of educational services, including providing lodging, are also exempt for VAT purposes. Therefore, the scope of this exemption includes residence fee income, among others.

#### **4.3.2 Consequence of having both exempt and taxable supplies for higher education institutions**

In addition to tuition fees, subsidies, and residence fees, higher education institutions generate other income streams. These include research income, investment income, and venue hire, among others. Each revenue stream must be assessed under the VAT Act to determine whether it qualifies as exempt, zero-rated, or standard-rated. If these income streams do not meet the requirements of exempt supplies, they may be classified as zero-rated supplies under section 11 or standard-rated supplies under section 7(1)(a) of the VAT Act.

Higher education institutions have multiple supplies with different VAT statuses, so they may incur expenses for taxable and non-taxable supplies. As a result, only a portion of the input tax on these expenses may be deductible. An assessment would be required to understand the effect of this in line with section 17(1) of the VAT Act, which states –

17. Permissible deductions in respect of input tax —

- (1) 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) where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95 percent of the total intended use of such goods or services, the goods or services concerned may, for the purposes of this Act be regarded as having been acquired wholly for the purpose of making taxable supplies;

(SAICA, 2022)

As noted in section 17(1) above, only input costs for making taxable supplies can be deducted. The expenses must be apportioned if they are only partially used for this purpose. The SARS VAT Guide 404 expands this further, noting that the first step in performing an apportionment exercise is establishing which costs are directly attributed to making taxable or exempt supplies. Expenses directly attributable to taxable supplies, namely supplies at 15 percent or 0 percent, are fully deductible. Expenses directly attributable to exempt supplies are not deductible. Once this exercise is done, any other costs related to the production of taxable and non-taxable supplies will require the application of an apportionment method to calculate what portion may be deductible for VAT purposes (SARS, 2022a).

As noted in section 17(1)(i) of the VAT Act above, if the intended supply is 95 percent or greater, the 5 percent need not be considered further. The application of the 5 percent threshold is an important observation as if a recommendation is made, for example, that educational services should be standard-rated or zero-rated, there may be a portion of other supplies, for example, investment income, which may still be exempt, however, if these exempt supplies are lower than 5 percent then they will not affect the treatment of the balance of the supplies. Given that higher education institutions have multiple supplies with different tax statuses, they need to consider how to apply the apportionment of costs, as highlighted in section 17(1). The turnover method is currently the only apportionment method approved by SARS that does not require written approval. It is important to note that if this method results in an unrealistic result, it could also be disallowed (SARS, 2022a).

The SARS VAT Guide 404 states that the apportionment method implemented by the vendor must adequately reflect the supplier's resources and produce results that are "fair and reasonable" (SARS, 2022a:65). If this is not the case, SARS requires that they are approached for a more appropriate apportionment method (SARS, 2022a). The SARS VAT Guide 404 states that once an apportionment method is used, the apportionment percentage needs to be calculated for each period. However, it is not always possible to calculate this accurately. SARS, therefore, allows for an estimation of the VAT and an adjustment for the over or underestimated VAT when it can be calculated accurately, which occurs once the annual financial statements are finalised. This concession is merely an administrative allowance and does not impact any requirements of the VAT Act (SARS, 2022a).

#### **4.3.3 The impact of the Value Class Rulings (VCRs) on higher education institutions**

Section 17(1) notes that per section 41B of the VAT Act and Chapter 7 of the Tax Administration Act, the Commissioner may issue a binding VAT class ruling equivalent to a binding class ruling, which would be required if the turnover method approved by SARS does not provide a fair approximation of the input tax that should be deductible for mixed-use expenses. SARS gave an interim ruling to implement the input-based apportionment method with some modifications to higher education institutions that initially experienced difficulties coding their income streams in line with the requirements of the VAT Act. SARS issued its first VCR for higher education institutions on 1 August 2012 (Nelson, 2016).

Nelson (2016) noted that using a varied input-based apportionment method makes sense and explained its simplicity, calculated by merely excluding mixed-use expenses. Only expenses directly attributable to taxable supplies are established as a proportion of taxable and non-taxable supplies. The result will give a reasonably accurate indication of what portion of the mixed-use expenses should be deductible. This calculation differs from the previous input-based method, which included the VAT incurred on mixed-use expenditure in the denominator (Jeewa, 2016). Subsequent to the initial VCR issued in 2012, the VCR has been reissued with adjustments multiple times. The latest VCR was issued on 24 February 2022 and is valid for three years from 1 January 2022 until the earlier of a change in legislation or 31 December 2024. The request for the VCR was made for USAf by PWC (SARS, 2022c).

The VCR noted that a ruling is required due to the complexities caused by goods and services used for mixed purposes. It highlighted that the most significant risk relates to income from research, as these supplies are subjective and often result in different interpretations and VAT treatment. The industry, therefore, required further guidance from SARS to ensure the consistent treatment of these revenue streams across higher education institutions. The request was also made to extend the period for adjustments to the apportionment calculation from 6 to 12 months. In addition, the VCR addressed changes in use adjustments for capital assets and imported services (SARS, 2022c). For this study, the change of use adjustments on capital assets is not considered further.

The VCR provides the following definitions and classifications for the different types of research –

‘applied research’, means a project which is primarily directed towards a specific practical aim or objective and should result in the application of new knowledge into a process or product, or the transfer of existing knowledge into a new process or product, for the benefit of the donor or for the immediate purposes of the commercializing product.

‘basic research’ means experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any particular application or use in view.

‘research grant’ means any appropriation of funds by an organ of state within the Republic to a university for the purposes of research where the involvement or development of students is a requirement or condition.

Research projects entered into by a university partly meet the requirements contained in the definition of “enterprise” at the point when the research activity can be defined as ‘applied research’.

Contract research projects where there is student involvement, whether such involvement is of an administrative nature or where student participation in such projects is not a requirement for his/her specific degree, the expenditure incurred in such projects will be regarded as mixed expenses. The Commissioner is therefore of the view that any student involvement projects of such nature contribute to the educational activity of the respective student. As a result, any educational activity, whether such activity is incidental or limited, must be recognized, in which case, the expenditure incurred in such projects will be incurred for mixed purposes.

For the purposes of direct attribution, where expenses are incurred for contract research projects and there is no student involvement, such expenses are regarded as being incurred wholly for the purposes of making taxable supplies and the input tax may be deducted in full. Similarly, expenses incurred for basic research projects are incurred wholly for non-enterprise activities.

(SARS, 2022c:5)

These definitions and classifications are crucial as they determine how the research input expense should be treated. Once classified, institutions must assess each research grant to determine its category. Once it has been classified into one of the options noted above, the VCR stipulates specific percentages that are deductible for each research activity as follows:

**Table 4.2: Types and treatment of research per the VCR**

| Type of research                  | Input tax treatment                 |
|-----------------------------------|-------------------------------------|
| Basic                             | None                                |
| Applied                           | 50 percent of input tax deductible  |
| Contract (student involvement)    | 50 percent of input tax deductible  |
| Contract (no student involvement) | 100 percent of input tax deductible |

*Source: (SARS, 2022c:6)*

Institutions require systems that can correctly code the treatment of research income in line with the VCR. They also need staff with some tax expertise to review and categorise their research income streams in line with the VCR. These costs support the view from previous authors that compliance is costly. When assessing the treatment of research income in line with the VCR, higher education institutions must also be mindful of whether foreign research funds meet the requirements of a foreign donor project.

The VAT Guide defines a foreign-donor funded project (FDFP) as a project where the government has established an agreement with an international donor. The contracts with these donors are referred to as “Official Development Assistance Agreements (ODAAAs) and are binding on the Republic under section 231(3) of the Constitution of the Republic of South Africa (the Constitution)” (SARS, 2022a:7).

Suppose a higher education institution engages with a foreign organisation, resulting in research income that meets the requirements of a foreign donor funded project (FDFP). In that case, these projects must be assessed to establish the VAT treatment. The regulations have specific rules and administrative requirements for the projects. One such requirement, outlined in section 50(2A) of the VAT Act, which is explained in the reference guide for Foreign Donor Projects, is a requirement for the institution to apply to the Commissioner for approval to register the FDFP as a separate unit within institution’s VAT registration (SARS, 2022b). The additional requirements around FDFPs highlight the complexity that higher education institutions must navigate to ensure VAT compliance with research income.

In addition to research activities, the VCR addressed general overheads related to mixed-use expenses. The VCR indicates that institutions should continue using the varied input-based

method of apportionment. As mentioned above, this equates to the institutions establishing what part of their mixed-use input tax is deductible through a formula that calculates this amount as a percentage of directly attributable taxable and exempt costs. The formula for this calculation is indicated below.

**Table 4.3: Formula for apportionment per the VCR**

$$y = \frac{a}{(a + b)} \times \frac{100}{1}$$

|               |  |
|---------------|--|
| Where–        |  |
| “y”=          | apportionment ratio/percentage;  |
| “a”=          | the VAT incurred wholly for the purposes of taxable supplies made during the period; and   |
| “b”=          | the VAT incurred wholly for the purposes of all exempt and non-supplies made during the period.  |
| <b>Notes:</b> |  |
| 1.            | <p>“a” in the formula includes:</p> <ul style="list-style-type: none"> <li>• 100 percent of all input tax incurred in relation to contract research funding where there is no student involvement.</li> <li>• 50 percent of all input tax incurred in relation to “applied research” funded by sources other than contracted research.</li> <li>• Input tax incurred wholly in the course of making taxable supplies other than research.</li> </ul> |
| 2.            | <p>“b” in the formula also specifically includes:</p> <ul style="list-style-type: none"> <li>• The VAT incurred on “applied research” activities which is not deductible as input tax as a result of this ruling in respect of research activities.</li> </ul>   |
| 3.            | Exclude from the calculation the input tax on any goods or services acquired where the input tax on those goods or services is specifically denied.  |
| 4.            | Exclude from the calculation any expenses incurred in respect of foreign donor funded projects.  |

|    |   |
|----|---|
| 5. | Exclude from the calculation expenditure on any capital goods or services acquired, unless acquired under a rental agreement/operating lease. |
| 6. | The apportionment percentage should be rounded off to two decimal places.   |

*Source: (SARS, 2022c:6-7)*

The VCR caps the percentage calculated above at 12.5 percent. The lower percentage calculated, or 12.5 percent, will, therefore, be used to calculate the amount of input tax that may be deductible for mixed-use supplies. The VCR also allowed an estimation based on the previous year's calculation but required a top-up adjustment based on the actual calculation for the year in question using the current year's source documentation. The VCR allows this adjustment nine months after year-end. The VCR is applicable for assets under R1 million rand for research purposes. However, where assets are greater than R1 million and are a mixed-use expense, an application to SARS is required for a special apportionment rate (SARS, 2022c).

As can be seen under the notes to the formula, the calculation will include the input tax allowed for each of the research activities, as explained previously. Institutions, therefore, need to keep records of each research income stream and its consequent VAT treatment in addition to the relevant source documentation to accurately calculate the apportionment percentage to be applied to mixed-use input supplies.

Nelson (2016) elaborated on the requirements for these institutions. These institutions manage projects by opening cost centres. Each project must be critically assessed to establish whether it requires a cost centre or should use an existing one. Each cost centre must then be coded per the project's VAT requirements. There are instances where expenses in these cost centres need to be split among multiple cost centres, depending on the basis on which they were opened. It is evident that these institutions invest significant time and resources in managing these projects.

The final aspect addressed in the VCR concerns the treatment of imported services. In terms of the VAT Act section 1(1), imported services have five requirements –

1. A service is supplied
2. The supply is made by a supplier outside the country
3. The supply must be made to a resident in the country
4. The services must be utilised or consumed in the country

5. The supply must be used other than for making taxable supplies.

(SARS, 1991)

If these five requirements are met, then in terms of section 7(1)(c), VAT should be levied on this supply at the standard rate and paid over by the recipient of the service in terms of section 7(2) (SARS, 2022c). Silke et al. (2023) explained imported services as a reverse charge mechanism designed to prevent unfair competition where exempt businesses purchase goods and services from foreign suppliers without incurring VAT instead of buying these items from South African vendors who charge VAT. The imported service requirement will apply to higher education institutions as they primarily provide exempt services.

