Dear Madam/s

TECHNICAL TAX PROPOSALS FOR ANNEXURE C OF THE BUDGET REVIEW

We refer to the invitation to submit technical proposals to improve or correct current tax legislation. Set out below please find the SAICA National Tax Committee’s proposals with respect to the Value-added Tax Act, No. 89 of 1991 (the VAT Act), as well as proposals in respect of specific sections of the Tax Administration Act, No. 28 of 2011 (the TAA) insofar as these relate to the administration of Value-added Tax (VAT). The income tax and related tax administration proposals are submitted in a separate document, for ease of consideration.

1. Section 1 of the VAT Act – Definition of second-hand goods

The legal nature of the problem
With effect from 1 April 2015 gold, gold coins and goods containing gold will no longer be defined as second-hand goods for VAT purposes.

Detailed factual description of the relevant transaction/s
Where a dealer in gold and related products acquires gold or goods containing gold from a non-vendor on or after 1 April 2015, a notional VAT input tax credit will be denied.

Where such person subsequently on-supplies the good/s to a third person, the supply will be subject to VAT.

We understand that the above amendment was proposed to overcome VAT fraud allegedly perpetrated at a large scale in the secondary gold market.
In our view, the proposed amendment will result in VAT effectively being levied on VAT. This will be prejudicial to the purchaser of the goods and will have an inflationary impact.

We are further of the view that the proposed amendment is neither fair nor neutral, favouring non-vendors over vendors for the subsequent resale of second-hand goods containing gold. That may cause an unintended anomaly in the secondary market for gold in the South African economy.

The current wording of the legislation (including “goods containing gold”) would, furthermore in practice, be difficult to apply. A large number of products include gold to some extent, but the products are not traded in the primary or secondary gold markets. It could never have been the legislator’s intention to exclude all such products in the basket of products on which a notional input tax credit may not be claimed.

**The nature of the businesses impacted by the transaction**

The secondary gold trading industry (jewellers, etc.) will be directly impacted by the proposed amendment. It could also impact on any industry manufacturing products containing any element of gold (for example the electronics industry).

**Proposal/s**

We recommend that the exclusion of gold, gold coins and goods containing gold be deleted from the definition of second-hand goods in section 1 of the VAT Act.

2. **Section 1 of the VAT Act – The meaning of regularly or continuously in the definition of enterprise**

**The legal nature of the problem**

Interpretational difficulties arise in practice with regards to the words *regularly or continuously* in the definition of *enterprise* in section 1(1) of the VAT Act.

**Detailed factual description of the relevant transaction**

In practice SARS often refuses to register a person on the basis of not being satisfied that the person is carrying on an enterprise or other activity on a regular and continuous basis in or partly in South Africa.

This is prevalent both in the case of local registration and non-resident registrations.

In the case of non-resident registrations economic activities are often conducted in South Africa, while no actual physical activities are conducted locally. Especially in the case of sub-contracting arrangements this often leads to interpretational difficulties.

**The nature of the businesses impacted by the transaction**

This issue impacts any business seeking registration.
Proposal/s
We recommend that the interpretation of the term be clarified to avoid unnecessary disputes between vendors and SARS and to streamline the registration process.

3. Section 1 of the VAT Act – Definition of electronic services

Issue 1 – Deletion of certain items as limited ‘B2B’ concessions
The legal nature of the problem
In addition to the VAT amendments promulgated into law on 12 December 2013, a Regulation was published setting out an exhaustive list of services that qualify as electronically supplied services.

A business-to-business (B2B) and business-to-consumer (B2C) distinction was not made in respect of electronically supplied services. As such, foreign electronic suppliers that supply electronic services to South African VAT registered businesses, entitled to a full input tax deduction in respect of the service acquired, are required to register for VAT in South Africa.

Limited B2B concessions were granted by amending the final Regulation and deleting certain services, which have been considered ‘predominantly’ B2B. Services such as “the supply of software” and “subscription service to a database” were deleted from the final Regulation.

Detailed factual description of the relevant transaction
As highlighted above, South Africa has not made a B2B and B2C distinction in respect of electronically supplied services. However, limited concessions were nevertheless granted whereby electronic services considered to be predominantly B2B in nature were deleted from the list of qualifying electronic services. One such supply deleted was the supply of ‘software’.

It is important to note that while the supply of software may be considered a B2B supply, it also contains a significant B2C element. The deletion of software from the list of qualifying electronic services will result in local suppliers being placed at a competitive disadvantage. Software may be acquired either electronically, whereby it is downloaded, or purchased on a physical disc in store and then uploaded onto the computer.

While the one is an electronic supplied service and the other is the supply of goods, the exclusion of the supply of software from qualifying electronic services will nevertheless impact the market supplying software on physical discs. That is, consumers will be incentivised to acquire the software electronically from foreign suppliers (excluding 14%) rather than to buy physical disc software from local suppliers (inclusive of 14% VAT).
Furthermore, the manner in which the list of qualifying electronic services was amended in order to grant limited B2B concessions was ineffective. That is, while the supply of software was deleted other types of services remained which may, arguably, catch the supply of software depending on the manner in which it was supplied (e.g. subscription service to a website or web application). This creates confusion in respect of applying the list of qualifying electronic services and determining whether a foreign supplier qualifies to register for VAT in South Africa.

The nature of the businesses impacted by the transactions
Foreign electronic service suppliers are impacted by the above problems and the manner in which foreign electronic service suppliers are able to efficiently and effectively operate in SA. Some have indicated that they will cease any operations in SA if it is this difficult to transact and adhere to the VAT legislation.

Issue 2 – Accounting basis
Legal nature of the problem
While the current VAT amendment to section 15 of the VAT Act clearly provides that the invoice basis will automatically apply for all electronic service suppliers, but such suppliers may apply to the Commissioner in writing for the payment basis of accounting to be applied, SARS has verbally advised and indicated in published registration guidelines that the payment basis of accounting will automatically apply.

Detailed factual description of the relevant transaction
Section 15 of the VAT Act was amended to address vendors registered for VAT in respect of the new electronic service provisions. Section 15(1) and 15(2)(a)(vii) of the VAT Act clearly provide that the invoice basis of accounting will automatically apply unless the vendor has applied to the Commissioner in writing for the payment basis to apply:

Section 15 - Accounting basis. – (1) Except as hereinafter provided, every vendor shall account for tax payable on an invoice basis for the purposes of section 16.

(2) Subject to the provisions of subsections (2A) and (3), the Commissioner may, on application in writing by a vendor, direct that the vendor account for the tax payable on a payment basis for the purposes of section 16 with effect from the vendor’s registration in terms of this Act or, where he has accounted for tax payable on an invoice basis prior to making an application under this section, from the commencement of the tax period immediately following the tax period during which that direction is made by the commissioner (hereinafter referred to as the changeover period), if—

(a) the vendor is – …

(vii) carrying on an enterprise as contemplated in paragraph (b)(vi) of the definition of “enterprise” in section 1 [i.e. foreign electronic service suppliers];…” [Emphasis added]

During electronic service workshops with the South African Revenue Service (SARS) and National Treasury it was highlighted that the above amendment was supposed to
read as ‘payment basis of accounting’ and would automatically apply unless the vendor applied to the Commissioner in writing for the invoice basis to apply. That is, the opposite of what was actually promulgated.

No VAT ruling or amendments have been issued or promulgated as of yet to correct the above. However, it would appear that all registrations are being automatically processed on the payment basis of accounting, even where the vendor specifically indicates that the invoice basis, in terms of law, is supposed to be applied.

We appreciate that the SA government wishes to obtain VAT revenue from electronically supplied services in the month where payment is actually received and not a later tax period when an invoice is issued.

The average company operating on a recognised accounting system applies the invoice basis of accounting to all transactions globally. As such, the following should be borne in mind with regard to requiring the foreign company to apply the payment basis in respect of supplies to South Africa only.

**The nature of the businesses impacted by the transactions**

Foreign electronic service suppliers are impacted by the above problems and the manner in which foreign electronic service suppliers are able to efficiently and effectively operate in SA. Some have indicated that they will cease any operations in SA if it is this difficult to transact and adhere to the VAT legislation.

**Proposal/s**

The current wording of section 15 of the VAT Act in respect of electronic services should remain as is and be applied accordingly.

**Issue 3 – Exchange rate and tax invoice requirements**

**Legal nature of the problem**

A draft Binding General Ruling was published in respect of further tax invoice concessions and exchange rates that may be applied. We appreciated that it may take a while to finalise the draft Binding General Ruling but this is causing uncertainty in the market.

