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South African Revenue Service
Private Bag X923
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0001

BY E-MAIL: policycomments@sars.gov.za

SUBMISSION: DRAFT REGULATIONS ON ELECTRONIC SERVICES

Dear Sir/Madam

The South African Revenue Service’s Draft Regulations prescribing electronic services for the purpose of the definition of “electronic services” in section 1 of the Value-Added Tax Act, 1991 refers. We hereby present the SAICA National Tax Committee’s response to your request for comments.

In this submission we have also dealt with certain elements of the Taxation Laws Amendment Act of 2013. We acknowledge that this does not strictly fall within the ambit of the request for comments, but we thought it necessary to provide the milieu against which our comments are made.

We have tried to keep the discussion of our submissions as concise as possible, which does mean that you might require further clarification. In this respect, you are more than welcome to contact us.

As always, SAICA thanks SARS for the ongoing opportunity to participate in the development and interpretation of the SA tax law.
1. **Introduction**

As a general guiding principle the Commissioner for the South African Revenue Services (SARS) is mandated to collect all tax that is legally payable. This should be done in the most efficient manner, create certainty for the taxpayer, reduce the likelihood of tax leakages as far as possible, and should not inhibit trade.

It is common cause that VAT is a consumption tax aimed at taxing the consumption of goods and services in South Africa. The current (and global) mechanism by which services supplied by non-residents are taxed within a taxing jurisdiction is the imported services/reverse charge mechanism. The 2013 amendments to the VAT Act dealing with the treatment of the supply of electronic services essentially seek to tax a specific element of imported services as a local supply. This inherently places certain compliance requirements on supplies from off-shore. This submission deals mainly with practical and interpretational difficulties anticipated once the legislation becomes effective on 1 April 2014.

2. **Structural issues**

The current draft regulation makes provision for the inclusion of various categories of electronic services, i.e. educational services, games and games of chance, information system services, internet-based auction services, maintenance services and certain miscellaneous services (which include e-books, film, images, music and software). The supplies must be made by means of any electronic agent, electronic communication or the internet, and must be supplied for a consideration.

The wide reach of the definition of electronic services coupled with the very low compulsory registration threshold (i.e. where the total cumulative value of electronic services exceeds R50 000 any time after 1 April 2014), will result in a large number of entities having to register as vendors and most likely a high level of non-compliance with the requirements by many affected parties.
The following are some examples of the difficulties likely to be experienced in practice:

i. **Global shared service centres (SSC)**

Many global companies have shared SSCs in specific countries from where the global operations are serviced. Services supplied by SSC are wide ranging, but almost without exception will include elements of *information systems services* and *maintenance services* as envisaged in the draft regulation.

In terms of the current structure of the VAT Act, services falling outside the ambit of the electronic services definition will be regarded as imported services (to the extent used for non-enterprise purposes). The invoice from the SSC would accordingly have to be split between *electronic services* and *other services*. This places an onerous burden on the non-resident supplier of electronic and other services to classify the services according to the South African tax regime that is not necessarily aligned with global practice and definitions.

The non-resident would also be required to implement a dual invoicing system; one for enterprise purpose and one for, what we assume will be out of scope supplies.

Based on the current wording of the legislation it is however uncertain whether other supplies made by the newly registered entity will indeed constitute non-supplies for VAT purposes. The definition of *enterprise* in section 1 of the VAT Act refers to “any enterprise or activity which is carried on continuously or regularly by a person in the Republic or partly in the Republic …”. The issue for consideration is whether one can assume that the other activities are excluded from the SA VAT enterprise ambit on the basis that the underlying activity or enterprise is not partially conducted in SA (hence the need for a special inclusion paragraph in the definition of enterprise in section 1 of the VAT Act).

ii. **Inter-group charges**
A similar challenge as discussed with regards to SSCs above results where group companies charge inter-company management fees. The inter-company or group fees often contain elements of electronic services as defined. Currently section 10(22) of the VAT Act requires that the consideration for a supply must be split between the element relating to a taxable supply and any other element.