Therefore, in addition to the administration around research and mixed-use input supplies, higher education institutions also require a process and systems to assess, catalogue, and manage their payments to foreign suppliers and consequent payments to SARS for imported services to ensure that they comply with section 7(1)c and section 7(2) of the VAT Act. The VCR required that where foreign services are acquired for purposes other than making taxable supplies, including exempt or non-taxable supplies, the taxable portion of the expense is calculated by applying the apportionment ratio calculated above to the actual cost of the service (SARS, 2022c).

The treatment of VAT on electronic services should be considered alongside imported services, as these will impact higher education institutions. The regulations were enacted on 1 June 2014 and have been updated since. The VAT guide states an electronic service is where a service is provided, and at least two of the following circumstances are relevant -

- that the service is provided to a South African resident,
- the payment for the service is made from a South African bank account,
- the address of the recipient is located in South Africa

(SARS, 2022a)

To summarise, a transaction will meet the definition of an electronic service if a foreign supplier provides electronic services to a resident and meets two of the three requirements above. Suppose these requirements are met, and the revenue generated by the supplier in South Africa exceeds the VAT registration threshold of R1 million. In that case, that supplier must

register for VAT in South Africa. However, if the foreign supplier is not registered, there will still be VAT consequences if the service meets the definition of an imported service. The possibility of this occurring would need to be assessed by the higher education institution to determine whether there is any VAT payable. A new requirement relevant to suppliers of electronic services in the VAT Act states that if an intermediary is supplying these electronic services, there may be circumstances where they will be liable for the VAT to SARS (SARS, 2022a).

The Guide from SARS on FAQ: Electronic Services provides several examples of electronic services, including educational services, games, webcasts, and access to library services and software, among others (SARS, 2019). These examples include several electronic services that may be relevant to higher education institutions, especially in providing educational services, and require assessment to determine the VAT consequences.

It is helpful to provide figures for the industry and context of the quantum of the problem of assessing the income streams of higher educational institutions. When viewing the public higher education industry as a whole for the period from 2012 to 2022, the income growth has been substantial, with cash flows from operations (comprising primarily tuition fees and government grants/subsidies) of R48 430 million in 2012 (StatsSA, 2013) compared to R101 260 million in 2022 (StatsSA, 2023), which translates to a growth of 109 percent over this period. The increase in research income within these institutions has also been significant. The annual research survey issued by the Department of Science, Technology and Innovation indicates the growth of research in higher education provides the following definitions for the figures presented, which are summarised as follows:

Applied research is considered research that is original with the intention of acquiring new knowledge. The research generally has a practical objective.

Basic research has no specific practical application and is generally theoretical, but still with the aim of acquiring new knowledge of the underlying research area.

Experimental development is systematic and draws on knowledge from research or experience that already exists with the aim of producing new processes, materials, or products. It could also drive the improvement of existing processes or products.

(CeSTII, 2024)

**Table 4.4: Proportional higher education sector R&D expenditure by type of research (2012/13 to 2021/22)**

| TYPE OF RESEARCH                  | 2012/13      | 2013/14      | 2014/15      | 2015/16      | 2016/17      | 2017/18      | 2018/19      | 2019/20      | 2020/21      | 2021/22      |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
|                                   | %            | %            | %            | %            | %            | %            | %            | %            | %            | %            |
| Basic research                    | 52.4         | 51.9         | 54.9         | 54.6         | 57.3         | 55.7         | 56.6         | 57.4         | 50.6         | 51.4         |
| Applied research                  | 32.6         | 33.1         | 31.6         | 32.2         | 29.7         | 32.8         | 32.6         | 31.7         | 32.1         | 32.6         |
| Experimental development research | 15.0         | 15.0         | 13.4         | 13.2         | 13.0         | 11.5         | 10.7         | 10.8         | 17.3         | 16.1         |
| <b>Total</b>                      | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> |

Source: (CeSTII, 2024:73)

As shown in Table 4.3 above, the research categories have remained similar from 2012 to 2022, with basic research fluctuating between 50-57 percent. Applied research ranges between 29-33 percent, and experimental research ranges from 10-17.5 percent. Even though there has not been much change in the categories of research, there has been substantial growth in the value of research, as noted below.

**Table 5.4: Higher education sector R&D expenditure by type of research (2012/13 to 2021/22)**

| TYPE OF RESEARCH                  | 2012/13          | 2013/14          | 2014/15          | 2015/16          | 2016/17           | 2017/18           | 2018/19           | 2019/20           | 2020/21           | 2021/22           |
|-----------------------------------|------------------|------------------|------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
|                                   | R'000            | R'000            | R'000            | R'000            | R'000             | R'000             | R'000             | R'000             | R'000             | R'000             |
| Basic research                    | 3 843 906        | 3 785 149        | 4 601 453        | 5 395 693        | 6 679 585         | 7 243 562         | 7 463 879         | 8 145 359         | 6 979 245         | 7 308 509         |
| Applied research                  | 2 390 090        | 2 412 316        | 2 649 558        | 3 176 685        | 3 466 381         | 4 264 753         | 4 303 881         | 4 497 102         | 4 423 435         | 4 633 761         |
| Experimental development research | 1 099 157        | 1 095 388        | 1 126 565        | 1 304 245        | 1 513 291         | 1 501 561         | 1 415 358         | 1 536 500         | 2 383 056         | 2 289 858         |
| <b>Total</b>                      | <b>7 333 153</b> | <b>7 292 853</b> | <b>8 377 575</b> | <b>9 876 623</b> | <b>11 659 258</b> | <b>13 009 876</b> | <b>13 183 119</b> | <b>14 178 960</b> | <b>13 785 736</b> | <b>14 232 128</b> |

Source: (CeSTII, 2024:73)

As seen from Table 4.4 above, the value of research expenditure indicates that research income has almost doubled in ten years, with a growth of 94 percent from 2012 to 2022. The management and resources required to manage these funds, especially those in line with the requirements of the VCR, would be immense.

In summary, higher education institutions experience multiple challenges in complying with the VAT Act. The main reason for this is that they have both exempt and taxable supplies, and the nature of their operations results in them having mixed-use supplies. These supplies require

additional administration and involve the application of an apportionment method via a VCR, which needs to be approved by SARS.

The VCR is highly complex as it requires that each higher education institution's research supplies be categorised into applied, basic and contract research, either with or without student involvement. Each category and sub-category would require its own assessment to establish its VAT treatment. The VCR applies a varied input-based apportionment method to calculate the VAT deductible on mixed-use supplies. As outlined above, the VAT deductible for research purposes is part of this calculation and requires substantial administration. Nelson (2016) argued that the varied input-based method is not sustainable in the long term due to its complex calculation and the financial resources required to maintain it. The VCR also guides the treatment of 'imported services,' which would be relevant to higher education institutions as their primary source of income is exempt. SNG Grant Thornton (2022) noted that imported services apply to costs such as membership fees to international bodies and accreditation fees, among others. The impact of electronic services should be considered in conjunction with imported services.

Exempt services are generally problematic for higher education institutions. The analysis above clearly indicates the complexity required to comply, along with the resources, systems, and processes needed to ensure they do not violate the VCR and the VAT Act. The nature of these calculations and assessments is complex. It often requires that these institutions appoint external consultants to assist with these calculations at a significant cost to higher education institutions. The primary driver of the additional compliance administration is the exemption of educational supplies. If these services were standard-rated or zero-rated, given that this supply is a higher education institution's largest revenue stream, there would be a significant reduction in the administration and the related financial and human resources required.

There have been attempts by industry to address the concerns above. One such attempt was a presentation to the Davis Tax Committee on the potential reforms required to improve the situation (SNG Grant Thornton, 2022). The report from the Davis Committee supported the theoretical view that people with low incomes should be targeted through government interventions rather than tax policy and endorsed the guidance the OCED provided. The Committee acknowledged the complexity and burden caused by multiple VAT rates and understood the value of a single VAT rate; however, no significant recommendation to change the treatment of educational services was made in their final report (Davis and Woolard, 2018).

The reason for this is better explained in a report issued by Treasury from the panel of experts appointed through the Davis Tax Committee to consider proposals submitted to zero-rate additional supplies.

In assessing the proposals, the panel considered the effect of their recommendations on five outcomes, which are summarised as follows:

1. The intention was for the tax system to remain progressive.
2. They considered how to ensure that VAT could be more progressive.
3. They wanted any goods and services identified for potential zero rating to have the status of merit good and assist the more vulnerable groups, which included women, the elderly, the disabled, and minors, where possible.
4. They were cognizant of the impact of zero rating on government revenue and were conscious that this should not be too high.
5. They believed that any benefits of zero rating should have a limited impact on producers or retailers.

(Treasury, 2018)

In unpacking outcome three above, the panel noted that even though merit goods benefit society, care should be taken that they are not consumed primarily by the more affluent in society. The impact would be regressive if concessions were made for these merit goods. The report noted that more targeted measures should instead be used to assist people experiencing poverty. This assessment was supported by their review of the average annual household income for April 2018, which indicated that affluent households spend more on items such as education than the poor, who spend more on food and non-alcoholic drinks (Treasury, 2018).

The panel the Davis Tax Committee appointed to review the funding of tertiary education did not address the VAT consequences of educational supplies. However, they did support the view noted above and provided statistics indicating that the wealthy are more likely to attend university. They also reported that 10 percent of the rich receive 48 percent of subsidies allocated to tertiary institutions (Davis et al., 2016). Based on the benefits the wealthy already experience from the current funding structure, it is clear why the Davis Tax Committee did not recommend any additional beneficial concessions for the industry. However, the problems outlined above around the compliance difficulties experienced by higher education institutions

remain, and consideration of alternative treatments, especially those recommended by global role players, are considered further below.

#### **4.4 Recommendations made by global role players regarding exemptions for VAT purposes**

After the VATCOM recommendations, PWC considered whether they made sense relative to how other countries treated their educational supplies. An analysis of the current treatment of this supply in Africa does not yield very different results from those published by PWC in its report in 2005 (PWC, 2023). The decision to keep this supply exempt appears to be driven by socio-economic variables. However, at the time of the original PWC analysis, several countries chose not to exempt educational services, especially in Europe, the Americas, and Asia (PWC, 2005).

One of the principles VATCOM based its recommendations on was to keep the number of supplies eligible for concessions to a minimum. Even then, VATCOM acknowledged that tax policy should not be used to address social inequities and disparities. More practical mechanisms can be deployed to target and assist the specific societal groups that VAT concessions may wish to address. A more effective method would be to use government policy rather than tax policy to achieve these outcomes. In addition, with the implementation of concessions, administration and compliance complications have increased significantly.

The literature review noted that these administrative difficulties extend to all industries with multiple VAT rates, so the recommendation is that they be kept to a minimum. The OECD also supported this view. Their guidelines provided principles and standards for the VAT treatment of primarily international services. The guidelines ensure consistent treatment of cross-border transactions that do not distort international trade. They were designed to assist countries in setting and implementing their VAT policies (OECD, 2017). The guidelines, which were completed in 2015, were endorsed by 104 participating jurisdictions and organisations and were seen as the global standard and “the reference point for designing and implementing legislation.” (OECD, 2017:4).

Conceptually, the guidelines explained that VAT is a final consumption tax, and consumption is incurred only by individuals in private households. Since businesses cannot be the final consumers, this tax burden should not fall on them. The intention of VAT being collected by businesses and then deducted by all in the value chain other than the final consumer allows the

core principle of tax neutrality to be enforced (OECD, 2017). This assessment was confirmed again by Bunn et al. (2021) in their evaluation of OECD countries in 2019.

The neutrality principle is also one of the great benefits of VAT, as it forces businesses to report their income correctly, given that they are held accountable by the next business in the value chain (Slemrod and Velayudhan, 2022). Cnossen (2015) explained VAT further, noting that VAT should drive revenue that is raised predictably and efficiently. The benefits of VAT and GST are further expounded on by Bunn et al. (2021), who explained that the tax does not impact economic growth as, conceptually, the tax is levied on the final consumer and not on businesses, who are one of the main contributors to long term economic growth.

These principles were also included in the OECD guidelines, which refer to the Ottawa Tax Framework Conditions established in 1998 and endorsed by ministers globally. Although the conditions were agreed upon for the taxation of e-commerce, they provide direction regarding what principles should be considered when tax policy is drafted. Similar to those noted by VATCOM in their deliberations, they are summarised as follows:

Neutrality: There were three principles: firstly, that tax should be neutral and equitable; secondly, decisions taken by businesses should not be based on tax consequences; and thirdly, taxpayers carrying out similar businesses or transactions should be taxed similarly.