To date no feedback has been provided in respect of the status of the matter and foreign electronic service suppliers are left uncertain as to what they may rely on in the interim. Similar issues exist in respect of tax invoice requirements for foreign electronic service suppliers who cannot satisfy the full requirements set out in the VAT Act.

**Detailed factual description of the relevant transaction**

In terms of current prevailing binding rulings the only exchange rate that may officially be applied for purposes of determining the Rand value of VAT payable, is the South African Reserve Bank (SARB) rate.
Foreign eService suppliers expressed difficulty with amending their systems to apply a different exchange rate for SA supplies only. The common alternative exchange rates applied by foreign eService suppliers are the European Central Bank and Bloomberg. A draft general binding ruling was issued addressing such alternative exchange rates, as well as concessions in respect of tax invoice requirements. However, the draft binding general ruling has not been finalized and no feedback has been published in respect of the matter or status thereof. As such, foreign eService suppliers have been left uncertain of what rates may officially be applied and what officially constitutes a valid tax invoice for them.

Furthermore, certain foreign eService suppliers will be required to change their systems to accommodate SA legislative requirements and are not able to, financially and practically, change their systems before knowing what exactly is required of them.

The nature of the businesses impacted by the transactions
Foreign electronic service suppliers are impacted by the above problems and the manner in which foreign electronic service suppliers are able to efficiently and effectively operate in SA. Some have indicated that they will cease any operations in SA if it is difficult to transact and adhere to the VAT legislation.

Proposal/s
We recommend that the draft binding ruling be finalised and published as soon as possible and be made affective from the date of the original amending legislation.

Issue 4 – Ring-fencing of foreign electronic service enterprise activities
Legal nature of the problem
We have been advised, and this is practically how it is applied as well, that the activities of foreign electronic service suppliers are ring-fenced in the sense that registration as a foreign eService supplier will relate to eServices only and not any other activities. If the foreign supplier has other activities, which satisfy the definition of carrying on an enterprise in SA, then a separate registration is required in respect of such other activities.

Detailed factual description of the relevant transaction
SARS has provided the verbal opinion that due to the manner in which eService suppliers was incorporated into the definition of ‘enterprise’ it is sufficiently ring-fenced to apply to electronic services only. As such, if a foreign eService supplier also carries on other VAT enterprise activities in SA, the eService supplier is required to submit a separate VAT registration application and effectively maintain two separate VAT registrations in SA despite carrying on one ‘enterprise’.
The nature of the businesses impacted by the problem
Foreign electronic service suppliers are impacted by the above problems and the manner in which foreign electronic service suppliers are able to efficiently and effectively operate in SA. Some have indicated that they will cease any operations in SA if it is this difficult to transact and adhere to the VAT legislation.

Proposal/s
The concept of the eService supplier being ring-fenced should be clear in the legislation. For example, amend section 23 of the VAT Act so that it is clear that the eService VAT registration is separate and independent from all other registrations, or amend the definition of ‘enterprise’ to provide clarity in this regard. Furthermore, vendors should be entitled to apply to SARS to forego any concessions granted to foreign eService suppliers so that one registration is required for all activities.

4. Section 1 of the VAT Act – the definition of input tax and the meaning of acquired

The legal nature of the problem
Input tax is defined in section 1 of the VAT Act as “… where the goods or services are acquired by the vendor …” Confusion within SARS and with taxpayers exists as to what constitutes “acquired” in relation to claiming input tax.

Detailed factual description of the relevant transaction/s
In order for a vendor to claim input tax, it must comply with the requirements of the definition of “input tax” in section 1 and section 16(3) of the VAT Act.

In terms of the definition of “input tax” it means VAT incurred where the goods or services concerned are acquired by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies or, where the goods or services are acquired by the vendor partly for such purpose, to the extent (as determined in accordance with the provisions of section 17) that the goods or services concerned are acquired by the vendor for such purpose.

Based on the principles of input tax relating to general expenses and overheads such as office equipment rental, office rent and other operating leases, vendors do not acquire ownership of the goods but are still entitled to claim input tax deductions. The VAT treatment should be the same in cases where the vendor uses a foreign supplier and imports the goods into the Republic.

In practice, certain SARS officials are of the view that a vendor has to obtain ownership of the goods before the vendor is entitled to claim the VAT incurred on importation of the relevant goods as an input tax deduction. Not only is there an inconsistent treatment within SARS but the treatment is also not aligned with the international treatment of input tax relating to import VAT.
It is also not aligned with the international VAT principles of a tax on the value added. If it is required that a vendor must become the legal owner of the goods, VAT incurred on leased and rented goods will not qualify as recoverable in put tax, resulting in a cascading and inflationary impact on the final consumer. It is common cause that one cannot obtain legal ownership of services. SARS, however, never disputed the fact that such services are acquired for the purposes of claiming input tax.

**Nature of businesses impacted**

All businesses importing goods into South Africa that do not acquire ownership of such goods e.g. beneficiation industries, repair and maintenance industries supplying services to non-residents, manufacturing entities etc.

**Proposal/s**

We recommend that the only requirement should be that the goods or services are used, consumed, or supplied by the vendor in the course of making taxable supplies.

We recommend that the word *acquired* be deleted from the definition of “input tax” and substituted with the word *obtained, received* or similar words. Alternatively, the definition can be extended to include acquiring ownership or possession of the goods or services.

5. **Section 1 of the VAT Act – Independent offshore branches – the meaning of “system of accounting”**

**The legal nature of the problem**

Proviso (ii) to the definition of enterprise provides that:

> “any branch or main business of an enterprise permanently situated at premises outside the Republic, shall be deemed to be carried on by a person separate from the vendor, if:
> (aa) ...; and
> (bb) an independent system of accounting is maintained by the concern in respect of the branch or main business” (my emphasis)

Section 29 of the TAA provides that:

> “(1) A person must keep records, books of account or documents that-
> (a) Enable the person to observe the requirements of a tax Act;
> (b) Are specifically required under a tax Act or by the Commissioner by public notice” (my emphasis)

From the above provision it is evident that the person must only keep records or books of account or documents that enable the person to observe the requirements of a tax Act. Section 55 of the VAT Act contains those additional records envisaged in section 29(1)(b) of the TAA. This section requires specific “records and documentation” to be
kept, including all relevant source documents, containing prescribed information. In particular, section 55(1)(b) provides that:

“the charts and codes of account, the accounting instruction manuals and the system and programme documents which describe the accounting system used in each tax period in the supply of goods and services” must be kept.

**Detailed factual description of the relevant transaction**

Vendors, especially non-resident persons who are vendors, most often use Excel or other similar software to record all transactions, all of which are supported by source documents. Since these software programmes are not specifically designed as accounting software, and since neither the VAT Act nor TAA defines the term “system of accounting”, it is somewhat ambiguous whether conventional books of account are envisaged by the term “system of accounting”. Based on our reading of the above sections, it is our contention that neither of the legislations prescribes the accounting system required, but merely requires specific records and source documents which must be kept.

**The nature of the businesses impacted by the problem**

All vendors, but in particular non-resident vendors.

**Proposal/s**

We recommend that proviso (bb) to the definition of “enterprise” be amended to make specific reference to records envisaged in Part A of Chapter 4 of the TAA.

6. **Section 1 of the VAT Act - Definition of “resident of the Republic”**

**The legal nature of the problem**

The term “resident of the Republic” is defined as:

“means a resident as defined in section 1 of the Income Tax Act: Provided that any other person or any other company shall be deemed to be a resident of the Republic to the extent that such person or company carries on in the Republic any enterprise or other activity and has a fixed or permanent place in the Republic relating to such enterprise or other activity;” (my Emphasis).

Section 1 of the Income Tax Act defines the term “resident” as meaning, *inter alia,*:

“(b) a person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic, but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation....”
Detailed factual description of the relevant transaction

There are numerous provisions in the VAT Act that deal with supplies made to persons who are not residents of the Republic. These include exemptions, zero rated supplies of goods or services and specific supplies in section 54(2A) and 64(6) of the VAT Act (that have the effect of deeming the import to be made by the agent and to effectively deem the supply made to the non-resident principal to be made to the agent). Since VAT is a self-assessment system, where the supplier/importer is liable for the VAT, whether or not VAT was indeed charged, it follows that the onus is on the vendor/supplier to determine if the recipient is a resident of the Republic or not.

As is evident from the said two definitions, there are at least three matters to consider in determining whether a company incorporated outside the Republic is a resident of the Republic or not.

