Dear Sir

VALUE ADDED TAX (“VAT”): COMMENTS SUBMISSION ON ZERO-RATING OF LOCALLY SUPPLIED SERVICES ON BEHALF OF FOREIGN PRINCIPALS

We set out below the SAICA VAT Sub-Committee’s (a Sub-Committee of SAICA’s National Tax Committee) submission comments in relation to the zero-rating of locally supplied services on behalf of foreign principals.

Background

The South African VAT system is based on the destination basis, that is the final consumer of goods and services must bear the cost of the VAT charge in the supply chain.

The above is achieved by levying VAT on the local supply of goods and services, the importation of goods and the importation of services under certain circumstances. The VAT system then contains an input tax credit system for recipients of goods and services who are not the final consumer thereof. This ensures VAT equilibrium in the overall supply chain.

Difficulties arise where local suppliers make supplies to local recipients on behalf of non-residents who are not registered vendors in South Africa. Under these circumstances special rules are required to avoid non-recoverable VAT being incurred by the local recipient.

As an example: a UK company contracts with a RSA supplier of goods and service to make a supply to a RSA recipient. Without special rules, the RSA supplier would be required to charge VAT to the UK company (being its principal). The UK company will not be able to recover the VAT so charged and will accordingly on-charge the VAT to the RSA recipient as part of its overall price. This causes an unintended and undesirable escalating effect of the VAT cost in the supply chain.

There are three areas that need to be addressed to overcome the above difficulty; (1) where goods are supplied by a local supplier to a local recipient on behalf of a non-vendor foreign principal, 2) where services are supplied directly in connection with moveable property on
behalf of a foreign principal, such goods being supplied to a local recipient, and (3) where services are supplied to a local recipient by a local supplier on behalf of a foreign principal.

**The VAT Act**

Section 11(1)(q) caters for situation (1) above while section 11(2)(I)(ii)(bb) caters for situation (2).

No rule currently exists in the VAT Act to avoid the cascading effect caused by situation (3) above.

**Proposals**

We recommend that a special rule be introduced equivalent to section 11(1)(q) of the VAT Act. We proposed the following wording for the new section:

Section 11(2)(?) the services –

(i) are supplied by a vendor to a person who is not a resident of the Republic and not a vendor and who has contracted with the vendor to supply services to a recipient, who is a vendor in the Republic; and

(ii) form part of a supply by the person referred to in paragraph (i) to the recipient; and

(iii) are used by the recipient wholly for the purpose of consumption, use or supply in the course of making taxable supplies.

A further amendment would be required to exclude such services from the ambit of imported services to avoid a cascading effect. This is to avoid SA VAT being recovered by the foreign principal in its sales price and further non-recoverable VAT on imported services being payable where the recipient of the service will not be using the services in the course of its VAT enterprise.

For example, a foreign principal enters into an agreement with a RSA non-VAT registered person to supply (say) training services. The foreign principal sub-contracts the services to a local supplier. The local supplier will have to charge VAT on its invoice to its foreign principal (the local recipient not being registered as a vendor). The foreign principal would recover the VAT cost from its client in SA (i.e. he would charge R114 for his services). The SA recipient would be required to account for VAT on the imported service (i.e. 14% of R114). The effective amount of non-recoverable VAT in the supply chain therefore escalates to 29.96% (14% + 14% of 114). If the supply had been made directly by the RSA supplier to the RSA recipient, the net VAT cost would have been 14%, as intended in destination based VAT systems.
We recommend a new sub-section be introduced in section 14 to exclude any services falling within the ambit of the new section 11(2)(?). The following could be potential wording for the section:

Section 14(5)(e)
*a supply of services as contemplated in section 11(2)(?).*

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

Yours faithfully

Muneer Hassan CA(SA)
**PROJECT DIRECTOR: TAX**
The South African Institute of Chartered Accountants

cc: Keith.Engel@Treasury.gov.za
    nalberts@sars.gov.za
    laconnell@sars.gov.za