Efficiency: Compliance and administration costs should be kept to a minimum.

Certainty and simplicity: Tax policy should be simplified and clearly stated so that taxpayers understand and can plan for when the tax should be paid, how it should be paid, and where it should be paid.

Effectiveness and fairness: Tax policy should allow the right amount of tax to be collected at the appropriate time and should minimise any opportunity for tax evasion or avoidance, ensuring that the controls to manage this possibility are proportionate to the risk.

Flexibility: Tax systems should be technologically and commercially relevant while ensuring they are flexible and agile.

(OECD, 2017)

The guidelines considered VAT's neutrality as one of the core principles. While they acknowledge that each jurisdiction may have policies requiring exemptions, these concessions should not result in disproportionate administration and compliance costs (OECD, 2017). Cnossen (2015), however, explained that reduced VAT rates result in indeterminate variations

in the effective tax rate and effectively make standard-rated goods luxury goods. It would also increase the price the producer charges to recover the VAT, which is not claimable.

In his further analysis, Cnossen (2022) estimated that within the Dutch VAT system, the effective VAT rate due to concessions is 11 percent compared to the actual VAT rate of 21 percent. If all supplies are taxed equally, there could be an argument to reduce the actual VAT rate by 10 percent. Slemrod and Velayudhan (2022) explained in their assessment of VAT that the use of exemptions results in a tax with a subsidy added on and explained further that when these ‘subsidies’ are given, they inherently result in the need for a higher standard rate to fund them. Cnossen (2015) also noted the pervasive nature of exempting supplies and indicated that it affects not just the exempted organisation but other entities. In addition to these difficulties, it also reduces the revenue available to the fiscus, especially in African countries, where funds are required to meet the multiple demands on these governments and encourage tax avoidance (Cnossen, 2015).

The regressivity of VAT is a general area of contention when concessions are considered. While the common belief is that VAT is a regressive tax, Thomas (2022) argued this assumption may be incorrect as it uses income as its base. He argued that the model should instead be based on expenditure. The results using expenditure as the driver indicated that VAT is not regressive and, in some cases, can be slightly progressive. The extent of the regression or progression is related to the item tested, and even though food items could be progressive, often, the greater benefit goes to the more affluent. Bunn et al. (2021) expand this notion from Thomas (2022) by noting that the rich pay more consumption taxes because they spend more.

In this context, it could be argued that the recommendation to use VAT to address socio-economic issues is not practical. Cnossen (2015) also noted that in the context of exempting educational services, the more affluent often enjoy the benefit of this exemption, as opposed to the poor, whom the exemption was targeting.

Research compiled by Bunn et al. (2021) tested the effect of exemptions using a VRR (Vat Revenue Ratio) to assess the consequence of revenue collections of exemptions and taxpayer compliance. The lower the VRR, the greater the loss of potential revenue. The average of OECD countries is 0.56, which indicates that revenue of 44 percent is lost due to exemptions and taxpayer compliance. However, New Zealand has a VRR of 0.99, which suggests that its VAT structure effectively collects the optimum amount of VAT. They supported this finding

further by indicating that New Zealand raises the most VAT, at 9.8 percent of their GDP (Bunn et al., 2021). The effectiveness of this model was confirmed by de la Feria and Swista (2024), who labelled the GST model implemented in New Zealand as being technically superior compared to other models implemented around the world.

Cnossen (2022) argued that it makes sense to tax all supplies equally, especially when assessing the C-efficiency ratio, which is driven by concessions in VAT rates and would positively impact revenue for this fiscus, in addition to driving economic growth. He recommended that exemptions should only be allowed where administration is complex and reduced rates should not be permitted.

In a report from the IMF for the Davis Tax Committee, Ueda and Thackray (2015) estimated that the C-efficiency ratio for South Africa ranged at 63.6 percent between 2007 and 2013, which is relatively high; however, Botswana and Burkina Faso are higher at approximately 70 percent. The reason for the higher result is that fewer concessions are allowed on goods and services in South Africa. However, the change in consumer choices has reduced the figure in the later years compared to 2007. There was a decline in the potential revenue collections, which the study theorised was due to a change in the tax base (Ueda and Thackray, 2015).

Research by Simon and Harding (2020) indicated that these rates also impacted the ITR (Implicit Tax Rate), which is defined as the ratio of consumption tax to consumption. They concluded that during the economic crisis between the period 2007 to 2009, there was a decrease in this rate for most OECD countries, primarily fuelled by the change in the composition of consumption spending. During this period, there was greater government spending and more spending by the public on necessary goods, and given that the taxation rates on these kinds of goods are usually lower than the standard rate in these countries, this resulted in lower potential VAT revenue available for collection. Taxpayer compliance may also have impacted the results, but the change in the composition of consumption spending played a more significant role.

They also noted further that, given the explanation above, countries with greater exposure to exemptions would be more susceptible to variations in revenue collection during an economic crisis than those with less. They recommended that the tax base be broadened to reduce the variations and keep exemptions to a minimum. This further supports the assessment that exemptions cause difficulties and essentially do not achieve the goals for which they are

implemented (Simon and Harding, 2020). When considering the current situation in South Africa against what Cnossen (2022) and Simon and Harding (2020) noted and recommended, it may be time to review the number of concessions given in the VAT Act, despite the high C-efficiency, to assist in increasing the tax base, improving revenue income and managing the fluctuations in the VAT revenue available to the fiscus.

In their article, de la Feria and Swista (2024) presented a different approach to addressing the perceived regressivity of VAT, other than through traditional welfare payments or exemptions. They argued that countries other than New Zealand have not adopted the current conceptually correct manner of implementing VAT without exemptions. Most countries implement some exemptions owing to difficulties in welfare programmes effectively assisting targeted socio-economic groups. Political pressure is also due to an uneducated understanding and mistrust of tax policy. This results in these countries implementing a hybrid VAT model consisting of exemptions and a welfare programme. Ultimately, this is not a successful approach when considering the demands of a successful VAT or GST programme to collect the highest possible revenue but ensure that the poorest households are not unduly penalised (de la Feria and Swista, 2024).

A possible model that could be implemented and suggested by de la Feria and Swista (2024) to address the issues noted above would be a broad-based tax model with a single rate, which provides a real-time, digitised VAT compensation subsidy to poorer households. The model requires everyone to pay VAT, but individuals from poorer households will receive a real-time VAT subsidy when making purchases.

There is some balance required in the model, as the higher the threshold for the poor households, the less revenue the fiscus receives; however, the model is progressive and, if properly implemented, will better address the regressivity accusations against a broad-based VAT model. One of the critical requirements is a properly digitised system to accommodate the real-time compensation subsidy, which de la Feria and Swista (2024) noted can be done using some of the systems currently available. This is a progressive solution to a real problem with VAT implementation, but further investigation is needed as to its potential application in South Africa.

## **4.5 Alternative VAT treatment of educational services implemented to reduce the administration burden of compliance**

This section explores the process of implementing the VAT model in New Zealand and the treatment of educational services. The principles that informed the decision by VATCOM to standard rate medical services are also considered further. Thereafter, an assessment of the current higher education landscape is made.

### **4.5.1 Standard-rating of educational services in New Zealand**

When VATCOM considered the representations made by stakeholders to make changes to the VAT Bill, they did so with reference to the VAT model that New Zealand implemented, noting that the implementation of this model had been successful in that country. Given that this model informed the South African VAT environment, it is worth understanding what process the government of New Zealand followed in its implementation.

Dickson and White (2008) noted that the implementation of VAT in New Zealand essentially translated into an improvement on the European model that was in place at the time. They indicated that countries implementing VAT often base the implementation on the New Zealand model. The fundamental difference between New Zealand's model and other models is that they apply a uniform, single VAT rate to all supplies. The decision to implement this rate was deliberate, and the principle of a single rate has remained in place since the inception of VAT in New Zealand.

Dickson and White (2008) explained that the Meade Report developed by a committee chaired by Professor JE Meade was a helpful reference document in developing the VAT Act, driving the need for a systematic and structured tax policy, which was a critical requirement in the 1980s, as New Zealand still had an ineffective indirect tax, given that it omitted 67 percent of the potential tax available for collection. The problem with this was that the tax revenue collected was insufficient to meet the expenditure demand, and it would be utterly ineffective in achieving the strategy of the New Zealand government at the time, which was to place greater reliance on revenue collected from indirect taxes to meet fiscal requirements (Dickson and White, 2008).

A report by a task team in 1981 – 1982 recommended that the wholesale tax used by New Zealand at the time should be changed to a credit offset method, and the tax base should be

widened. They understood, for example, that taxing food was regressive. It was explained that based on the evidence available at the time, for expenses of \$100, poorer households spent approximately \$6.50 on food, while the more affluent incurred costs of \$12, suggesting that any concessions allowed on food items would benefit the wealthy more than the targeted poorer population. (Dickson and White, 2008). Sawyer (2020) noted that the task team that supplied this recommendation was the McCaw review, and they felt that this change would also assist in reducing personal income tax to top earners from 60 percent to 33 percent, which was one of the requests of the government at the time the report was presented. The recommended change to the consumption tax was not accepted at the time of the report but rather by the government in place in 1984.

When considering implementing the recommendation, the government was concerned about whether the public would buy into this change. They realised that to succeed in this endeavour, they would need to launch significant public relations and education campaigns and engage with both the public sector and private businesses. The government ensured the campaign was successful with widespread, genuine engagement with the relevant stakeholders. This kind of consultation was also unique as it had never been done in relation to any legislation before (Dickson and White, 2008). The process used for the consultations was through the issue of a White Paper in 1985, which provided proposals on how the new Goods and Services Tax (GST) would work and how special cases would be handled (Muir, 1993). Sawyer (2020) noted that the requests for comment on the White Paper asked for requests for improvements to the proposals, but in addition to this, asked how the tax could be implemented smoothly and could be integrated with business.

The Inland Revenue Service and the Advisory Panel on the Goods and Services Tax (Sawyer, 2020) accepted recommendations from the public for changes to the proposals in the White Paper. They submitted reports to the government, which used the information to make considered amendments to the proposals (Muir, 1993). The public also bought into the process as they saw the changes to the White Paper initially issued based on the result of these consultations, cementing the public's acceptance of the new legislation (Dickson and White, 2008).

The government of the time delayed the implementation of the tax from April 1986 to October 1986 to ensure that the public was adequately educated on the requirements of the new GST Act. The education campaign involved a multi-media approach using publications and video.

It was overseen by the GST Coordinating Office, which was set up by the government (Muir, 1993). Muir (1993) noted that he believes the success of the tax was due in significant part to this campaign as the public contributed to the drafting of the tax through the inputs to the White Paper and understood the tax as a result of the education campaign. There was consensus on this from Maples and Sawyer (2017), who noted that the transition into the new Act was seamless primarily due to this engagement and education campaign.

There were some initial difficulties in implementing the tax due to broadening the tax base, which required a significant increase in the number of businesses required to register for GST. Muir (1993) indicated that the initial estimates were significantly underestimated at 180 000, with the number skyrocketing to 250 000, placing significant strain on the authorities. In addition, problems were experienced in processing returns, resulting in delays and court cases due to fraudulent refunds. However, eventually, Inland Revenue was able to accommodate the increased submissions and adjust its systems to improve the processing of returns and refunds.

As mentioned above, implementing a single-rate GST tax system across a greater population was deliberate to increase revenue demands at the time (Dickson and White, 2008). The positives and negatives of the single-rate, broad-based GST system, referred to as the BBLR (Broad Based Low Rate) framework in New Zealand, are noted by Sawyer (2020) and summarised as follows:

The benefits of the BBLR model are:

- It is simple, straightforward, and logical;
- It includes all sectors, which ensures consistent taxation across the economy;
- It assists in reducing economic distortion;
- The general public understands the critical aspects of the model;
- It is durable.

The difficulties experienced by the BBLR model are:

- The model does not apply tax rates based on elasticities;
- It is regressive and does not consider equity.

(Sawyer, 2020)

In addition to the positives listed by Sawyer above, another great benefit of GST is the reduced administration and related cost savings. As a result of having a single rate system, there are no lists of classifications and no requirement for assistance from the regulator to provide guidance

and interpretations of the Act. Applying a single rate also means that no external expertise is required from accounting or law firms to assist in giving advice or engaging with the regulator, which dramatically helps contain costs in this area. Organisations are also not required to apply and be considered for special exemptions (Dickson and White, 2008).