Firstly, the reference to “a fixed or permanent place in the Republic relating to such enterprise or activity” is ambiguous in the VAT context, since no proxy exists in terms of which this determination can be made. Often non-residents may carry on an enterprise in the Republic which renders it liable to be registered for VAT albeit that the company has no offices, construction/installation site or any employees in the Republic, and it is not subject to any income tax, given the double tax treaty.

In practice, services are often not supplied from any fixed place in the Republic, but rather from various different locations.

To register as a VAT vendor, SARS requires that the company appoints a VAT representative, whom is a natural person and who is a resident of the Republic. The company must also appoint someone in South Africa who is responsible for the accounting records and liaison with SARS in this regard.

SARS further requires that a business address capable of inspection be provided. For non-resident registrants the business address of the accounting officer is generally given, since this is the premises where all the financial records are maintained.

Under the above circumstances, where other VAT vendors in South Africa supply services to be utilised, consumed or to be supplied by such non-resident registrant, the supply of services by such South African suppliers may qualify to be zero-rated being supplied to a non-resident. This seems to be an anomaly when compared to supplies made to South African vendors.

In addition, if considered that the concept of effective management is one that generally requires an in-depth understanding of whom in the organisation is responsible for what managerial functions and where these individuals are located when such activities are conducted, it is common cause that this aspect often results in disputes/different opinions on where effective management actually takes place. To complicate matters, the
interpretation of double tax treaties is equally fact/circumstance specific and often difficult to interpret.

The documentary requirements prescribed by SARS to prove that the services were supplied to a person who is not a resident of South Africa is generally a declaration by the recipient. Generally non-residents confirm that they are not residents of the Republic on the basis that they are not ordinarily resident in South Africa.

To make an assessment of a person’s status as a non-resident, however, goes beyond the enquiry of where a person normally resides. To make a proper assessment a vendor would generally require access to detailed information of its clients. It follows that although the vendor is unable to determine beyond any reasonable doubt whether or not the customer is a resident of South Africa, the VAT Act places the onus on the vendor/supplier. If viewed in the above light, this onus may be viewed as administratively unfair.

**The nature of the businesses impacted by the problem**
All vendors supplying goods or services to foreign entities.

**Proposal/s**
We recommend that the reference to “resident as defined in section 1 of the Income Tax Act” be deleted and be replaced by the following:
“Any natural person who is ordinarily resident of the Republic or any person (other than a natural person) which is incorporated, established or formed in the Republic, Provided that …”

We further recommend that the proviso to the definition of “resident of the Republic” be amended to read as follows:
“… to the extent that such person or company constitutes a vendor”.

The recommended amendments will have the effect of including any person who is or is required to be registered as a vendor.

Although the recommended amendments will not resolve all of the difficulties, it will have the effect that supplies to a non-resident that is or should be registered for VAT, will be subject to VAT at the standard rate.

Further, the onus placed on the supplier to determine if the recipient is a resident of South Africa will be simplified and there will be no need to consider whether the company’s effective management is in the Republic or whether any exception exists in terms of a double tax treaty.
7. Section 8(25) of the VAT Act - Group restructurings

The legal nature of the problem – overall
Section 8(25) of the VAT Act provides that:
“where any goods or services are supplied by a vendor to another vendor, those vendors must for purposes of that supply or subsequent supplies of those goods or services, be deemed to be one and the same person provided the provisions of section 42, 44, 45 or 47 of the Income Tax Act are complied with; Provided that this subsection shall not apply to a supply contemplated in section 42 or 45 of the Income Tax Act, unless—
(i) that supply is of an enterprise or part of an enterprise which is capable of separate operation, where the supplier and recipient have agreed in writing that such enterprise or part, as the case may be, is disposed of as a going concern”. (our emphasis)

Detailed factual description of the relevant transaction
Issue 1 – the ambit of the application of the section
From the wording of section 8(25), it is evident that it will apply if the provisions of section 42, 44, 45 or 47 of the Income Tax Act are adhered to. In many instances, the group relief will only apply to certain assets. It may be due to the fact that the assets do not qualify for the group relief or the parties decide to exclude certain assets from the group relief. However, irrespective of the fact that the assets are not transferred in terms of group relief, the assets are nevertheless supplied as part of the transaction.

From a VAT perspective, one of two interpretations may apply, namely:
• That section 8(25) applies only to the extent to which assets being transferred in terms of the group relief afforded by the said sections in the Income Tax Act. This will imply that the remaining assets transferred as part of the business will be taxable at either the standard or zero rate. In this regard, it is quite possible that section 11(1)(e) (the supply of a going concern) will not apply to the remaining assets, as such assets may not constitute all the assets necessary to continue carrying on the enterprise. Thus, where section 11(1)(e) does not apply, that portion of the enterprise will be subject to standard rate VAT and / or exempt (debtors, etc.). This further implies that if it was not for section 8(25) the vendor would have been in a position to apply the zero-rate provision as envisaged in section 11(1)(e). However, now the vendor has a cash flow disadvantage where it has to account for standard rated VAT on a portion of the supply; or
• That section 8(25) applies where group relief is sought, whether in respect of some or all of the assets, where a business is transferred as a going concern.

Section 8(25) was introduced with Act 31 of 2005. The explanatory memorandum stipulates that the reason for the amendment is to ensure that there are no VAT consequences for either vendor where the vendors are partially taxable
entities. However, as can be seen from the above, dependent upon the interpretation, it will have consequences where both parties are fully taxable vendors but the group relief is limited to a portion of the business being transferred / supplied.

Proposal/s
We recommend that the wording in section 8(25) be clarified to give effect to the second interpretation. We further recommend that a vendor be given a choice to rather utilise section 11(1)(e) on the entire supply.

Issue 2 – the exclusion of unincorporated bodies of persons
Unincorporated bodies of persons are deemed to be persons separate from its members and are VAT registered separately from its members.

From an Income Tax perspective bodies of persons are not recognised as separate persons. In instances where group relief is applied in a scenario that involves an unincorporated body of persons, the group relief provisions are applied to the members of the unincorporated body of persons and not to the VAT registered body of persons.

While the member makes the supply from an income tax perspective, from a VAT perspective the body of persons makes the supply. As a result, the effect is that where an unincorporated body of persons is party to these agreements, they are excluded from the relief envisaged in section 8(25) since the supplier (selling vendor) for income tax and VAT purposes differs.

Proposal/s
It is recommended that the wording of the section be clarified so as to ensure the inclusion of unincorporated bodies of persons who are vendors.

Issue 3 – meaning of “going concern”
Section 8(25) will only apply where either section 42 or section 45 are utilised and the supply constitutes a going concern.

Act 17 of 2009 brought about amendments to section 8(25) by the insertion of the requirements that the supply must be a going concern where group relief in terms of section 42 or 45 is utilised. The reason for the amendment, as set out in the Explanatory Memorandum, was due to the fact that the group relief sections allow supplies between group entities where the supplies are merely capital assets or trading stock. The amendment to the VAT Act is to limit the application of section 8(25) to going concern transfers (similar to the going concern rules of section 11(1)(e)).

Unlike section 11(1)(e), section 8(25) does not provide any specific criteria on what constitutes a going concern. This means that the meaning of the term is to be interpreted in accordance with its ordinary meaning as used in the English language. To this end, the most common description of the term is that it is a business that is profitable or a
business that generates sufficient income to avoid bankruptcy. From a VAT perspective, the profitability of an enterprise, or whether or not an enterprise is solvent are generally not criteria and are certainly not part of the criteria of section 11(1)(e).

Further, from the latter description that requires income generated to be sufficient to remain solvent, it follows that if solvency is in whole or in part secured by way of equity investment, the enterprise will not be considered a going concern. This means that if for example a plantation farm, or a construction activity, which will only yield income in future, is disposed of, the provisions of section 8(25) will not apply.

Proposal/s
We recommend that the wording of section 8(25) be amended to provide clarity on the meaning to be assumed for the term “going concern”.

The nature of the businesses impacted by the problem
All vendors involved in group restructurings.

8. Section 9(4)(b) of the VAT Act - Extension of application to connected persons

The legal nature of the problem
Section 9(4) of the VAT Act calls for a special time-of-supply in circumstances where the whole of a consideration is not determinable at the time goods or services are supplied in terms of specific types of agreements.

This provision is currently subject to section 9(2)(a), which renders it not applicable to connected persons and thus prejudices these persons.