This will result in global head office companies impacted by the new legislation having to register for VAT in South Africa with very onerous compliance requirements.

**Recommendation – structural challenges**

These issues need to be clarified. Furthermore, where a foreign entity is already registered as vendor as a result of non-electronic services related activities, do they need to draw a distinction between normal supplies accounted for on the invoice basis and electronic services on the payments basis?

3 **Supplies to registered vendors in the RSA**

The current legislation draws no distinction between supplies that are made between businesses to businesses (B2B) and between businesses and the final consumer (B2C). The majority of the above challenges highlighted are due to supplies being made between businesses.

We submit that the risk of VAT leakages cluster around B2C supplies (primarily because final consumers do not declare the tax on the imported services).

We therefore recommend that the final regulation provides SARS with discretion, on application, to exclude certain categories of supplies of electronic services supplied B2B. This will ensure that most of the unintended inclusions discussed above are excluded and will provide SARS with the necessary safeguards if B2C supplies are adequately defined.
As an alternative it could be considered to change the words “to a recipient that is a resident of the Republic” in paragraph 2 of the Schedule to “to a recipient that is a resident of the Republic and not a vendor”.

4. Other practical issues

There are various practical issues that will need to be resolved or clarified before the new legislation can be implemented in practice and the registration of foreign companies in South Africa. This includes, but is not limited to the following:

i. SARS process related issues

The general registration and compliance protocols need to be finalised and communicated as soon as possible. New registrants should know what forms need to be filled in, where the forms must be submitted, what supporting documentation is required, the manner in which filing of returns must be affected, what supporting documentation must be retained, in which form and where, etc.

SARS staff needs to be trained to avoid bottle necks

The requirement that a person who is not a resident of the RSA must appoint a local representative vendor may also prove problematic.

ii. Industry related operational issues

The invoicing requirements in practice (the new rules require that a tax invoice must be issued in all instances (this would include supplies with a value of less than R50)). This is an extremely onerous requirement for on-line trading.

Output tax must be accounted for on the payments basis. Clarity is required around the issue of what constitutes consideration received. For example, is a payment received if it reflects in the vendor’s bank account? How are payments dealt with where the payment takes a period of time to clear through the banking system (as is
the case with most credit card transactions)? See also our further comments on this issue below.

iii. Treatment of royalty payments

Confirmation is sought that royalty payments made to non-residents, as envisaged in the VAT News dealing with the issue, will not form part of the new paragraph (b)(vi) enterprise vendors, i.e. that royalties paid will still remain out of scope notwithstanding the fact that the person is registered for the supply of electronic services.

iv. Transitional arrangements

Confirmation is sought whether any time of supply rules will be introduced in the regulation to deal with transitional arrangements e.g. where payment is received on 29 March for services to be supplied after 1 April 2014.

Clarity is required in instances where the supply chain of certain categories of electronic services includes non-resident suppliers to SA distributors. The SA distributor is responsible for supplying the electronic services to the SA end-user in terms of a distribution right granted by the non-resident supplier to the SA distributor. Under these circumstances, it is not certain if the supplier will be regarded as having supplied electronic services to the distributor, the essence of the supply being only the right to market and distribute the supplies in SA. This is particularly relevant in the software supply chain.

v. Goods classified as services for Customs purposes

Where goods are imported and the importation for customs purposes is classified as services (for example software installed on computers imported), would this be excluded from the ambit of the supply of taxable electronic services?

It is recommended that this be clarified in the regulation.
5. The definition of electronic services – specific references

i. Educational services:

From the current wording it would appear that non-resident suppliers of educational services may be pulled into the VAT net based purely on the fact that the person making the supply in question is not regulated by an educational authority in that export country. It is assumed that the intention is to bring the exemption in section 14(5)(c) into the definition of educational services in the draft regulation and we agree with that. Any uncertainty in regard will most likely give rise to disputes.