The benefits above are a big selling point for using the New Zealand model as it reduces costs while collecting the highest potential tax revenue and assisting in lowering misallocations and wrong interpretations of which goods fall into which categories. De la Feria and Krever (2013) noted that exemptions result in increased litigation, affect consumer choice, and can result in aggressive tax planning, not to mention the compliance and administration difficulties they cause. They noted that exemptions effectively result in businesses being overtaxed and consumers being undertaxed, and they questioned the effectiveness of such a model. However, under a single tax system, these concerns no longer arise.

New Zealand addressed the distributional effect of this single VAT rate by implementing adjustments to pension benefits. For low-income households, the government provided relief through compensatory income schemes, which the government preferred to the ineffective adjustment to VAT rates (Dickson and White, 2008). The effectiveness of one of these schemes was tested by Thomas (2022), who confirmed that it was more effective than implementing reduced GST rates.

De la Feria and Krever (2013) explained that using different VAT rates or exemptions for merit goods ultimately translates to tax expenditures. A cost-benefit exercise should be done to establish if the use of reduced rates is the most appropriate method to address social and distributional goals, but ultimately, the use of exemptions results in significant revenue costs to the fiscus. The low-income groups would be in a better financial position if the standard rate were implemented, and the income generated would be returned to them as a grant. Additional revenue would be available to assist the government in other programmes. Thomas (2022) demonstrated via simulations that an income-tested cash transfer was more effective in helping people experiencing poverty in 23 of the OECD countries, supporting the recommendation that these countries should take this initiative to address distributional differences instead of through consumption taxes. The compensatory income schemes implemented in New Zealand appeared successful; however, there were years when there were no inflationary adjustments that would have been necessary for these households. There is some criticism that even though the administration of VAT requires minimal resources, managing these grants requires

substantial resources. However, this argument is countered by the authors in that these resources are necessary for most administrations regardless, so the model implemented by New Zealand would not change this requirement significantly (Dickson and White, 2008).

GST is applied when goods and services are supplied by a registered person in New Zealand carrying on a taxable activity (Muir, 1993). To better understand, the following are extracts from the Goods and Sales Tax Act of 1985, No. 141 as of 1 April 2024 –

#### Imposition of tax

##### 8 Imposition of goods and services tax on supply

- (1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.
- (2) For the purposes of this Act, goods and services shall be deemed to be supplied in New Zealand if the supplier is resident in New Zealand, and shall be deemed to be supplied outside New Zealand if the supplier is a non-resident.

#### Taxable activity –

##### 6 Meaning of term taxable activity

- (1) For the purposes of this Act, the term *taxable activity* means—
  - (a) any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:
  - (b) without limiting the generality of paragraph (a), the activities of any public authority or any local authority or public purpose Crown-controlled company.

- (2) Anything done in connection with the beginning or ending, including a premature ending, of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity.

Registered person -

51 Persons making supplies in course of taxable activity to be registered

- (1) Subject to this Act, every person who, on or after 1 October 1986, carries on any taxable activity and is not registered, becomes liable to be registered—

- (a) at the end of any month where the total value of supplies made in New Zealand in that month and the 11 months immediately preceding that month in the course of carrying on all taxable activities has exceeded \$60,000 (or such larger amount as the Governor-General may, from time to time, by Order in Council declare (*see* subsection (8))):

provided that a person does not become liable to be registered by virtue of this paragraph where the Commissioner is satisfied that the value of those supplies in the period of 12 months beginning on the day after the last day of the period referred to in the said paragraph will not exceed that amount:

Supply –

5 Meaning of term supply

- (1) For the purposes of this Act, the term supply includes all forms of supply.

Goods and services and taxable supply

2 Interpretation

**goods** means all kinds of personal or real property; but does not include choses in action, money, cryptocurrency, or a product that is transmitted by means of a wire, cable, radio, optical or other electromagnetic system or by means of a similar technical system

**services** means anything which is not goods or money or cryptocurrency

**taxable supply** means a supply of goods and services in New Zealand that is charged with tax under section 8 and includes a supply that section 11, 11A, 11AB or 11B requires to be charged at the rate of 0%

(IRD, 2024)

While there are many similarities to the VAT Act, there are limited exempt and zero-rated supplies. Some exemptions for difficult-to-tax transactions, including financial transactions, residential accommodation, and zero-rated supplies, apply mainly to exports (Muir, 1993). Dickson and White (2008) noted that the tax policy implemented in New Zealand is incredibly stable, with only one policy review conducted at the time of their publication, which recommended no changes to the tax structure. They note that the tax is a low administration tax, with minimal resource requirements from the government to manage. The reason for this is based primarily on the two principles that form the foundation of the tax, namely that it is a single tax and, secondly, a broad tax. However, they noted that although the tax structure is almost optimal, the compliance costs were initially regressive towards smaller businesses. The problem has been addressed to some extent by the introduction of computers, which were not available at the time of the implementation of GST.

Maples and Sawyer (2017) noted that since the inception of the GST in New Zealand, there have been some changes to clarify certain aspects of the VAT, and these have caused some complexities. The rate has been amended twice, with the last adjustment occurring in 2010, resulting in an increased VAT rate of 15 percent.

The adjustment was a result of a recommendation from the Victoria University of Wellington Tax Working Group, referred to as VUW TWG, which, in its findings, supported the view that the GST model was sound and the broad-based approach should continue. They recommended the rate adjustment to address income tax concerns, noting that the increased revenue could be used to fund a reduction in the income tax rate (Sawyer, 2020). White (2020) indicated that this would encourage the population to save and invest more of their available funds instead of spending. This recommendation was approved and effective from 1 October 2010 (Sawyer, 2020), when the rate was adjusted from 12.5 percent to 15 percent (Sawyer, 2020). The most recent review of the New Zealand GST model was conducted by the Tax Working Group, which was appointed in 2018. They also recommended that the current model continue, highlighting the cost and complexities caused by exemptions. They supported other groups'

conclusions and reviews that welfare interventions were the best way to address socioeconomic disparities (White, 2020).

The success of the New Zealand model was in contradiction to the model implemented in Europe, which had multiple rates and required complex administration. While the European systems could accommodate this, having been constructed over many years, it was more difficult for developing countries. The narrower base caused by multiple VAT rates also required higher standard rates to collect sufficient revenue (De la Feria and Krever, 2013). White (2020) noted that the practical implementation problems and compliance difficulties caused by having multiple VAT rates often outweigh any perceived benefit they may have for poorer communities.

The New Zealand model provided an alternate option and was referred to as the modern VAT. The model implemented in New Zealand also demonstrated that an efficient VAT policy could tax supplies categorised as too difficult to tax and were therefore allocated an exemption status in the traditional European model (De la Feria and Krever, 2013). White (2020) noted that the model's success is demonstrated by the change in the collections, which increased from 3.2 percent of GDP in 1985 to 9.7 percent in 2018. It has also implemented the 6<sup>th</sup> lowest GST rate out of 35 OECD countries, which provides a compelling case and credibility as to why it is the model against which GST/VAT success is measured.

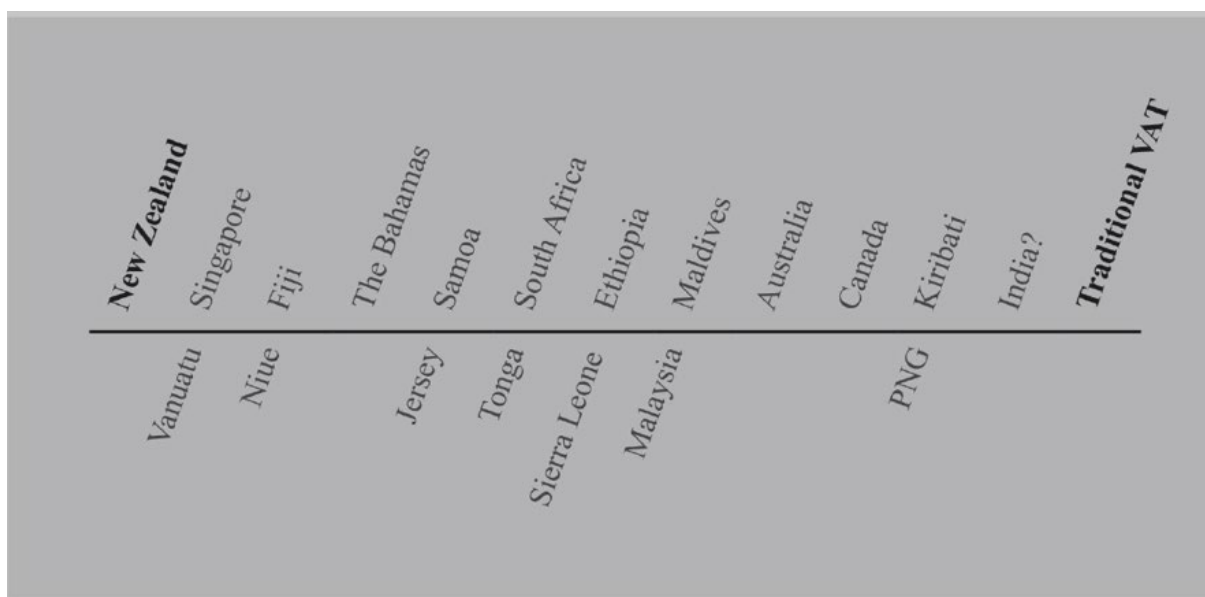
White (2020) further indicated that one of the critical success factors of the GST implemented in New Zealand is its consistent revenue collection during the global crisis. Simon and Harding (2020) demonstrated that countries with narrow bases and more rates are more exposed to global economic changes due to the nature of consumption. Financial circumstances change consumption patterns, directly affecting the revenue collected from indirect taxes. If all goods and services are taxed, the impact is not as severe. White (2020) reported that, during the COVID-19 pandemic, New Zealand continued to show solid results, which supports the findings that a broad-based tax is more resilient in times of economic crisis.

Several countries have implemented a VAT policy since New Zealand implemented the GST Act, which Maples and Sawyer (2017) believe was influenced by the New Zealand model, perhaps to a moderate extent. White (2020) indicated that there has been a substantial growth in the number of OECD countries that have implemented a VAT/GST model, which grew from 13 in 1975 to 36 in 2018. Maples and Sawyer (2017) noted that the reason for the assessment

that these countries implemented their models based on the New Zealand model is that most of these countries generally implemented a tax policy with fewer exemptions, as opposed to the traditional VAT model in place in Europe. However, very few countries have fully implemented the New Zealand model, even though, at the time, it appeared that the countries in the Pacific area that implemented their VAT policies after New Zealand, based their models on the New Zealand model, as mentioned before, this included South Africa (Maples and Sawyer, 2017).

Figure 4.1 below indicates where the South African VAT model lies relative to the New Zealand model, with minimal exemptions, compared to the traditional model, which has many exemptions. As can be seen, it appears that the model lies in the middle, with a slight bias towards the New Zealand model. Although this is better than many others, it demonstrates that there is perhaps scope to reduce the exemptions it has in place further.

**Figure 4.1: New Zealand GST Model Adoption Spectrum**



*Source: (Maples and Sawyer, 2017:25)*

As noted above, New Zealand fully taxes most supplies, including educational supplies. In addition, according to Dickson and White (2008), government subsidies allocated to the institutions that provide these services are also fully taxable. They explained the reason for this is that even though this may complicate the administration of the grants, it is still similar to the administration that would be required if these services were zero-rated. Private education institutions are also taxed, ensuring no advantage to these institutions and that competition between public and private institutions is maintained (Dickson and White, 2008).

De la Feria and Krever (2013) further justified this by noting that if these subsidies are taxed, the organisation receiving the subsidy would need to register for VAT and, therefore, be able to claim the input VAT related to the use of the subsidy, which would, in turn, assist in reducing the subsidy required by the organisation as it would be offset by the tax input refunds received. Krever (2008) noted that it is the cleanest way to manage the confusion that arises around the treatment of VAT inputs, especially when public and private institutions engage with each other, as there is often uncertainty about whether inputs are deductible.