It often happens that the value of a supply between connected persons cannot be determined at the time the goods or services are supplied. Such supplies are subject to VAT at the time the goods or services are supplied. However, there is no potential risk of loss for the fiscus or a risk of abuse if the supplies are made to connected persons who are registered vendors and who are entitled to claim the total amount of VAT as input tax.

Detailed factual description of the relevant transaction/s
Section 9(4) provides that where goods are supplied (other than in terms of an instalment credit agreement or a rental agreement) and the consideration for the supply is not determined at the time the goods are appropriated, then the supply is deemed to take place at the time when payment for the supply is due or is received, or an invoice relating to the supply is issued.

Section 9(4) is however made subject to section 9(2). Accordingly, where supplies are made between connected persons and the consideration for the supply cannot be
determined when the goods are appropriated, VAT is payable when the goods are
removed or are made available in terms of section 9(2).

If the consideration cannot be determined when the goods are appropriated, the output
VAT payable in terms of section 10(2) and section 10(3) cannot be calculated. There is,
therefore, no provision in the VAT Act to enable the supplying vendor to estimate the
amount of VAT payable when the goods are made available or are removed. In addition,
section 21(1) does not provide for an adjustment to be made subsequently to an estimated
amount of consideration.

Proposal/s
We recommend that section 9(4) should be made applicable to supplies made to VAT
registered connected persons that are fully taxable.

The nature of the business/es impacted by the problem
Typically, supplies made by unincorporated joint venture mining companies that supply
the ore or concentrate mined to the joint venture partners are affected. The consideration
for the ore or concentrate is determined based on the quality of the ore or concentrate, the
exchange rate and the international price of the product once refined, which only happens
some time after the ore or concentrate is delivered.

9. Sections 11(1)(q) & 11(2)(l) of the VAT Act

The legal nature of the problem
The interaction between section 11(2)(l) and 11(1)(q) gives undesired outcomes under
certain circumstances.

Section 11(1)(q) provides for the zero-rating of a transaction where goods are supplied
by a vendor to a non-resident non-vendor;

- Where the vendor must deliver the goods to another resident vendor, as part of the
  non-resident’s supply to the second resident vendor; or
- Who will use them in the course or furtherance of his enterprise.

This is to avoid a cascading effect of VAT for the VAT registered purchaser.

Detailed factual description of the relevant transaction
The application of section 11(1)(q) is limited to the supply of goods to a non-resident. If
the local vendor to a local recipient who is the client of a non-resident supplies services
(and not goods), there is currently no provision available in section 11(2) to provide for
the zero-rating of such services.

The only provision in section 11(2) that bears a slight resemblance to section 11(1)(q) is
section 11(2)(f)(ii)(bb), which only applies if the services are supplied directly in
connection with certain movable property. If the services provided by the local vendor to
the non-resident are not supplied directly in connection with movable property, the zero-rating will not apply.

**The nature of the businesses impacted by the problem**
Supplies of services by local VAT registered suppliers, to non-resident non-vendors, where the supply is made to a SA recipient who is a registered vendor.

**Proposal**s
A provision comparable to section 11(1)(q) should be inserted into section 11(2) for services but limited to recipients that are fully taxable.

**10. Section 12(h) of the VAT Act - Supplies of educational services**

**The legal nature of the problem**
Section 12(h) of the VAT Act provides that:

“the supply by a school, university, technicon 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 sub-paragraph (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 board and lodging.” (my emphasis)

Section 12(h)(i) exempts from VAT “the supply of educational services” by various educational institutions that are registered in terms of specific Acts of Parliament or by public benefit organisations.

**Detailed factual description of the relevant transaction**

**Issue 1 – the extent of the exemption**
From the said sections, it is evident that the exemption applies to any educational institution, which is registered in terms of the applicable Act, of any educational services supplied by it.

In practice it is common cause for schools, universities, colleges and technicons to provide other educational services, for which they are not accredited in terms of any Act. These educational courses are similar to those provided by other companies and institutions, which are not registered as schools or higher educational institutions.

The above has the effect that such educational services provided by schools, universities, colleges and technicons are exempt from VAT, whilst the supply of such educational services by other institutions is taxable. The VAT Act generally exempts from VAT specific types of supplies and not supplies made by specific persons (i.e. the supplies are exempt not the supplier). This situation places registered educational institutions in an advantaged situation in respect of the supply of any non-accredited courses.
Proposal/s
We recommend that the section be amended to limit it to those educational services in respect of which the educational institution is registered / accredited to provide. This will ensure level playing fields in respect of all non-accredited courses.

Issue 2 – charges not in the form of school/tuition fees
The section also exempts from VAT the supply of goods or services which are necessary for, subordinate to and incidental to the supply of any educational services by the educational institutions. However, the exemption only applies if such goods or services are supplied for a consideration in the form of school or tuition fees. It is common cause that schools, universities, colleges and technicons often supply services that are necessary for, subordinate to and incidental to the supply of the actual educational services for a consideration that is distinctly separate from the school fees or tuition fees. This includes registration fees, re-marking fees etc.

The effect of the section is that such services become taxable simply due to the fact that fees, separate and in addition to the tuition fees are charged, albeit that the services are necessary for, subordinate and incidental to the supply of the educational services.

Proposal/s
We recommend that the criteria that services necessary, subordinate and incidental to educational services supplied wholly or mainly for the benefit of students/learners, not be limited to circumstances where the consideration is in the form of school fees or tuition fees. This will ensure that fees such as re-marking fees, registration fees etc. will be exempt from VAT.

Issue 3 – payment for board and lodging
As is the case with the abovementioned services, the exemption also applies to domestic goods or services supplied solely or mainly for the benefit of students and learners, provided that such goods or services are supplied for a consideration in the form of payment for board and lodging.

The term “board and lodging” means that food and accommodation need to be supplied. This implies that where any of these institutions merely supplies lodging (i.e. accommodation for a consideration) the exemption does not apply. Currently, most of these institutions supply lodging only, with separate canteen facilities should students which to buy meals.

Proposal/s
As far as the board and lodging is concerned, we recommend that the term “board and lodging” be amended to read “lodging or board and lodging”. This will ensure that where only boarding or lodging is supplied to students, the exemption will still apply.
The nature of the businesses impacted by the problem
Vendors supplying educational services similar to those provided by qualifying educational institutions, e.g. vocational training.

11. Section 14 of the VAT Act – Imported services

The legal nature of the problem
Determination of “the extent” of taxable use as envisaged in the definition of imported services in section 1 of the VAT Act.

The VAT Act, VAT Guides and Binding General Rulings currently do not provide guidance on how to determine “the extent” or how to quantify the extent to which services supplied by non-residents are utilised for the purposes of making taxable supplies by the South African recipient of such services.

Detailed factual description of the relevant transaction
The SARS VAT 404 Guide for Vendors (VAT 404), read with Binding General Ruling 16 (dated 25 March 2013), states that the standard turnover based method is the default apportionment method that must be used to calculate the extent of taxable use of goods and/or services acquired, i.e. the input VAT claimable on goods and/or services acquired that relates to “mixed” supplies.

The VAT 404 further provides guidance on the inclusion and exclusion of revenue items in the numerator and denominator in calculating the apportionment ratio.

Section 17(1) of the VAT Act further states that where the apportionment ratio is calculated on the basis of the standard turnover based method is more than 95%, the goods and/or services acquired are deemed to be acquired wholly for taxable purposes. Consequently, the VAT paid on the acquisition of the goods and/or services are claimable in full as input VAT.

Some jurisdictions with VAT systems require vendors to account for output VAT at the applicable rate on services acquired from non-residents (typically referred to as reverse-charge provisions). The vendor is then entitled to recover the VAT paid as input tax to extent that such services are used for taxable purposes.

The provisions relating to imported services in the SA VAT legislation does not involve input tax. Put differently, imported services are administered by the charging provisions of the VAT Act (i.e. section 7 of the VAT Act) and those relating to the claiming of input tax credits do not apply. It follows that the input tax apportionment method(s) does not technically apply to imported services.
The burden to prove that the VAT payable on the supply of the imported services has been calculated correctly is upon the vendor.

Uncertainty exists if vendors correctly calculate the amount of VAT payable on imported services as a result of using non-prescribed methods of determining “the extent” of the taxable use of services acquired from non-residents.

The nature of the business/s impacted by the problem
All purchasers (VAT vendors and any other person) that procure services from off-shore suppliers.

Proposal/s
We recommend that, similar to the prescribed standard turnover based method that must be used to calculate a vendor’s apportionment ratio for input VAT purposes, a method should be legislated on how vendors should calculate "the extent" to which services received from foreign suppliers have been utilised for the purpose of making taxable supplies.

