Dear Sir

REQUEST FROM NATIONAL TREASURY: SUGGESTED 2008 AMENDMENTS TO THE VALUE ADDED TAX ACT

Set out below please find the SAICA VAT sub-committee’s submission on the above-mentioned subject.

Introduction

There are a number of critical areas in the VAT Act that requires attention and clarification. This applies both to the current wording of certain sections in the VAT Act as well as interpretational issues.

The most significant issues from a VAT policy point of view is the need for place of supply rules and clarity on SARS’ interpretation of the term “directly in connection with” as envisaged in section 11(2)(l) of the VAT Act.

The above issues will need to be dealt with at the policy level and will form the subject matter of formal submissions in 2009 by the SAICA National Tax Committee. This document only deals with potential amendments to the VAT Act that does not require policy decisions.

Section 16(3)

Section 16(3) of the VAT Act currently determines that the net amount payable to SARS must be calculated “by deducting from the sum of the amounts of output tax of the vendor which are attributable to that period, as determined under subsection (4), and the amounts (if any) received by the vendor during that period by way of refunds of tax charged under section 7(1)(b) and (c) and 7(3)(a), the following amounts, namely-”
The requirement to include amounts of refunds received in respect of payments in terms of 7(1)(c) of the VAT Act in the computation of the net amount payable to SARS results in nullifying any refund of VAT on imported services (thereby unduly increasing the VAT burden on the vendor). The intention with the inclusion of refunds received in terms of VAT paid on the importation of goods (section 7(1)(b)) and VAT paid on excisable goods and subject to the environmental levy (section 7(3)(a)) in the amount to determine the net amount of VAT payable to SARS, is based on the assumption that the vendor will be entitled to an input tax deduction in respect of the original payment of VAT made. This ensures that the vendor does not get a “double refund” of the VAT paid, i.e. such amounts qualifying as normal deductible input tax and being refunded by customs and excise through the refund mechanisms applicable there (on the overpayment of VAT and customs and excise duties).

VAT payable in terms of section 7(1)(c) of the VAT Act is however only payable to the extent that services are acquired for the purpose other than making taxable supplies (normally non-enterprise (exempt) activities). Such amounts paid can never constitute taxable supplies. Where VAT on imported services are accordingly refunded on the basis of there being an overpayment (which generally would be the result of having overstated the extent of the exempt use), the amount of VAT initially paid would not have been recoverable through the normal VAT system. These amounts should accordingly also not be added to output tax attributable to a tax period as is currently required.

The above can be explained by the following example. Assume that a vendor imports services with a value of R100. At the time of importation the vendor estimates that he will use the services 30% of taxable purposes (i.e. 70% for exempt/non-enterprise purposes). After the importation the vendor discovers a computation error. The actual use of the service will be wholly for taxable purposes. The vendor initially pays VAT @ 14% of R70, but thereafter applies for a refund of the amount so paid on the basis that no VAT was payable on the import of the service (being used wholly for taxable purposes).

The VAT payable on the importation of the service should be nil, the supply being used wholly for taxable purposes. The practical effect of the current wording of the Act is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT Paid on importation (R70*14%)</td>
<td>R9.80</td>
</tr>
<tr>
<td>Input tax deduction (not input tax as defined)</td>
<td>Nil</td>
</tr>
<tr>
<td>Refund received on application</td>
<td>R(9.80)</td>
</tr>
<tr>
<td>Refund added to output tax (section 16(3))</td>
<td>R9.80</td>
</tr>
<tr>
<td>Net cost to the vendor (not recoverable)</td>
<td>R9.80</td>
</tr>
</tbody>
</table>

We recommend that the section be amended as follows:

“by deducting from the sum of the amounts of output tax of the vendor which are attributable to that period, as determined under subsection (4), and the amounts (if any) received by the vendor during that period by way of refunds of tax charged under section 7(1)(b) and (c) and 7(3)(a), the following amounts, namely-”.

Sections 8(2) and 22(3)(b)(ii)(dd)

The combination of the above sections has the effect that a vendor who decides to deregister and who holds capital assets at the time of deregistration will be required to account for
output tax on both the value of the assets held on the date of deregistration as well as the outstanding debt relating to such assets. Where significant assets have been acquired under instalment sale agreements, this will represent a significant cost to the vendor.

The above can be demonstrated by the following example. Assume that a vendor acquires new machinery for R1,140,000 (including VAT at 14%) the day before he decides to deregister as a VAT vendor. The vendor settles the supplier’s account the day after he has deregistered as a vendor. Section 8(2) will require an adjustment of R140,000 and a further adjustment of R140,000 will be required in terms of section 22(3)(b)(ii)(dd), the debt not having been settled at the time of deregistration.

The above double taxation could not have been intended by the legislator. We therefore recommend that section 22(3)(b)(ii)(dd) be amended to exclude any goods or services to which section 8(2) applies.

Section 22(3)
Further to the above we recommend that section 22(3) be amended to exclude inter-group transactions where both parties are registered vendors. The current situation does not add anything to the coffers of the fiscus but results in significant practical difficulties within a group context. Alternatively it should only apply to inter-group transactions where one group company has made an adjustment for doubtful debts.

Section 1 - definition of foreign donor funded project
The current ambit of the definition only includes donations by foreign governments to South African state institutions. Consideration should be given to expanding the ambit of the definition to include local donors. Local donors are currently reluctant to make donations where the VAT cost is a cost to the projects. The definition may still be restrictive as far as the application of the funds and the nature of funded projects are concerned, but should not exclude local donors.

Further comments
We further recommend that consideration be given to the implementation of the recent recommendations made by SAICA re the import/export process in our submission dealing with this issue.

Please do not hesitate to contact me should you wish to discuss the above.

Yours faithfully

M Hassan CA(SA)

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