The Inland Revenue Department of New Zealand offers guidance to educational centres, including Table 4. 5: Type of educational income and GST liability below on the treatment of income –

**Table 4.6: Type of educational income and GST liability**

| Type of income   | Liable for GST | Not liable for GST | Exempt from GST | Liable for income tax | Not liable for income tax |
|--|----------------|--------------------|-----------------|-----------------------|---------------------------|
| Grants and subsidies   | ✓              |                    |                 |                       | ✓*                        |
| Donations and unconditional gifts  |                | ✓                  |                 |                       | ✓                         |
| Koha   |                | ✓                  |                 |                       | ✓                         |
| Bequests   |                | ✓                  |                 |                       | ✓                         |
| Voluntary contributions to schools operated by a board of trustees bound by the Education Act 1989 |                | ✓                  |                 |                       | ✓                         |
| Payments for take-home projects  | ✓              |                    |                 | ✓                     |                           |
| School trips   |                | ✓*                 |                 |                       | ✓*                        |
| Examination fees   |                | ✓*                 |                 |                       | ✓*                        |
| Private school fees  | ✓*             |                    |                 | ✓*                    |                           |
| Attendance dues  | ✓              |                    |                 | ✓                     |                           |
| Payments to kindergartens, early childhood centres, playcentres and kohanga reo                    | ✓              |                    |                 | ✓                     |                           |
| University tuition fees  | ✓              |                    |                 | ✓                     |                           |
| Hostel fees  | ✓              |                    |                 | ✓                     |                           |
| Raffles  | ✓              |                    |                 |                       | ✓*                        |
| Sale of donated goods and services   |                |                    | ✓*              |                       | ✓                         |
| Sale of purchased goods  | ✓              |                    |                 | ✓                     |                           |
| Trading activities   | ✓              |                    |                 | ✓                     |                           |
| Hall and equipment hire  | ✓              |                    |                 | ✓                     |                           |
| Residential rent   |                |                    | ✓*              | ✓                     |                           |
| Commercial rent  | ✓              |                    |                 | ✓                     |                           |
| Sale of assets and equipment   | ✓              |                    |                 |                       | ✓                         |
| Building and maintenance recoveries  | ✓              |                    |                 |                       | ✓                         |
| Insurance receipts   | ✓              |                    |                 |                       | ✓                         |
| Penalties or fines   | ✓              |                    |                 | ✓                     |                           |
| Textbook deposits  |                | ✓*                 |                 |                       | ✓*                        |
| Advertising and sponsorship  | ✓              |                    |                 | ✓                     |                           |
| Interest and dividends   |                |                    | ✓               | ✓                     |                           |

\* Can be liable in certain situations. Contact us on 0800 377 774 for more information.

Source: (IRD, 2022:15)

The publication notes that education centres covered by the guidelines include all organisations providing education, including day care centres, schools, and universities (IRD, 2022).

The guideline provides further information on the table above, clarifying the taxing of contributions to school trips, which are usually voluntary and, therefore, not taxable. The income from examination fees that must be paid to an external supplier is not taxable. Funds received for residential rent are not liable for GST; however, commercial rent is. Income from textbook deposits is not liable for GST if they are refundable (IRD, 2022). As noted before, university tuition fees are subject to GST, and the guidelines note that they are not viewed as donations for GST purposes. Hostel fees are also taxable, even though there is a specific calculation on what GST is charged. It notes grants and subsidies include those from the Crown or government (IRD, 2022). These would be similar to the government grants received by higher educational institutions to fund their operations.

The guideline on Grants and Subsidies issued by the Inland Revenue Department provides more information by noting that grants or subsidies are payments made to individuals or organisations for specific operational requirements for a business or to start up a business. It notes that grants or subsidies from local and government departments are also included in this definition and would need to return GST (IRD, 2020). The guidelines for Educational Centres also note that private school fees, which include schools not established under the Education Act 1989, are also subject to GST (IRD, 2022).

#### **4.5.2 A case for standard-rating based on the treatment of medical services and medicines**

When VATCOM considered what adjustments should be made to the VAT Bill and educational supplies, they also considered the treatment of medical services and medicines. The VAT Bill initially indicated that services offered by several medical practitioners would be exempt, including dentists, doctors, dieticians, and optometrists, and goods necessary to provide these services were also exempt. Services provided by hospitals, clinics, and nursing homes supported by local authorities were also exempt from tax. Medicines provided during a consultation were exempt, however, any other medicine and goods such as glasses, contact lenses, or prosthodontics were not exempt and, therefore, subject to VAT (VATCOM, 1991).

Multiple medical industry stakeholders made representations regarding the treatment of these supplies, which ranged from zero-rating to standard-rating, with most of the submissions recommending zero-rating. Concerns raised by practitioners related to the increased amount of administration required to correctly classify and manage the tax on those services that were exempt services and others that were not. The issue around apportionment was raised due to a

much more complex compliance environment, which was a direct result of the exemption of some services. The concern around not claiming the input costs for exempt services was raised as a concern, and they argued that it would result in them either having to absorb these costs or increasing their fees to recover them (VATCOM, 1991).

The pharmaceutical companies were concerned about the recommended treatment of medicines, noting that the administration required to comply with managing which medicines should be subject to VAT and which were exempt would be onerous. This complexity would be further exacerbated in hospitals, which would need to establish which medicines were used by patients and which were used when they were discharged (VATCOM, 1991). Hablutzel (2021) noted that with VAT taxing a broader base of services, hospitals would struggle to pass the additional costs onto patients. The systems required to manage this were anticipated to be expensive, especially for smaller retailers. The problem around consumer choice was also raised, as consumers may visit doctors to obtain their medicines rather than pharmacies, impacting this industry further (VATCOM, 1991).

VATCOM considered these concerns and recommended that all medical services and medicines be subject to VAT, primarily to level the playing fields. Given that people experiencing poverty would only pay minimal amounts due to government-funded facilities, VATCOM believed this would not materially impact them. In addition, the high administration costs by both the suppliers of these goods and services, along with the authorities trying to monitor them, were also key drivers in this decision (VATCOM, 1991). PWC (2005) supported this decision, noting that the government had already made significant contributions to assist people experiencing poverty via subsidies, so further assistance through a change in rate was not considered necessary.

When summarising the submissions and considering the drivers that informed VATCOM's recommendation, there appear to be three reasons that convinced VATCOM to standard-rate these supplies. First, there would be increased administration and costs for the necessary infrastructure should medical services and medicines be exempted. Secondly, there were concerns about how the industry would establish which medicines should be subject to VAT based on whether they were issued in a hospital or as part of a consultation. Finally, there was concern about the possibility of not passing the VAT incurred onto their patients.

If the same principles applied by VATCOM in making medical services and medicine standard-rated are applied to educational supplies in higher education institutions today, an argument could be made that educational supplies should be standard-rated. In its report to Treasury, PWC (2005) assessed the general requirements for a supply to qualify as a merit good. These requirements included goods and services in the public interest and essential goods and services. Given that section 27 of the Bill of Rights in the Constitution states that everyone has the right to have access to health care and that the State must take reasonable measures within its available resources to provide such care (Juta, 2014), it is not unreasonable to conclude that medical services are in the public interest and essential and would therefore qualify as a merit good. Bangalee and Suleman (2017) noted that VATCOM still elected to standard-rate these goods and services despite this classification.

PWC (2005) reviewed 24 African countries and noted 20 exempted medical services in their report. In contrast, all 29 countries in Europe they investigated exempted these supplies. In Eastern Europe, two out of five countries exempted these supplies. In the Americas, eight of 12 exempted medical services and eight of 14 in Asia (PWC, 2005). Therefore, the argument and support of standard-rating these supplies against this backdrop and its classification as a merit good would have been unusual and compelling.

Ylämö (2016) assessed the potential impact of the Finnish government changing the rate of VAT on supplies, including various medical services, specifically focusing on the effect changes in the VAT rates would have on healthcare services. Ylämö (2016) noted that Finland had many economic concerns, so VAT to increase revenue to the fiscus had garnered more attention. At the time, the government indicated a shift in private healthcare costs, which was identified as a potential area for increasing tax revenue.

One of the areas of complexity Ylämö (2016) identified was the interpretation of the regulations about different categories of healthcare services, specifically the difference between aesthetical surgery and reconstructive surgery, as both had different VAT rates applied. There was concern that this differentiation implied that more legal interpretation would be required, and there would be a change in consumers' choices, such as obtaining aesthetical surgery from other cheaper countries. There was also concern that suppliers would rather insource some of the services for healthcare services, which were exempt, as this would reduce the trapped VAT that these suppliers would incur (Ylämö, 2016).

This finding again supports the concern raised by authors in previous sections of this study that multiple VAT rates change spending behaviour and are unnecessary for the benefit of the fiscus. It also confirms the decision by VATCOM that multiple rates would cause confusion and further supports their decision to standard rate medical services.

In contrast to the study in Finland, Acosta-Margain (2011) studied the impact of a 2 percent general increase in the VAT rate in Mexico in 2009, which included previously untaxed medicines. The government's intention at the time was to transition to a single VAT rate with no exemptions eventually. There are similarities to some of the socio-economic difficulties that Mexico deals with compared to South Africa. Acosta-Margain (2011:2) noted that the top decile earned 37,62 percent of the income in Mexico while the bottom only earned 1,22 percent. As a result of this and with the regressive nature of VAT, compensatory measures had to be put in place to protect people with low incomes.

Acosta-Margain (2011) demonstrated that the 2 percent increase in the VAT rate was more significant for the poor than the more affluent, as the lower-income households spend a larger percentage of their disposable income on these merit goods. The study, however, argued that the measures put in place by the government to compensate people with low incomes for the higher VAT rate were progressive and more than countered the regressive consequence of the increase in the VAT rate.

When the results of the Mexico study are compared to the results of the Finnish study, it is worth noting that the difficulties highlighted by VATCOM in deciding to standard-rate medical services were evident in the Finnish model. However, by implementing a compensatory measure to ensure that the lower-income households were not unduly penalised due to the decision to implement a general VAT increase, the model in Mexico ensured these households were better off than a concession in the VAT rate would have afforded them.

In South Africa, Hablutzel (2021) noted that public hospitals are advantaged over private hospitals as the subsidies they receive to run their operations are essentially exempted, as no VAT is charged. While this is true, it is difficult to properly assess this benefit due to the problems in the management of public healthcare facilities. Maphumulo and Bhengu (2019) noted that some of the reasons were due to nepotism and corruption in recruiting staff, along with the lack of upkeep of the infrastructure and good leadership in the facilities. Even though there are problems in the public healthcare systems, several initiatives have assisted in

improving the quality of care in these facilities, but much more needs to be done. Even though these problems exist in the public healthcare system, it is still worth understanding the potential impact the standard-rating of medical supplies and services had on the private sector.

Ramjee (2013) attempted to quantify the average cost per admission to hospitals for private hospitals compared to public hospitals to indicate the price differential between these sectors. As there is not much common data available, this was the only data available to be analysed to assess these sectors. In addition, due to the limited public information, the study made assumptions to adjust the available data to allow for several variables in the provision of services between the two sectors to make the figures more comparable.

The adjustments included allowances for case mix, employment factors, preferential purchasing, corporate tax, and VAT. Even though the analysis is sensitive to several variables, it is estimated that the cost per admission for private hospitals is around 5.8 percent higher in private hospitals compared to public hospitals in the 2010 year of assessment (Ramjee, 2013). This is the percentage after reducing the cost for the standard-rating of this supply and indicates that despite the impact of VAT on these services, the cost and demand were still higher.

In a study comparing the prices of medicines in South Africa, Thaver et al. (2021) tested 74 medicines to understand the price difference between the private and public healthcare sectors. They noted, "on average, the price differential between the private and public sector medicines was 395.47%" (Thaver et al., 2021:194). They pointed out that the pricing systems were not transparent in the methods they used to formulate their pricing structures and recommended that this aspect of the pricing system required further intervention.

They theorised that preferential pricing through tender processes might assist public facilities, and single exit prices (SEP) helped manage the escalations on private medicine prices. However, despite these two interventions, the prices of medicines were usually higher in the private sector, with the lowest variance at 33 percent and the highest at 1964.7 percent (Thaver et al., 2021:202). They noted that although the tender practice has helped lower the public sector medicine prices, it is unclear whether the lower price results from this (Thaver et al., 2021). Considering the concerns the authors expressed, it still appears that the price variations have not been impacted significantly by any tax considerations.

Given the limited information available on comparatives between pricing in the public healthcare sector versus the private, it may assist further in assessing the impact that the

standard-rating has had on the supply of medical services and medicine in the private healthcare environment by understanding the growth in this sector. Lorenzoni and Roubal (2016) indicated in their study that 41.8 percent of all healthcare expenditure in South Africa was for private providers, which was in respect of 17 percent of the population for 2013, which was higher than any other OECD country. They noted that in relation to this expenditure, the authors expected it would be lower, given that South Africa had one of the lowest GDPs (Gross Domestic Product) in the group of 20 OECD countries selected. However, the expenditure was in line with the more affluent countries.