12. Section 15(2) of the VAT Act – Payments basis of accounting for VAT

The legal nature of the problem
Currently, the categories of vendors allowed to account for VAT on the payments basis are limited. The threshold under which a person is allowed to register on the payments basis has also not been revised for a number of years.

Detailed factual description of the relevant transaction/s
Only certain categories of vendors are allowed to account for VAT on the payments basis. This includes any public authority, any water board or similar institution, any regional electricity distributor, any municipal entity, any municipality, any association not for gain as well as certain suppliers of electronic services.

The VAT Act further provides for any natural person or an unincorporated body of natural persons to account for VAT on the payments basis, where the value of such person or body’s taxable supplies does not exceed R2.5 million per annum.

The above monetary limit, as well as the limitation to natural persons, negatively impacts the ability of small businesses to manage their cash flows.

The nature of the businesses impacted by the problem
Most small to medium sized businesses are impacted by the current limitation.

Proposal/s
In light of the Government’s stated intention to support small to medium businesses, we recommend that the qualification criteria be extended to non-natural persons. We further
recommend that the qualifying threshold be increased to at least R5 million.

13. Section 16(2)(a) of the VAT Act - Minor deficiencies in disclosure requirements on tax invoices

The legal nature of the problem
Sections 16(2)(a), 20 and 21 of the VAT Act read together with the definition of input tax in section 1 of the VAT Act – input tax is only deductible if a vendor is in possession of a tax invoice or credit note as envisaged in sections 20 and 21 respectively, at the time that a VAT return in which the deduction is made, is submitted.

Detailed factual description of the relevant transaction/s
The purpose of the above requirement is to ensure that a full and complete audit trail exists with regards to output tax declared and input tax claimed. In practice, circumstances often occur where minor elements of the tax invoice do not fully comply with the specific requirements of the VAT Act, but where the audit trail is not adversely affected.

The nature of the businesses impacted by the problem
This issue applies to all VAT vendors.

Proposal/s
Currently, SARS has no discretion to allow input tax in such instances. We recommend that the Commissioner be granted discretion to allow input tax where documents may not be fully compliant with the VAT legislation, but where the audit trail is not impacted in a material manner.

14. Section 17(2)(c) of the VAT Act – Denial of input tax on the acquisition of motor cars

The legal nature of the problem
Section 17(2)(c) read with section 18(3) of the VAT Act – the blanket denial of input tax on motor cars coupled with imposing VAT on the fringe benefits arising from the use of company owned vehicles, gives rise to an anomaly in the general structure of the VAT Act as well as double taxation.

Detailed factual description of the relevant transaction/s
Section 17(2)(c) of the VAT Act denies a vendor a deduction of input tax on the acquisition of any motor car as defined. This denial applies notwithstanding the actual use to which the motor vehicle is put.

The denial of the input tax credit is based on the assumption that the motor car will be used for private use or consumption, hence the effective self-supply charge.
Over and above the denial of the input tax credit on the acquisition of the vehicle, output tax is also payable on the taxable fringe benefit that accrues to an employee as a result of being granted the use of the company owned car. The value on which output tax is payable has been adjusted downwards compared to the value applicable for income tax purposes (on the basis that no input tax credit was allowed).

One of the basic governing principals of VAT is that input tax may be claimed to the extent that it has been incurred by a vendor for the purpose of consumption, use or supply in the course of making taxable supplies. In the case of the acquisition of a motor car, there is a presumption of private use, and hence the denial of an input tax credit.

Notwithstanding the denial of the input tax credit, output tax is payable by the vendor on the private use of the vehicle as envisaged in the Seventh Schedule to the Income Tax Act. Essentially, the same supply for VAT purposes is taxed twice; once when the input tax deduction is denied and on an on-going basis when the vehicle is actually applied for private use.

**The nature of the businesses impacted by the transaction**
The issue applies to all vendors.

**Proposal/s**
We recommend that the blanket denial of input tax on the acquisition of a motor car be abolished and the value to the placed on the private use of the motor cars be aligned with the valuation rules in the Seventh Schedule to the VAT Act. This will ensure that VAT neutrality is restored.

15. **Section 17(1) of the VAT Act – Time frames within which to respond to application for apportionment rulings**

**The legal nature of the problem**
Consideration should be given to the introduction of legislated time frames within which SARS must issue a ruling for an alternative apportionment method, failing which the requested method may be used as the default method in order to create certainty.

**Detailed factual description of the relevant transaction/s**

**Time lines**
There are numerous instances in the law and in the rules where both SARS and the taxpayer are required to adhere to certain time frames. With regards to this particular issue, the law currently restricts vendors to applying for apportionment rulings for the current financial year and prospectively (usually the ruling given will allow the method to be used from the beginning of the financial year in which it was requested and for a subsequent three years).
However, no time frame is given in which SARS is required to respond to and give finality to the ruling application. In some cases, the final response runs into years during which the vendor is effectively in limbo as to how to treat its ostensibly apportionable VAT. The unreasonableness of putting vendors in such a situation whilst at the same time penalising them where a negative ruling is granted is irrational and fails the premise under which tax systems are supposed to operate; that being fair and equitable.

Furthermore, if the nature of a vendor’s business has not changed there should be no reason not to grant the vendor the same method for prior financial years. It is the principle, which has been established, and such principle should be applied historically as well.

We submit that the impact of the failure of the legislation to compel SARS to respond with finality to an apportionment ruling request on the vendor is obvious. A vendor cannot reasonably be expected to wait for months and sometimes years to obtain a conclusive answer on how to treat the VAT on its expenses. This is exacerbated by the fact that it is the vendor which is voluntarily attempting to obtain certainty and being forthcoming.

The nature of the business/es impacted by the problem
All vendors making any level of mixed supplies are impacted by the issue.

Proposal/s
We recommend:
- The introduction of legislated time frames in which an apportionment ruling application must be responded to;
- The introduction of legislation that will allow vendors to obtain retrospective apportionment rulings;
- That vendors are permitted to use the alternative apportionment method detailed in its application whilst the application is in the process of being responded to without prejudice;
- That clear principles are set out in terms of determining whether an apportionment of input tax is required or not; and
- That guidance is given in terms of what methods may be acceptable and guidance in terms of how specific income streams should be treated.

16. Section 17(1) of the VAT Act – Apportionment – shortcomings in the turnover-based method of apportionment

The legal nature of the problem
The VAT rules require a vendor who makes both taxable supplies and supplies other than taxable supplies (such as loans earning interest) to claim input tax only to the extent that
the goods or services concerned are acquired for consumption in making taxable supplies.

In terms of section 17 of the VAT Act, if the intended taxable use of the goods and services exceeds 95%, the goods and services concerned are regarded as having been acquired wholly for the purpose of making taxable supplies and the input VAT is then recoverable in full.

The current standard method of apportionment that all vendors must use as a default method, has various deficiencies.

**Detailed factual description of the relevant transaction/s**

**Current local principles**

The VAT 404 specifies that the denominator (total value of all supplies) “should include any other amounts ‘received or accrued’ in the period (whether in respect of supplies or not)”. The terms “received and accrued” are not defined in the VAT or Income Tax Acts. The High Court ruled in *Geldenhuys v CIR* [1947] (14 SATC 149) case that “received” means “beneficially received” (i.e. on the recipient’s own behalf) and in *CIR v People Stores (Walvis Bay) (Pty) Ltd* [1990] (52 SATC 9), that “accrued” means “unconditional entitlement”.

According to SARS, this means that vendors must include in the denominator (for example):
- Realised gains on foreign exchange transactions
- Dividend and interest income
- Proceeds of a debtor’s book securitisation (for working capital purposes).

The only approved method that may be used to apportion VAT incurred for mixed purposes, without specific prior written approval from the Commissioner, is the turnover-based method. This method applies by default in the absence of a specific ruling obtained by the vendor to use another method as there is usually a fairly good correlation between the income of a business and the resources (or costs) that are employed to produce that income.

The VAT 404 states that the following formula should be used:

Formula: \( y = \frac{a}{a + b + c} \)

Where:
- \( y \) = the apportionment ratio/percentage;
- \( a \) = the value of all taxable supplies (including deemed taxable supplies) made during the period;
- \( b \) = the value of all exempt supplies made during the period; and
c = the sum of any other amounts of income not included in “a” or “b” in the formula, which were received or which accrued during the period (whether in respect of a supply or not).

