

The Value Added Tax implications of illegal transactions

SP van Zyl*

SUMMARY

In the case of *MP Finance Group CC (In Liquidation) v CSARS* the High Court of Appeal ruled that income "received by" a taxpayer from illegal gains will be taxable in the hands of the taxpayer. This article explores whether or not the decision in the *MP Finance*-case (and preceding cases on the taxation of illegal receipts) can be applied to determine if illegal transactions are subject to VAT and moreover if a trader in illegal goods and services should register as a VAT vendor. Although strictly speaking no analogy can be drawn between the charging provisions for income tax and VAT, it is clear that in the determination of the taxability of illegal income, the courts applied the principle of tax neutrality. In terms of the principle of tax neutrality, taxes are not concerned with the legality or illegality of a transaction, but rather with whether the transaction complies with the requirements for it to be taxed or not. That said, the European Court of Justice has a different approach in applying this principle. According to the European Court of Justice where the intrinsic nature of the goods excludes it from the commercial arena (like narcotic drugs) it should not be subject to VAT, but where the goods compete with a legal market it must be subject to VAT. Charging VAT on illegal transactions might give the impression that government benefits from criminal activities. However, if illegal transactions are not subject to VAT the trader in illegal goods will benefit as his products will be 14% cheaper than his rival's. Is this necessarily a moral dilemma? In conclusion three arguments can be deduced on the question if illegal transactions should be subject to VAT:

1. Illegal transactions should not be taxed at all. Illegal goods or services fall outside the sphere of the application of the charging provision in section 7(1) of the VAT Act. Moreover, taxing illegal transactions lends a *quasi*-validity to the contract and gives the impression that government benefits from crime.

* SP van Zyl LLB LLM AIPSA (UP) MTP (SAIT). Senior lecturer, Mercantile Law, School of Law, University of South Africa (vzylsp@unisa.ac.za).

2. The intrinsic nature of the goods concerned should determine the VAT-ability thereof. Where the nature of the goods excludes it from the commercial sphere, like narcotics, it should not be subject to VAT. Where the illegal goods compete with a legal market the goods should be subject to VAT to eliminate unjust competition.

3. The principle of tax neutrality makes it clear that the illegality of a transaction has no influence on its taxability. The charging provision in terms of section 7(1) of the VAT act is not concerned with the legality of the transaction. If the transaction complies with the requirements for it to be taxed, it should be subject to VAT.

KEYWORDS: Value Added Tax; illegal transactions; vendor registration; output VAT; input VAT; tax neutrality; tax morality.