They noted that the results indicated that spending on healthcare insurance was up to six times more than the average for OECD countries in 2013, an anomaly that only occurred in South Africa. Generally, there was a correlation between the hospital prices and the GDP of the 20 OECD countries tested (Lorenzoni and Roubal, 2016). In his review, van der Heever (2019) noted that in 1998, there were 162 private hospitals compared to 216 in 2010. This translates to a growth of 33 percent in this period. The number of beds in the same period grew from 20 908 in 1998 (van der Heever, 2019) to 27 586 in 2006 (Matsebula and Willie, 2007) to 31 067 in 2010 (van der Heever, 2019), a growth of 48.5 percent from 1998 to 2010. Hablutzel (2021) noted an increase of 184 percent in private hospital beds within 20 years of implementing the standard-rating of medical services and medicines.

In relation to hospitals, Lorenzoni and Roubal (2016) noted that the results indicate that private hospitals are expensive compared to what is expected in relation to the country's income. They noted that there are no regulations to manage the prices charged by hospitals, and the price increases are usually agreed upon through negotiations between the hospitals and medical schemes. McIntyre and Thiede (2007) supported this view, noting that private health costs have increased substantially over time due to a lack of tariff controls and agreements between hospitals and specialists, which has driven prices up. The prices of hospital fees increased by 6.8 percent in 2012 and 6.2 percent in 2013, which was higher than inflation of 5.6 percent and 5.7 percent, respectively (Lorenzoni and Roubal, 2016:21).

Matsebula and Willie (2007) noted in 2006 that 80 percent of all theatre facilities and 66.5 percent of the hospitals were owned by three groups, namely Netcare, Mediclinic, and Life Healthcare, with the largest of these being Life Healthcare, which at the time owned 25.9 percent of the hospitals and tied ownership of the total beds at 26.4 percent with Netcare. A

review of the financial position of these two private sector groups presents the following results.

For the 1997 year of assessment, the Netcare Limited Group had approximately 5 600 hospital beds in 35 healthcare facilities (Netcare, 1997:7). The group reflected turnover of R909 million with a profit after taxation of R48 million (Netcare, 1997). In 2023, the Netcare Limited Group reflected a turnover of R23 669 million and a profit after tax of R1 336 million (Netcare, 2023a). They had 49 acute hospitals and 12 day clinics, with 9 903 hospital beds, and 14 mental health hospitals, with 1007 hospital beds (Netcare, 2023b:7).

In 2023, the Life Healthcare Group reflected in their integrated report that they had 48 acute hospitals with a capacity of 8 297 beds. The revenue from their South African operations grew by 10.1 percent from 2022 to R21 985 million in 2023 (Life, 2023b), with revenue from continuing operations for the group of R22 641 million and profit after tax from continuing operations of R1 428 million (Life, 2023a).

According to the Hospitals Association of South Africa Fast Facts webpage, private hospitals “contributed R55.5 billion to the national economy, which represents 1.3% of GDP and stimulated the production of goods and services of R130.9 billion through the economy” (HASA, 2024). They noted that these figures are understated as they only represent the results from three groups: Life Healthcare, Netcare, and Mediclinic.

The income generated by the private sector is significant based on the data analysed above. When you consider these results, against the backdrop that 75 percent of South African households used public healthcare facilities when they were ill (Mhlanga and Ndhlovu, 2021) and that the Department of Health incurred expenditure of R64.6 billion for the 2022/23 year (Treasury, 2023), the view that there was substantial growth in the private hospital market since the implementation of standard-rating of medical services and medicines seems reasonable.

This information further supports the assessment that although medical services and medicines were standard-rated for VAT purposes, there appears to be no evidence that this has significantly impacted the growth of the private healthcare industry, even though this sector would have had to bear the brunt of the burden in managing the implications of standard-rating of these services.

### **4.5.3 The current higher education and training industry landscape**

When considering whether educational services can be treated similarly to the treatment of medical services and medicines or whether the New Zealand model is better, it is worth understanding the sector as a whole. The Department of Higher Education and Training manages post-school education within South Africa, including public and private higher education institutions, technical and vocational colleges, skills development and education, and the SETAs (DHET, 2024a).

The SETAs are managed under the Skills Development Act, 1998, Chapter 2, section 10, which sets out their functions and responsibilities. The SETAs are required to develop and implement sector plans and learning programmes. They are also required to support the NQF implementation, perform quality assurance, and disburse levies collected from employers. Their final responsibility is to report to the Minister of Higher Education via the Director-General on the use of the funds allocated to them (W&RSeta, 2020). SARS (2017) states that training grants paid to SETAs are zero-rated. The Minister of Higher Education and Training also has oversight of the National Student Financial Aid Scheme (NSFAS), established in terms of the National Student Financial Aid Scheme Act 56 of 1999 (DHET, 1999). According to the NSFAS website, its vision is to operate within the post-school environment to provide financial resources equitably to students (NSFAS, 2024).

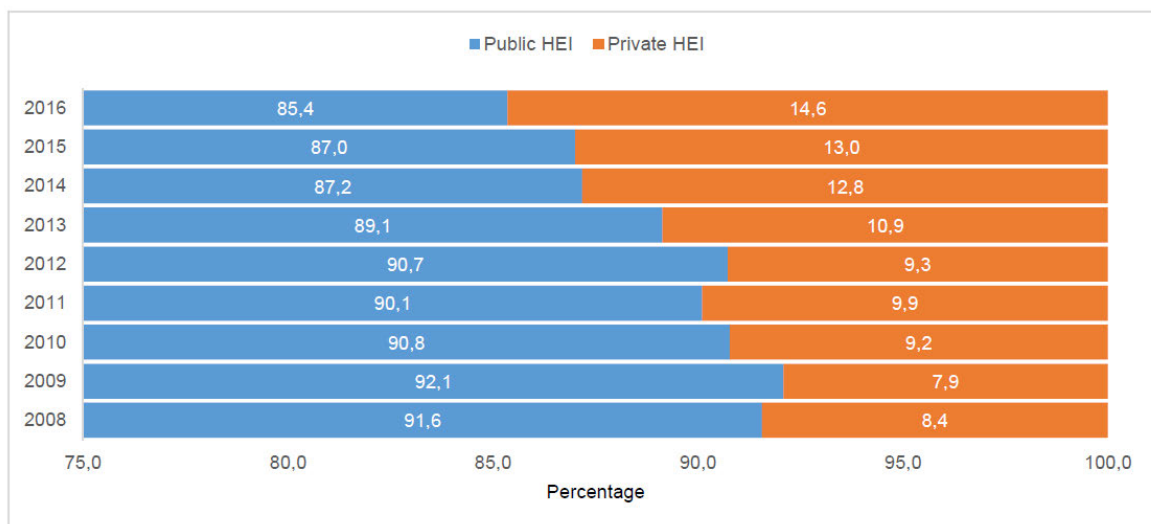
Higher education institutions are managed in terms of the Higher Education Act 101 of 1997. The Higher Education Act provides guidance on the operational and governance structures for managing these institutions and the requirements for establishing new higher education institutions (DHET, 1997). There are currently 26 public universities in South Africa (DHET, 2024b). According to StatsSA (2019), the number of students enrolled in public higher education universities and technikons has increased from 578 134 in 2000 to 975 837 in 2016, representing a growth of almost 69 percent in the public sector. In 2022, the enrolment figure was 1 077 768 (DHET, 2022), a further increase of 10.5 percent over the five-year period, representing an overall increase of 86% over the 22-year period.

The budget allocated to universities by government during the 2022/23 year was R46.7 billion, which was reduced to R44,6 billion for the 2023/24 year (DHET, 2023). Boughey and McKenna (2021) noted that public universities have changed their approach to focus more on

financial drivers to meet their demands, hence their need for additional income and the greater drive for donor or research income.

Even though there has been growth in the public higher education sector, the growth in the private higher education industry has been more significant, as highlighted in the table below from StatsSA (2019). Figure 4.2 below presents stats on the portion of enrolments made in public versus private higher education institutions. It shows that private education sector enrolments have been increasing faster than public higher education institutions in South Africa, with 14.6 percent of the enrolments in 2016 compared to 8.4 percent in 2008.

**Figure 4.2: Enrolment at public and private higher education institutions, 2008 to 2016**

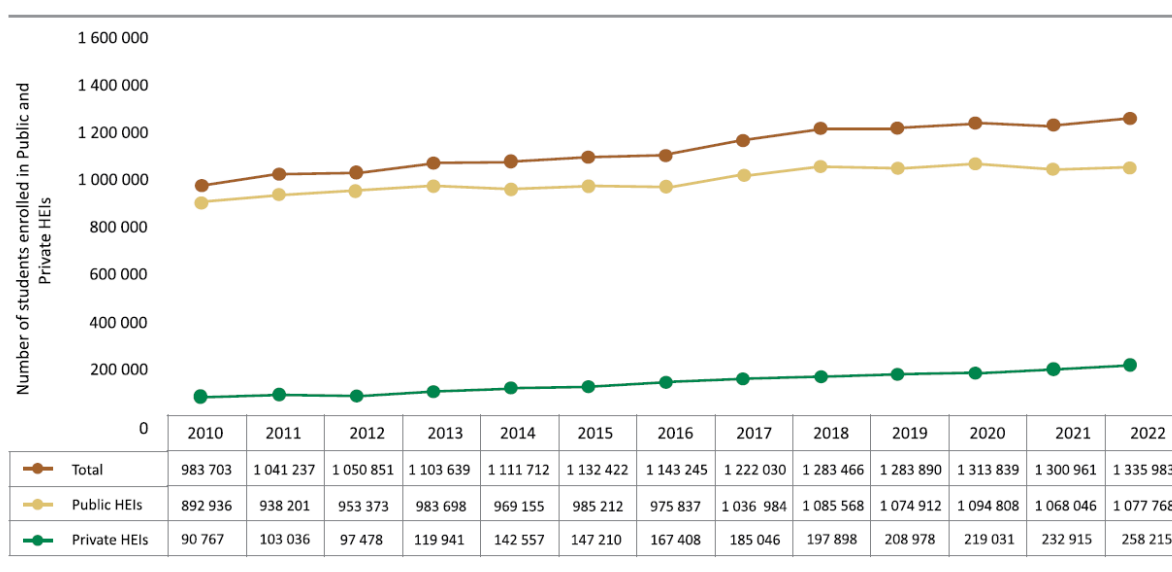


*Source: (StatsSA, 2019:41)*

This trend was confirmed further by a review of the Department of Higher Education statistics on enrolments, which indicated that in 2019 the public sector enrolled 1 074 912 (DHET, 2019) students as compared to 1 077 768 (DHET, 2022) in 2022, which shows a growth of 0.3 percent, compared the private sector, which enrolled 208 978 (DHET, 2019) students in 2019 compared to 258 215 (DHET, 2022) in 2022 representing growth of 23,5 percent in this sector.

Figure 4.3 below provides a graphical representation of the growth in the private versus public higher education sectors, indicating that the public sector has plateaued. In contrast, the private sector continues to grow at a steady pace.

**Figure 4.3: Number of students enrolled in public and private HEIs, 2010 to 2022**



Source: (DHET, 2024b:8)

The growth in the private sector may be impacted by the number of institutions in this sector, where the private higher education institutions are substantially more than public institutions, with a total of 125 (DHET, 2024b) compared to 26 public, as indicated in Table 4.6. The number of public higher education institutions has increased by 3 from 23 in 2012 (DHET, 2014), compared to a growth of 6 new private institutions from 119 in 2012 (DHET, 2014).

**Table 4.7: Overview of Post-School Education and Training Institutions and student enrolment, 2022**

|                                    | HEIs      |         |           |
|------------------------------------|-----------|---------|-----------|
|                                    | Public    | Private | Total     |
| <b>Number of institutions</b>      | 26        | 125     | 151       |
| <b>Number of students enrolled</b> | 1 077 768 | 258 215 | 1 335 983 |

Source: (DHET, 2024b:6)

According to their website, South Africa's largest private higher education provider is the Independent Institute of Education (IIE), which has five private higher education institution brands under its umbrella, operating at thirteen sites across South Africa (IIE, 2024). The IIE is part of the ADvTECH group, which reported revenue from their tertiary operations, which relates to the institutions under the IIE, of R826.9 million in 2014 (ADvTECH, 2015) compared

to R2 988 million in 2023 (ADvTECH, 2024), which shows substantial growth over less than ten years and demonstrates the growth in this market.