It is suggested that clarity is provided with regard to the requirement that “…the person … is not regulated by an educational authority in that export country…”. The wording in section 14(5)(c) envisages that the person making the supply is an educational institution.

The regulations also do not provide for instances where the supply of educational services is not regulated within the jurisdiction of the supplier. In other words the educational service provider will be pulled into the VAT net purely because the educational services are not regulated by an educational authority in its country. The final consumer in South Africa who in most instances is not registered for VAT will have to bear the cost 14% VAT on these educational services.

ii. Information System Services and Maintenance Services

We are of the view that the definitions of Information System Services (paragraph 5) and Maintenance Services (paragraph 7) are too wide and may include normal business transactions between foreign suppliers and VAT vendors in SA especially in the telecommunication industry which may not necessarily be directly on-supplied to the end-users in South Africa.

We have already suggested that paragraph 2(2) be amended to exclude form electronic services those services supplied to a vendor registered as such in the RSA.
If that suggestion is not implemented we recommend that it be considered to limit the two definitions by excluding normal business transactions (B2B).

6. **Nature of payment for services**

One of the proxies is that any payment in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No. 94 of 1990). It is not clear if the use of e-money or an 'electronic purse' where the payment is not made from any bank account was considered.

It is also stated that where any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No. 94 of 1990). It does not specify instances where the payment is made to a third party. There is opportunity for abuse, but this should be clarified.

7 **Additional recommendations**

In addition we appeal that it be considered to amend the legislation or to issue a binding general ruling directing the following:

i. **Identification of supplies for registration threshold purposes**

   In instances where the foreign supplier enters into a direct agreement with a local registered VAT vendor (either by means of an agency relationship or principal relationship), who assumes the obligation to invoice the customers with VAT on electronic services downloaded by the end users, the total value of such taxable supplies should not be included in the taxable supplies to determine the registration requirement.

   The foreign supplier should only have a requirement to register to the extent that it supplies electronic services directly to non-registered VAT vendors and the value of such taxable supplies exceed R50,000.

ii. **Responsibility to recover VAT**
The local VAT vendor will be responsible for the collection of the VAT on the invoice and the payment thereof to SARS. Accordingly the intention of the Act will be achieved by ensuring that users who download electronic services are liable for VAT, with the VAT being collected and paid to SARS by the local registered VAT vendor. 

There will accordingly be no VAT leakage for SARS in such scenarios. It will also ensure that the VAT is collected in such instances as opposed to relying on the foreign supplier to register for SA VAT.

iii. Zero-rating under certain circumstances

In addition to the above, even if a foreign supplier is required to register for SA VAT as a result of supplying electronic services directly to non-registered VAT vendors with a total value exceeding R50,000; any invoices received from the foreign supplier for electronic services rendered to local VAT registered vendor should be zero rated to the extent that the local VAT vendor assumes the obligation to pay over the VAT, as the users would have already been subjected to VAT by the local VAT registered vendor.

It is not clear whether the supply by means of any electronic agent, electronic communication or the Internet includes supplies by means of a telephone or satellite. It could mean that maintenance services via the internet e.g. online support will be caught but should the same maintenance support be supplied via the telephone it will not be caught, such as call centres. We recommend that this be clarified.

In situations where data such as software, games, music etc. are sent to the customer on a CD, the customs value will normally be the value of the disc (carrier medium). This will create a difference in tax revenue as the software etc. supplied electronically will be subject to VAT at 14% on the full value whereas the software supplied via CD will only be on the minimal value of the CD. It is not clear how this difference will be managed by Treasury.
We believe that our proposals are in line with OECD principles and legislation implemented in the European Union which regards supplies by a foreign supplier to a local VAT vendor to be a zero rated supply and accordingly that a foreign supplier will not have a registration requirement if it only supplies to a local VAT vendor whether the foreign supplier have a principal or agent relationship with the local VAT vendor.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

Piet Nel CA(SA)

**PROJECT DIRECTOR: TAX**

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