**International principles**

Generally, it is envisaged that the criteria in determining an appropriate apportionment method must take into consideration the following factors:

- A method should enable a vendor to reclaim no more input tax than that which is actually incurred to enable it to make taxable supplies, i.e. a basis which fairly reflects the intended use of the goods and services acquired;
- A method should be easily verifiable by the vendor and also SARS’ auditors; and
- A method should not be an unnecessary administrative burden on the vendor.

Whilst dividends received are, generally, high in value, the resources and costs that are used to earn this income are generally minimal. Where there is no relation between the different components of income and the costs incurred in respect of each type of income (i.e. taxable and non-taxable income) using income as a method to determine the taxable use of expenses does not provide an accurate reflection of the resources used to generate taxable and exempt supplies. International case law (refer Polysar and Sofitam cases below) suggests that where this is the case, dividend income should be excluded from the turnover-based formula.

European commentary on the case *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen* - Case C-60/90 states the following:

“Certain features of dividends account, in particular, for their exclusion from VAT. First, it is not in dispute that the existence of distributed profits is generally a prerequisite of paying a dividend and that payment is thus dependent on the company’s year-end results. Second, the proportions in which the dividend is distributed are determined by reference to the identity of the owner of a particular shareholding. Lastly, dividends represent, by their very nature, the return on investment in a company and are merely the result of ownership of that property”.

Commentary further provides that “in view, specifically, of the fact that the amount of the dividend thus depends partly on unknown factors and that entitlement to dividends is merely a function of shareholding, the direct link between the dividend and a supply of services (even where the services are supplied by a shareholder who is paid dividends), which is necessary if the dividends are to constitute consideration for the services, does not exist.” Thus, the receipt of dividends should not be included in the VAT apportionment denominator.

This was further supported by the European Union VAT case *Sofitam SA v Ministre chargé du Budget* C-333/91. In terms of the Sofitam case, it was held that the receipt of dividends must be “excluded from the denominator of the fraction used to calculate the
deductible portion” of input tax with respect to the standard turnover apportionment method because the receipt of dividends failed to satisfy and meet the definition and requirements for consideration for a supply.

**Difficulties in applying the above principles**

Holding companies receive dividends as a result of their shareholding in other companies. Where the holding company incurs the majority of its costs to provide services to group companies in return for management fees, an accurate apportionment ratio to claim input tax deductions will not be achieved. The Minister announced in the Budget Review in 2013 that the standard turnover method of apportionment for VAT purposes needs to be reviewed. More specifically, in the non-financial sectors, an apportionment formula based on turnover (or supplies made) would be inequitable where there is no direct correlation between costs incurred and the generation of income.

SARS’ view is that if an input is regarded as an overhead cost, the related expense is “tainted” and the input VAT paid should be apportioned in accordance with the ratio calculated above. This aspect is difficult to comprehend as although agreement can be reached in terms of what is regarded as overhead or not, it cannot be logically concluded that an overhead cost is utilised in the same proportion that the turnover method dictates. In other words, using income as a method to calculate a ratio to be applied to costs takes no cognisance in terms of what the associated costs are to be used for. This is in direct contradiction with the actual wording of section 17 which clearly states that an apportionment of input tax must be made in accordance with the same ratio 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 (albeit the ruling is acknowledged).

This means the purpose for which the cost was incurred must determine whether an apportionment is required. It cannot logically be deduced that a rental cost is used in the proportion determined by the turnover method to earn interest income as it is to earn the trading income. Even more absurd would be to attempt to attribute costs to the earning of exchange gains and the requirement to be prejudiced by the obligation to include exchange gains nonsensical.

The main aim of apportionment is to attribute VAT on inputs to the extent that the vendor makes taxable supplies. The method applied must correctly reflect the use to which inputs are put, and also the vendor’s activities.

By way of example, an investment company may spend large amounts on professional and consulting fees before it acquires a business in year 1. Furthermore, once the businesses have been acquired, the investment company will charge management fees. Only after some time will those investments yield dividends. The correct manner in which to apply apportionment would be to apportion the input tax on the costs incurred to determine whether or not to invest (i.e. the costs in year 1). The dividend income
earned after some time distorts the application of correct apportionment due to the current approved method that looks at income.

**The nature of the business/es impacted by the problem**
All vendors making any level of mixed supplies are impacted by the issue, especially holding companies.

**Proposal/s**
We propose that the default turnover method of apportionment be re-evaluated and either a revised turnover based method be considered or some other method. In this exercise the passive nature of the income derived by the vendor should be considered to arrive at an appropriate method.

We request that the legislation clearly sets out the principles to be applied when determining whether an apportionment of input tax is required or not. No such clear and precise guidelines exist.

It is customary for SARS to include obvious passive income streams in trading entities haphazardly without any due consideration as to how the expenses are utilised to generate income and without any due understanding as to the resultant consequence.

The basic principle of apportionment should be that the VAT treatment of inputs (fully claimable, fully disallowed or partially disallowed) should be an accurate demonstration of the purpose for which the expense was incurred. Using income to determine this is obviously flawed.

It may be conceded that an apportionment of input tax is required on particularly specific expenses where such exempt or non-supplies are apparent. However, it is not convincing and it is likely that a court would be similarly unconvinced to apply the ratio to each and every “overhead” expenditure item. Especially, where it can be shown that the effort (costs) of earning passive income such as interest and dividends is substantially less than with the earning of trading income and therefore using the pure turnover-based method would not provide a reasonable basis for determining an apportionment percentage.

As mentioned above, the VAT 404 stipulates what should be included in the denominator which includes all amounts received or accrued whether in respect of supplies or not. This implies that exchange gains are required to be included in the denominator. Again, it is difficult to concede to SARS’ view that all overhead expenses are utilised in the manner in which the turnover method dictates to earn such gain or making a loss. Particularly where the vendor concerned is not in the business of trading in foreign currency and merely earns the gain simply by virtue of the fact it sells in a currency other than that of the Republic of South Africa. The vendor would incur no lesser costs and perform no fewer activities if it had not incurred a foreign exchange gain. This fact supports that the gain/loss frankly happens without any identifiable or additional effort.
There may be bank costs that require direct attribution (fully denied), but this attribution dwarfs the broad application in the potential exposure tables above.

Insofar as it is a requirement to include interest income where the vendor is not in the business of lending money and earning a margin, it is similarly implausible for SARS to assume that the turnover method generates a ratio to be used equally across all overhead expenses.

In essence, using income as the logic to determine a ratio to apply to expenses is inequitable but also results in a completely distorted and erroneous result.

It is therefore requested, in light of the above comments, for the Commissioner to revise Its current stance in respect of apportionment methods and the manner in which it so broadly applies apportionment across expenses which patently have little or nothing to do with the earning of the exempt or non-supply income.

Introduce legislated time frames to compel SARS to finalise apportionment ruling applications and allow vendors to apply for retrospective apportionment rulings.

17. Section 17(1)(iii) of the VAT Act – back-dating of apportionment rulings

The legal nature of the problem
Section 17(1)(iii) of the VAT Act provides that:
“(iii) where a method for determining the ratio referred to in this subsection has been approved by the Commissioner, that method may only be changed “with effect from a future tax period, or from such other date as the Commissioner may consider equitable and such other date must fall-

(aa) in the case of a vendor who is a taxpayer as defined in section 1 of the Income Tax Act, within the year of assessment as defined in that Act, or

(bb) in the case of a vendor who is not a taxpayer as defined in section 1 of the Income Tax Act, within the period of twelve months ending on the last day of February, or if such vendor draws up annual financial statements in respect of a year ending other than on the last day of February, within that year.”

Detailed factual description of the relevant transaction
Prior to the amendment of the section in 2011, the retrospective effect of an apportionment ruling was not limited to the current financial year in which the approval is granted by SARS. Instead, the extent of the retrospectivity was purely subject to the period which the Commissioner may consider equitable. This principle is in line with the single most important requirement of any apportionment method, namely, that it must be equitable. By limiting the period to the current year of assessment can at best ensure that the method applied in that year is equitable, disregarding the fact that the method to be applied in prior years may be blatantly inequitable.
Based on the Explanatory Memorandum of 2011, the section was amended to ensure that where vendors apply for approval of an alternative apportionment method, any required retrospective effect is limited to the current financial year in order to ensure that such vendors cannot claim refunds of VAT excessively claimed in prior years due to the use of inequitable methods and to ensure that historic income tax returns for which the vendor was assessed, will not be required to be re-opened to adjust the deductible expenses and wear and tear allowances, as a result of the adjusted cost due to the new apportionment method applied.