Similar growth has been experienced by another private higher education provider, the NetEd Group, where its holding company recently noted that it “has experienced more than 25% student enrolment growth year on year for the past three years. It currently provides fully accredited education to more than 17,000 students at its 13 campuses across South Africa” (EXEO, 2024). The difference between a private and public higher education institution relates to ownership. Public higher education institutions are ‘owned’ and therefore funded by government, as opposed to private institutions, which are owned by private investors (Qureshi and Khawaja, 2021) and not controlled by government (Buckner and Khoramshahi, 2021).

Boughey and McKenna (2021) noted that private higher education institutions are essential in meeting the excess demand for tertiary education that public institutions cannot manage. Private higher education institutions are generally better positioned to adapt their offerings to the demands of the market, making them more business-focused and agile, which public institutions typically struggle with (Tankou Epse Nukunah et al., 2019). However, Buckner and Khoramshahi (2021) found that this did not necessarily increase access as these institutions usually target the more affluent households with a lower relative number of students from poorer households (Irene and Hussain, 2021) In some countries with the expansion in private higher education institutions, there was less funding allocated to public institutions, thereby impacting on the overall effectiveness of these institutions in addressing the excess demand (Buckner and Khoramshahi, 2021).

Globally, private education has been growing at an astounding rate, with Qureshi and Khawaja (2021) noting that in some countries, private education institutions outnumber public higher education institutions or are expected to do so within the next ten years. In Asia, this is already the case. Levy (2018) noted that a third of the world's enrolments are in the private higher education sector, with at least 10 percent in every region. In Sub-Saharan Africa in 2010, enrolments were estimated to represent 17.8 percent of private education (Levy, 2018). Qureshi and Khawaja (2021) noted that this phenomenon appears to be especially relevant in developing countries, which is confirmed by Levy (2018), who noted that “the developed world, with 20.8% of the world’s population, has 39.3% of its higher education enrolments”(Levy, 2018:711). He noted further that of the developing countries reviewed, 37.8 percent of the enrolments were in private institutions, compared to 25.2 percent in the

developed countries (Levy, 2018). Globally, several internationally accredited universities have established campuses in developing countries to provide their degrees, which are often seen as a better product than those produced by local public institutions (Boughey and McKenna, 2021).

According to Qureshi and Khawaja (2021), this growth is first due to a change in economic policy in several countries where legislation has allowed private enterprises to provide services commercially that have historically only been offered by government. The second reason for the increase is the inability of public higher education institutions to meet the demand, primarily due to financial constraints. (Qureshi and Khawaja, 2021).

Irene and Hussain (2021) noted that in Sub-Saharan Africa, there are other reasons for this growth. Public higher education institutions have to deal with student protests, reduced financial allocations, and a loss of critical staff, which creates a prime environment for growth in this sector. Tuition fees of private institutions are usually higher, and the placement of the campuses allows them to accommodate only a small number of students from low-income households (Irene and Hussain, 2021). Considering that these institutions also enjoy the concession allowed by an exempt VAT status goes against the definition of a merit good, as noted in the previous sections.

Private higher education institutions aim to make a profit, with a strong drive to increase revenue and reduce costs (Boughey and McKenna, 2021). They, therefore, tend to create marketable degrees (Bird and Mugobo, 2021) within fewer focused disciplines that allow them to develop bespoke programmes that cater to business (Tankou Epse Nukunah et al., 2019), which ultimately assists them in achieving their profit goal. They generally do not invest substantially in the infrastructure a public higher education institution would require (Bird and Mugobo, 2021).

Private higher institutions focus more on career or vocational advancement, with the ultimate aim of work placement (Boughey and McKenna, 2021). Bird and Mugobo (2021) noted that the teaching focus of these institutions, with smaller venues and more learning-focused spaces, places them in a stronger position to achieve the placements of their graduates.

These drivers differ for public institutions, which, in addition to producing work-ready graduates, also have a strong research focus (Boughey and McKenna, 2021). Bird and Mugobo (2021) noted that the general view of private higher education institutions is that their research

output is minimal, and the investment in research infrastructure is not substantive. An analysis performed by Deacon et al. (2014) found minimal research produced by private higher education institutions, even though this was still higher than expected. The study also supported the conclusion that the private higher education sector did little international research.

In addition, Deacon et al. (2014) found no correlation between the number of academics appointed by private higher education institutions compared to their research output. The research was specific to the discipline in which the academic specialised with limited interdisciplinary research. It was speculated that one of the reasons for the low research output was due to no subsidy allocation from government for the research produced, which is a requirement in public higher education institutions (Deacon et al., 2014).

Private education institutions primarily exist for profit, and as research would not assist in achieving such goals, it is not a driver for these institutions. There is also the possibility that these institutions are still developing their footprint in higher education and have not yet matured in their research output (Deacon et al., 2014). Results from a review of the ADvTECH annual report (ADvTECH, 2024) reflect no research income from donors, which public higher education annual reports reflect, further supporting the assessment that there is minimal research income in these institutions.

The minimal research in the private higher education sector is an essential distinction, as research income is one of the main income streams that create the compliance difficulties that public higher education institutions experience. The challenges in classifying research income correctly for VAT purposes created the need for a VAT class ruling (VCR) from SARS. The ruling exacerbated compliance difficulties and the additional financial and human resources that public higher education institutions require as they struggle to comply with the requirements of the VAT Act.

#### **4.6 Chapter summary**

In this chapter, the data analysis was conducted. The first section clarifies the historical precedence that VATCOM established when it exempted education services and what drivers were relevant in this decision. Thereafter, the impact of this decision on the higher education sector was explained, along with the difficulties that the VCR causes. In order to identify an alternative recommendation, a global view was first considered where the consensus appears that minimal to no concessions should be created in VAT policy, as they are ineffective at

addressing the regressivity of VAT. Welfare initiatives should instead be considered to assist in this regard. An assessment of the implementation of the New Zealand model was performed, and some learning was found in the process followed by the New Zealand government when they implemented their VAT policy. The taxing of educational services and the related government grants that support these were understood and considered in support of the recommendation to standard-rate educational services in South Africa. The reasons for the standard-rating of medical services and medicines, which is a misnomer in VAT, as most other countries exempt this supply, were unpacked and understood to support the standard-rating recommendation further. The impact of standard-rating these services was also explored to know whether this decision had any significant effect on the growth of this sector. Finally, an assessment of the current higher education landscape was conducted, and it was established that private and public institutions do not have the same goals, so different VAT treatments should be considered for these two sectors.

The data from this chapter are further analysed and summarised in the next chapter. The next chapter intends to conclude the study and make recommendations.

## CHAPTER 5

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Summary of the study

The study explained the difficulties the higher education sector has experienced in managing multiple income streams with varied VAT treatments. This situation has resulted in a complex compliance environment with which these institutions struggle.

The study established the following objectives to address this problem:

1. To understand why educational services were exempted for VAT purposes.
2. To examine the impact of current multiple VAT statuses on higher education institutions.
3. To understand the global view of exemptions for VAT purposes.
4. To explore an alternative treatment of educational services for VAT purposes to assist in reducing the administration of compliance.

The following questions were posed to address the objectives:

1. Why were educational services exempted for VAT purposes?
2. How do current multiple VAT statuses impact higher education institutions?
3. What recommendations do global role players make regarding exemptions for VAT purposes?
4. What alternative VAT treatment of educational services can be implemented to reduce the administration burden of compliance?

The study applied a mixed-methods approach, using qualitative and quantitative methods to obtain and analyse the data. The data were analysed in the previous chapter, and the following are the conclusions.

#### 5.2 Conclusions

In response to the first question, the study investigated the reasons and principles underpinning the VATCOM decision to exempt education services. In deliberating on what changes should be recommended to the Minister regarding the VAT Bill, VATCOM based their recommendations on several principles that formed the foundation of their considerations. These included neutrality, equality, efficiency, productivity and simplicity (VATCOM, 1991).

They applied these principles in deciding to leave the Bill unchanged, with educational services remaining an exempt supply. Several factors supported this decision. First, VATCOM assessed that since these were public institutions primarily funded by the government, there would be no return to the fiscus if educational supplies were subject to VAT (VATCOM, 1991). Secondly and in conjunction with the first assessment, there was the understanding that the exemption status would be more beneficial to these institutions in that they would not need to comply with the demanding requirements of VAT, in terms of recordkeeping, etcetera, as they would not need to register for VAT (VATCOM, 1991).

Thirdly, educational supplies were considered merit goods, and there would have been pressure on the VATCOM not to levy any VAT on these goods (PWC, 2005), and finally, when benchmarking the treatment of educational supplies worldwide, most countries were exempting these supplies, even though some countries countered this decision and made this supply subject to VAT (PWC, 2005). Based on these factors and the circumstances at the time, it appears reasonable that VATCOM made the correct decision to exempt educational services.

However, subsequent to this and to answer the second question, the environment in which higher education institutions operate now is fundamentally different and more complex, with different drivers and circumstances affecting their decisions, especially in relation to their revenue. SNG Grant Thornton (2022) noted that these changed circumstances have resulted in more income streams than originally considered by VATCOM, which has created difficulties in complying with the VAT Act and resulted in substantial administrative effort.

To provide a summary, higher education institutions have both exempt and taxable supplies, and as a result, they also have mixed-use supplies that require additional administration and involve the application of an apportionment method, which needs to be approved by SARS (Nelson, 2016). Higher education institutions obtained this VCR as part of USAf, which appointed PWC to make the application to SARS. The VCR is highly complex as it requires that each research output of a higher education institution be categorised into applied, basic, and contract research with students and without student involvement. Each category and sub-category would require its own VAT treatment, as outlined in the analysis (SARS, 2022c). Consideration should also be given to the VAT implications of foreign donor projects.

The VCR applies a varied input-based apportionment method to calculate the VAT deductible on mixed-use supplies (SARS, 2022c). The VAT deductible for research purposes outlined

above would also form part of this calculation and requires substantial administration. Nelson (2016) argued that the varied input-based method is not sustainable in the long term due to its complex calculation and the financial resources required to maintain it.

The VCR also guides the treatment of ‘imported services,’ which would require VAT payable for services provided from a foreign source to a resident for services not used to generate taxable supplies (SARS, 2022c). Given that higher education institutions' primary source of income is exempt, they would meet these requirements often and are, therefore, required to make such payments. SNG Grant Thornton (2022) noted that imported services would be relevant to costs such as membership fees to international bodies and accreditation fees, among others. The impact of electronic services should be considered in conjunction with imported services.

To summarise, exempt services are generally problematic for higher education institutions. The analysis clearly demonstrates the complexity required to comply, along with the resources, systems, and processes needed to ensure they do not fall foul of the VCR and the VAT Act. The primary driver for the additional compliance administration in the analysis is the exemption of educational supplies. If these services were standard-rated or zero-rated, given that this supply is a higher education institution's largest revenue stream, there would be a significant reduction in the administration and the related financial and human resources required. The zero-rate status would provide additional benefits such as improved cost recovery, better resource allocation, and improved access to these institutions. However, as highlighted by Davis et al. (2016), in relation to higher education, this status primarily benefits the more affluent and would likely not be supported by the government.

When considering what solution to recommend, it was worth assessing international standards. The OECD guidelines are the reference point when deciding how to draft a tax policy (OECD, 2017). Similar to the process followed by VATCOM, the guidelines provide direction via several principles, which should be incorporated into good tax policy. These include neutrality, efficiency, certainty, simplicity, effectiveness, and fairness, with neutrality being one of the fundamental principles underlying a good VAT policy (OECD, 2017). Conceptually, the guidelines recommend no exemptions, but understanding that this may be difficult for some countries in practice indicates that they are kept to a minimum if necessary. Understanding the conceptual framework that should inform tax policy indicates that, in addition to the principles

noted above, VAT is fundamentally a consumption tax, and the final consumer should bear the tax (OECD, 2017) and not businesses in the value chain.

The problems caused by exempt supplies are twofold. First, the loss of funds to the fiscus and, in addition to that, a reduced effective tax rate. Theoretically, if all supplies are taxed at a standard rate, the overall rate could be reduced (Cnossen, 2022), or the additional income could be redirected to more effectively assist poorer households than the exemption would.