In practice, many vendors have requested confirmation of apportionment rulings in 2007, in respect of which SARS has still not re-approved such method or any other method. Equally, in recent years most vendors who applied for alternative apportionment methods have not received any confirmation of an alternative method from SARS within a year. In these circumstances SARS is thus compelled to ensure that these vendors are required to use the standard turnover basis of apportionment for all prior years, regardless of the fact that this method may yield grossly inequitable results.

Further, many associations not for gain only realise now that they are compelled to use the turnover basis of apportionment, as a result of foreign and local donations and bequests received. In many cases the turnover basis does not yield equitable results, given the nature of the taxable costs incurred and the nature of the activities of these vendors. In these circumstances, these organisations are hugely prejudiced by the fact that an alternative method that yields equitable results cannot be applied to prior years.

We consider that this stringent rule introduced with no discretionary powers afforded to SARS to ensure equity and fairness, discards the very foundation of the concept of apportionment. Further, it most often results in undue enrichment of the fiscus at the expense of taxpayers.

The nature of the businesses impacted by the problem
This affects all partially exempt vendors, e.g. insurance companies, associations not for gain etc.

Proposal/s
We recommend that the section be amended to give SARS the discretion to approve of the alternative apportionment method with retrospective effect, reckoned from a date that the Commissioner considers to be equitable.

18. Section 41B of the VAT Act – Objection against rulings issued by SARS

The legal nature of the problem
The Commissioner is allowed, in terms of section 41B of the VAT Act read with Chapter 7 of the TAA, to issue a VAT class ruling or a VAT ruling. A taxpayer, is in terms of section 104(2)(c) of the TAA, allowed to object to any decision under a tax Act.
Section 32 of the VAT Act provides for the decisions to which a taxpayer may object against.

**Detailed factual description of the relevant transaction/s**

In terms of Chapter 7 of the TAA, a VAT class ruling or VAT ruling will have a binding effect upon the Commissioner, subject to certain requirements and limitations. Currently, once SARS has made a decision and issued a ruling, that decision is final, which decision is not subject to objection and appeal. Taxpayers may be prejudiced by the incorrect interpretations of the VAT Act in rulings issued by SARS. To ensure that fair administrative justice is effected, a taxpayer must be allowed to object to a ruling issued by SARS.

**The nature of the business/es impacted by the problem**

This issue impacts all vendors applying to SARS for rulings.

**Proposal/s**

We recommend that the decisions provided for in section 32 of the VAT Act be extended to allow a taxpayer to object to a ruling issued by the Commissioner in terms of section 41B of the VAT Act.

19. **Section 39(7) of the VAT Act - Remittance of Interest**

**The legal nature of the problem**

Section 39(7) of the VAT Act provides that where the Commissioner is satisfied that the failure on the part of a person to make payment of tax within the period required by the Act was due to circumstances beyond the control of the taxpayer, the Commissioner may remit the interest payable in whole or in part.

Chapter 12 of the TAA currently limits circumstances beyond the taxpayer’s control, to three scenarios, i.e. as is the case with section 218 of the TAA, which deals with the remittance of penalties in exceptional circumstances.

- a natural or human-made disaster;
- a civil disturbance or disruption in services; or
- a serious illness or accident.

Section 218 deals with the remittance of penalties in exceptional circumstances, and includes the three scenarios listed above as well as the following:
- serious emotional or mental distress;
- any of the following acts by SARS –
  - a capturing error;
  - a processing delay;
  - provision of incorrect information in an official publication or media release issued by the Commissioner;
o delay in providing information to any person; or
o failure by SARS to provide sufficient time for an adequate response to a request for information by SARS;

• serious financial hardship, such as –
  o in the case of an individual, lack of basic living requirements; or
  o in the case of a business, an immediate danger that the continuity of business operations and the continued employment of its employees are jeopardised; or

• any other circumstance of analogous seriousness.

Section 39(7) used to provide discretionary powers to the Commissioner to remit the interest imposed, *inter alia*, if the Commissioner was satisfied, having regard to the input and output tax, that the late payment/non-payment did not result in any financial loss (including any interest loss) to the *fiscus*.

**Detailed factual description of the relevant transaction**

With the introduction of the TAA, the penalty regime intensified drastically, presumably to encourage compliance and to sufficiently punish offenders. In this regard, for any non-payment or late payment of VAT, the 10% late payment penalty applies, interest is imposed and understatement penalties are imposed (if the understatement did not result due to *bona fide* inadvertent error) generally either at 25% or 50%, unless the vendor was grossly negligent or intended to evade the payment of tax. However, if a vendor detects an underpayment of VAT and makes voluntary disclosure in terms of the voluntary disclosure programme (VDP), the Commissioner remits only the understatement to the extent indicated in the understatement penalty percentage table envisaged in section 223 of the TAA.

The VAT Act contains multiple intricacies, which often result in *bona fide* errors being made by vendors. Further, VAT is a transaction tax which is calculated using accounting or ERP systems, which in itself are often imperfect, not to mention the human intervention which inevitably results in *bona fide* human errors being made. In addition, since VAT is a tax collected by the *fiscus* only in respect of supplies made to persons who cannot claim full input tax, it follows that vendor to vendor supplies most often result in no VAT being collected by the *fiscus*, if both vendors make fully taxable supplies. However, despite the said realities, and unlike the case is with understatement penalties, the VAT Act and TAA provisions relating to the imposition/remittance of interest, disregard the fact that certain underpayments resulted due to *bona fide* inadvertent errors, which resulted in no financial loss or to a lesser financial loss to the *fiscus*.

It is trite law that interest, in substance, is the consideration payable for the use of someone else’s money. This is further evidenced by the concept of *mora* interest.

Based on the aforesaid, we submit that interest should legally only be imposed and be payable to the extent to which the *fiscus* suffered a financial loss (i.e. to the extent to
which the vendor used the money of the state). It is accordingly submitted that the discretionary powers currently afforded to the Commissioner with regards to the remittance of interest, are grossly inadequate and currently results in the undue enrichment of the state.

We acknowledge that it is not possible for the Commissioner to introduce a system where interest is only imposed to the extent of a financial loss suffered by the fiscus. We thus acknowledge that the Commissioner is to continue imposing interest on the full amount of VAT underpaid/late paid. However, to the extent to which the vendor can prove to the Commissioner that the interest imposed is excessive, given the extent of financial loss suffered by the fiscus, the Commissioner should have the obligation to remit any excess interest imposed.

**The nature of the businesses impacted by the problem**
All vendors ad impacted by the rules.

**Proposal/s**
We recommend that section 187(7) be amended to include the complete list of exceptional circumstances contained in section 218.

**20. Section 45A of the VAT Act – Method of calculating interest**

**The legal nature of the problem**
Section 45A of the VAT Act and Section 187(2) of the TAA provide for different methods of computing interest.

**Detailed factual description of the relevant transaction/s**
In practice the method of computing interest payable to/by SARS differs for VAT and other taxes.

**The nature of the businesses impacted by the problem**
The issue affects all vendors.

**Proposal/s**
We recommend that the VAT Act be aligned with section 187(2) of the TAA.

**21. Section 54 of the VAT Act – Agent and principals**

**The legal nature of the problem**
Section 54(2A)(a) provides that where any goods are imported into the Republic by an agent acting on behalf of another person, being the principal, such goods shall be deemed to be imported by such principal and not by the agent. Section 54(2A)(b) provides, *inter alia*, that:

“(b)*Notwithstanding the provisions of paragraph (a), where any goods are imported into
the Republic by an agent who is acting on behalf of another person who is the principal for the purposes of that importation and-

(i) The agent is a registered vendor; and

(ii) The principal is not a resident of the Republic and is not a registered vendor; and

(iii) the goods are imported by the principal for the purposes of a supply made or to be made by him to a person in the Republic; and

(iv) the agent obtains and retains documentary proof, as is acceptable to the Commissioner, that-

(aa) he paid the tax on importation on behalf of that principal; and

(bb) such agent and that principal agree in writing that the said tax has not and will not be reimbursed to such agent by that principal, that importation shall for the purposes of this Act be deemed to be made by such agent and not by that principal.’’

Section 8(20) of the VAT Act provides that where an importation of goods is deemed to have been made by an agent, as contemplated in section 54(2A)(b), such agent shall be deemed to make a supply of goods to the recipient of the supply by the principal as contemplated in subparagraph (iii) of that section.