Secondly, it affects consumer choice by driving producers to insource services, ultimately impacting competition. The regressivity of VAT is generally raised as an issue when considering why concessions are necessary. However, research by Thomas (2022) argued that VAT is not as regressive as believed, and concessions benefit the affluent more due to the volume of expenditure they incur. Ultimately, the best solution is to standard rate exempt supplies. This solution reduces administration and improves competition, in addition to stabilising tax revenue during turbulent economic events (Simon and Harding, 2020) and driving economic growth (Cnossen, 2022).

The model to address the socio-economic issues experienced by poorer households can be addressed through several interventions. The solution suggested by de la Feria and Swista (2024) is exciting, as it allows real-time benefit to these individuals through a digitised subsidy to compensate them for the higher VAT rates. It also assists in addressing the political issues along with the mistrust and misunderstanding experienced when changes to legislation are made (de la Feria and Swista, 2024).

The data analysis reviewed the model implemented in New Zealand. The fourth question also examined the VAT treatment of medical services and medicines in South Africa to suggest alternative treatments for education services. The model implemented in New Zealand taxes most supplies for VAT purposes; this includes educational services. This model is the standard against which other models should be measured (de la Feria and Swista, 2024).

There is much to learn from New Zealand's implementation of its broad-based low rate (BBLR) (Sawyer, 2020) model. First, they engaged with the public (Dickson and White, 2008). The process by which the VAT Bill was reviewed followed a similar process using the VATCOM to assess representations by stakeholders (VATCOM, 1991). However, what was different was that New Zealand kept the public informed of amendments so that they bought into the changes,

as they perceived their contributions were valued, cementing the new legislation's acceptance (Dickson and White, 2008).

The second step of New Zealand's implementation plan required extensive education through a pervasive campaign using multi-media platforms (Muir, 1993). They felt that this part of the implementation was so critical that they delayed the implementation of the Act (Muir, 1993) to ensure that this was done properly. This part of the implementation strategy was credited with the success of the Act (Muir, 1993). Given how critical it was and the success of this method, it is worth considering using this approach for any changes to legislation in the future, especially where it is likely to be contentious, such as a change to the VAT treatment of educational services.

The BBLR model (Sawyer, 2020) has many benefits, including increased revenue collection and a simple, understandable framework. However, the most critical for this study is its low administration and compliance requirements. Dickson and White (2008) noted that the benefits of this are that there are no classification challenges, interpretation rulings, and no assistance from expensive external consultants. Although not optimal, New Zealand's compensatory income scheme to address the socio-economic issue is still more successful than VAT concessions (de la Feria and Swista, 2024). Since its inception, the Act has undergone minimal changes, further affirming it as the model on which other countries base their VAT Acts (Maples and Sawyer, 2017).

The New Zealand model taxes educational supplies, which include tuition fees, residential income, and research income (IRD, 2024). Implementing this model would significantly assist higher education institutions, as the compliance difficulties they currently grapple with would no longer exist if implemented in South Africa.

In addition to the model implemented in New Zealand, an analysis was performed on the reasoning behind standard-rating medical services and medicines in South Africa. The decision taken by VATCOM to standard-rate these goods and services was against their VAT treatment worldwide, where they were exempt (PWC, 2005).

The main reasons for this decision are threefold. The first reason was the increased administration resulting from the exemption. Secondly, managing multiple VAT rates assigned to similar goods and services would create difficulties. Thirdly, the trapping of unclaimable VAT, which could affect consumer choice, was noted (VATCOM, 1991). These difficulties

are very similar to those mentioned earlier in this study. First, in relation to the additional administration barrier, the treatment of educational supplies in the higher education industry has changed significantly since the implementation of the VAT Act. The environment is extremely complex and requires a VAT class ruling to guide institutions in assessing VAT consequences (SARS, 2022c), often requiring interventions from external specialists. SNG Grant Thornton (2022) described the formula proposed by SARS to calculate the input that can be claimed as highly complex. Therefore, the treatment of educational services would meet the requirement of complex administration, similar to the argument used to standard-rate medical services and medicines.

The second reason provided relates to the difficulties in establishing which medicines were used where and the administration related to establishing whether medicines were subject to VAT or not (VATCOM, 1991). There could be a similar argument when considering the differentiation required in assessing the treatment of research activities. The treatment differs primarily based on the research use and whether students are involved (SARS, 2022c). These difficulties are similar to those that the medical community would have experienced in establishing how to tax similar services based on their origin and would, therefore, meet the parameters for the second reason noted.

The final consideration was passing the VAT onto patients (VATCOM, 1991). Given that this is already done in higher education institutions, there could be an argument that this VAT could be claimed if educational services were standard-rated. It could, therefore, be concluded that if VATCOM were assessing educational services in the context of higher education institutions today, there would be a compelling argument to standard-rate these services. Before a recommendation on an alternative VAT treatment for educational services can be considered, it is vital to understand the current higher education landscape in which higher education institutions operate.

The analysis highlighted the differences between public and private higher education institutions. The pace of growth is greater in private institutions compared to public, with 26 public compared to 125 private institutions (DHET, 2024b). The goals of these institutions are also quite different, with private institutions driving a profit goal through marketable programmes which deliver work-ready graduates and require less infrastructure than public institutions (Tankou Epse Nukunah et al., 2019). They focus on teaching and learning drivers to ensure success (Bird and Mugobo, 2021). However, while public institutions graduate work-

ready students, they also have a strong research focus (Boughey and McKenna, 2021) with no profit goals.

High research output is not a goal of private institutions (Bird and Mugobo, 2021), and this is an essential difference between these two types of institutions as it is one of the primary reasons for the apportionment difficulties experienced in public higher education institutions (SARS, 2022c). Private institutions benefit from advantages on both sides. They experience the advantages created by VAT concessions, yet the market they target is not the poorer households (Buckner and Khoramshahi, 2021) for whom these concessions are usually made. In addition, given their low research productivity (Deacon et al., 2014) and lack of research income (ADvTECH, 2024), they likely do not experience the same apportionment difficulties that public higher education institutions experience and do not expend the financial resources public institutions spend to comply with the VAT Act.

The neutrality principle governing the VATCOM and OECD guidelines noted that businesses should not be motivated by economic factors and should be taxed in a similar manner to businesses (OECD, 2017). When this principle is applied to public versus private higher education institutions, there is an argument that these institutions are quite different, with different goals and operations. Therefore, using the same VAT rate would not comply with this principle, and an argument to treat them differently can be made.

### **5.3 Recommendations**

Similar to the model implemented by VATCOM for treating medical services and medicines (VATCOM, 1991), educational services in public institutions could be exempted, while private education institutions could be standard-rated. As shown in the study, there appears to be no evidence that standard-rating private medical care has had any significant impact on the industry and the private education sector seems to be showing similar growth. Even though this solution is practical and would greatly assist in reducing the compliance burden of public institutions, it would not alleviate this burden completely, as there would still be challenges in managing imported and electronic services. In addition, there may be some issues with foreign donors who benefit from zero-rated supplies.

The optimal solution is to standard-rate all educational services. This solution would significantly reduce the compliance burden in public institutions. In addition to this, VAT would be collected from the private sector. When one considers that VAT is charged by training

organisations that offer short courses, a revenue stream that several higher education institutions are pursuing, this further supports the argument to standard-rate educational supplies. Currently, these supplies are standard-rated for VAT purposes as they do not meet the requirements of educational services (SAICA, 2022) under the definition in the VAT Act.

Further consideration would need to be given to implementing the standard-rating of educational services, but the study has identified some solutions that would assist. The process of changing legislation should follow the method applied by the New Zealand government, with extensive consultations and constant communication with key stakeholders (Dickson and White, 2008), as well as a substantial drive to educate on the benefits of the changes (Muir, 1993) and address the mistrust and misunderstanding inherent with legislation (de la Feria and Swista, 2024).

The subsidy received by public higher education institutions could be classified as a grant for VAT purposes or treated similarly to the SETA training grants (SARS, 2017) or welfare organisations, which are zero-rated (Jeewa, 2016). Given that SETA grants are managed by the Department of Higher Education and Training (DHET, 2024a) and the functions of higher education institutions and SETAs align, there is a case that the subsidies issued to higher education institutions could also be considered for this preferential VAT status.

The mechanism for a compensatory income grant similar to the New Zealand model (Dickson and White, 2008) already exists via NSFAS (NSFAS, 2024). Although there are some maladministration issues, if these are addressed and a system similar to the digitised real-time subsidy recommended by de la Feria and Swista (2024) is implemented, this will alleviate the challenges experienced by those who struggle with the higher VAT rate. The added revenue collected from private institutions could be redirected to further assist struggling students.

While the recommendation to change the VAT status of educational services is a drastic alternative to the status quo, there are many benefits. Conceptually, standard-rating educational supplies makes the most sense when considering the purpose for which VAT was created.

#### **5.4 Suggestions for further study**

Building on this recommendation, it would be interesting to understand the willingness of higher education institutions to support the standard-rating of this supply, especially if the mechanisms for assistance to low-income households were available. An area of study

following this research would be to engage with higher education institutions to understand what benefits this VAT treatment would afford them.

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## APPENDIX 1: TURNITIN REPORT SUMMARY

Updated dissertation - Compliance burden of VAT caused by exempt educational supplies in higher education and a suggested alternative - Turnitin.pdf

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Submitted to University of Cape Town

## APPENDIX 2: ETHICAL CLEARANCE



30 August 2024

Mrs Delzeen Stone (223103885)  
School Of Acc Economics&Fin  
Westville

Dear Mrs Delzeen Stone,

Original application number: 00027690  
Project title: Compliance burden of VAT caused by exempt educational supplies in higher education and a suggested alternative

### Exemption from Ethics Review

In response to your application received on 27 August 2024, your school has indicated that the protocol has been granted EXEMPTION FROM ETHICS REVIEW.

Any alteration/s to the exempted research protocol, e.g., Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through an amendment/modification prior to its implementation. The original exemption number must be cited.

For any changes that could result in potential risk, an ethics application including the proposed amendments must be submitted to the relevant UKZN Research Ethics Committee. The original exemption number must be cited.

In case you have further queries, please quote the above reference number.

#### PLEASE NOTE:

Research data should be securely stored in the discipline/department for a period of 5 years.

I take this opportunity of wishing you everything of the best with your study.

Yours sincerely,



  
Prof Claire Lauren Vermaak  
Academic Leader Research  
School Of Acc Economics&Fin

UKZN Research Ethics Office  
Westville Campus, Govan Mbeki Building  
Postal Address: Private Bag X54001, Durban 4000  
Website: <http://research.ukzn.ac.za/Research-Ethics/>

Founding Campuses:  Edgewood  Howard College  Medical School  Pietermaritzburg  Westville

INSPIRING GREATNESS

## APPENDIX 3: CERTIFICATE OF EDITING

|  |  |
|--|--|
|  <p><b>LINDA SCOTT<br/>DEVELOPMENTS</b><br/>PROMOTING LINGUISTIC &amp; CULTURAL INCLUSIVITY</p> | <p>Dr Linda Scott<br/>[Redacted]<br/>[Redacted]<br/>www.justedit.co.za<br/>[Redacted]<br/>[Redacted]<br/>Three Rivers<br/>1929</p> |
| <p><i>English language editing</i><br/><i>SATI membership number: 1002595</i></p>  |  |
| <p>24 November 2024</p>  |  |
| <p>To whom it may concern</p>  |  |
| <p>This is to confirm that I, the undersigned, have language edited the dissertation of</p>  |  |
| <p><b>Delzeen Stone</b></p>  |  |
| <p>Entitled:</p>   |  |
| <p><i>Compliance burden of VAT caused by exempt educational supplies in higher education and a suggested alternative</i></p>   |  |
| <p>The responsibility of implementing the recommended language changes rests with the author of the document.</p>  |  |
| <p>Yours truly,</p>  |  |
|   |  |
| <p>Dr Linda Scott</p>  |  |
| <p>SATI membership number: 1002595<br/>SACE membership number: 1086444<br/>ORCID ID: 0000-0001-3249-0782<br/>ETDP SETA Assessor/Moderator: SOR number: 494097</p>                |  |
| <p>PhD: Language Practice<br/>MA: Intercultural Communication<br/>BA (Hons): Language Practice<br/>NPDE and ACE</p>  |  |