Detailed factual description of the relevant transaction

Where a non-resident continuously and regularly imports goods into the Republic, for use or on-supply to any other person, that non-resident is liable to register as a VAT vendor in the Republic if its taxable turnover in a 12 month period exceeds the R1 million registration threshold. Where such non-resident is duly registered, the VAT incurred on importation will be claimable as input tax only by that vendor and section 54(2A)(b) does not apply. However, where a non-resident who is liable to register does not register as a vendor, such non-compliance will entitle the non-resident to the relief afforded by the section, by virtue of the fact that the person is not a resident of the Republic and not a registered vendor.

It is our understanding that the said sections were introduced to provide relief to vendors who purchase goods from non-residents (who are not liable and not able to register as VAT vendors), so as to avoid cascading.

The nature of the businesses impacted by the problem

Vendors that purchase goods from non-residents that are not liable/able to register as VAT vendors.

Proposal/s

We recommend that the word “registered” which precedes the word “vendor” in section 54(2A)(b)(ii) be deleted.
22. Section 72 of the VAT Act – Objection and appeal against section 72 rulings

The legal nature of the problem
Section 72 of the VAT Act provides that:
“If in any case the Commissioner is satisfied that in consequence of the manner in which any vendor or class of vendors conducts his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise in regard to the application of any of the provisions of this Act, the Commissioner may make an arrangement or decision as to—
(a) the manner in which such provisions shall be applied; or
(b) the calculation or payment of tax or the application of any rate of zero per cent or any exemption from tax provided in this Act, in the case of such vendor or class of vendors or any person transacting with such vendor or class of vendors as appears to overcome the difficulties, anomalies or incongruities: Provided that such decision or arrangement shall not have the effect of substantially reducing or increasing the ultimate liability for tax levied under this Act.”

Detailed factual description of the relevant transaction
We acknowledge that the concepts in section 72 seem to be unique in VAT systems across the globe. However, in an ever rapidly changing global environment, we contend that the concept envisaged in the section becomes increasingly essential.

We also acknowledge that, due to an incorrect interpretation of the section, the Commissioner has historically applied its discretion inappropriately to overcome administrative cumbersome issues, to condone past treatment where the fiscus did not suffer any financial loss etc. It is further acknowledged that unless the Commissioner treats applications for section 72 directives with extreme caution and diligence the Commissioner’s discretionary powers may have the effect of law making, which is confined to Parliament, as opposed to law administration. In addition, erroneous section 72 directives may deviate substantially from National Treasury’s policies as envisaged.

Our most recent experience is that the Commissioner now interprets the section so as to become superfluous. In this regard, the Commissioner tends to rely solely on the very wording of the legislation that causes the difficulties to suggest that the law does not make provision for a different interpretation or application, which is the very purpose of the section.

Neither the TAA nor the VAT Act makes provision for a taxpayer to object to any decision/direction made by the Commissioner in terms of section 72 of the VAT Act. This has the effect that where section 72 finds application and difficulties, incongruities and anomalies are experienced by a vendor in complying with any provision of the VAT Act, the vendor has no remedy in the TAA or VAT Act to rely upon should the Commissioner not apply the provisions of the section appropriately.
The nature of the business/es impacted by the problem
This issue impacts all vendors.

Proposal/s
We recommended that section 32 in the VAT Act be amended to include objections and appeals to section 72 rulings.

Proposals with respect to specific sections of the TAA, insofar as these sections relate to the administration of VAT

23. Section 213 of the TAA - Remittance of late payment penalties

The legal nature of the problem
Section 213 of the TAA imposes a percentage based penalty on the late payment of VAT. Section 217 of the TAA allows a taxpayer to request the Commissioner to remit the penalty imposed if the non-compliance results from a first incidence of non-compliance.

Detailed factual description of the relevant transaction
Often non-compliance results from circumstances beyond a taxpayer’s control. For example, a taxpayer’s internet connection may not be functioning or payments made via an EFT are not executed successfully. A taxpayer could make a calculation error or capturing error that is only discovered after the return is submitted.

If the non-compliance occurs more than once within a period of 36 months a taxpayer is without any remedy to request SARS to remit the penalty. In most instances, taxpayers do not have any intention not to make payment or postpone any liability in terms of a tax act. If a taxpayer is not entitled to request SARS to remit the penalty it will be severely prejudiced when the non-compliance occurred due to a bona fide inadvertent error.

The nature of the business/es impacted by the problem
This issue impacts all VAT vendors.

Proposal/s
We recommend that section 217 of the TAA be amended to allow a taxpayer to request the Commissioner to use its discretion to remit a late payment penalty if the non-compliance resulted from a bona fide inadvertent error.

24. Section 217 of the TAA – Remittance of penalties of first time offenders

The legal nature of the problem
Section 217(3) provides for the remittance of penalty if a penalty has been imposed in respect of-
• a first incidence of non-compliance;
• reasonable grounds for the non-compliance exists; and
• the non-compliance in issue has been remedied.

The terms “first incidence” is defined in section 208 as:
“means an incident of non-compliance by a person if no “penalty assessment” under this Chapter was issued during the preceding 36 months, whether involving an incidence of non-compliance of the same or a different kind, and for purposes of this definition a “penalty assessment” that was fully remitted under section 218 must be disregarded.” (our emphasis)

**Detailed factual description of the relevant transaction**
Considering that personal income tax returns are submitted once a year, and that provisional taxpayers are liable to submit at least two returns in a twelve month period, the reference to “36 months” in respect of VAT and PAYE, where monthly returns are to be filed, seemed excessively onerous.

**The nature of the businesses impacted by the problem**
This issue impacts all vendors.

**Proposal/s**
We recommend that periods shorter than 36 months are prescribed in respect of VAT and PAYE where monthly or two-monthly returns are to be submitted.

**25. Section 221 of the TAA – Understatement penalties**

**The legal nature of the problem**
Section 221 of the TAA defines the term “substantial understateement” as meaning a case where the prejudice to SARS or the fiscus exceeds the greater of five per cent of the amount of tax properly chargeable or refundable under a tax Act for the relevant tax period, or R1 000 000.

Section 223 provides that a 10% or 20% understatement penalty is imposed in respect of “substantial understatements”, unless there is voluntary disclosure.

**Detailed factual description of the relevant transaction**
We submit that the reference to the greater of 5% or R1 million per tax period, in respect of VAT where monthly or two-monthly returns are to be filed is too high, in comparison with say income tax.

**The nature of the businesses impacted by the problem**
This issue impacts all vendors.
Proposal/s
We recommend that the threshold for the quantification of a substantial understatement for VAT purposes be reconsidered.

26. Section 225 of the TAA – The meaning of a default

The legal nature of the problem
Section 225 defines the term “default” as meaning the submission of inaccurate or incomplete information to SARS, or the failure to submit information or the adoption of a tax position, where such submission, non-submission, or adoption resulted in:
- the taxpayer not being assessed for the correct amount of tax;
- the correct amount of tax not being paid by the taxpayer; or
- an incorrect refund being made by SARS.

Section 227 provides that one of the requirements for a voluntary disclosure is that the disclosure must involve a “default” which has not previously been disclosed by the applicant or a person referred to in section 226(3).

Detailed factual description of the relevant transaction
From the said provision, it appears as if a taxpayer is only entitled to make voluntary disclosure once, in respect of a default. However, the broad definition of “default” has no regard to the actual nature of the problem, giving rise to the understatement. This has the effect that, on a strict interpretation of the section, a taxpayer can only make voluntary disclosure once, regardless of the reason giving rise to such understatement.

It is acknowledged that the relief afforded in terms of the VDP may not have been intended to find application multiple times in respect of the same kind of errors. However, it is further believed that the VDP has as one of its objectives to promote tax compliance and to grant relief of understatement penalties where the taxpayer becomes aware of an understatement and wishes to regularise its tax affairs without incurring the full understatement penalty.

It goes without saying that multiple reasons may exist that result in an understatement, especially in the case of VAT, where input tax and output tax are to be accounted for on all taxable goods or services acquired or imported and on all taxable supplies made, including all the documentary requirements prescribed, not to mention the number of deeming provisions in the VAT Act.

The nature of the businesses impacted by the problem
This issue impacts all vendors.
Proposal/s
In order to ensure that vendors are able to make use of the relief afforded by the VDP in respect of each specific type of error detected by the vendor, we recommend that the definition of “default” be amended to make reference to a specific error made, which resulted in the taxpayer not being assessed for the correct amount of tax; the correct amount of tax not being paid by the taxpayer or an incorrect refund being made by SARS.

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

Yours faithfully

Piet Nel CA(SA)
PROJECT DIRECTOR: TAX
The South African Institute of Chartered Accountants (SAICA)