23 November 2020

To: The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS, 299 Bronkhorst Street
PRETORIA
0181

VIA EMAIL: National Treasury (2020AnnexCProp@treasury.gov.za)
SARS (acollins@sars.gov.za)

Dear Colleagues,

RE: ANNEXURE C PROPOSALS: VALUE-ADDED TAX

We attached the proposals from the SAIT VAT Technical Work Group (the WG) on as it pertains to VAT and related matters. We value the opportunity to participate in the legislative process and would welcome further engagement where appropriate.

Please do not hesitate to contact us should you need further information.

Yours sincerely,

SAIT VAT Technical Work Group

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All references are to legislation are to the Value-Added Tax Act, No. 89 of 1991, unless otherwise indicated.

1. SECTION 72 MATTERS

[Applicable provision: Section 72-rulings]

1.1 Proposal

1.1.1 Section 72 effectively provides that when a vendor (or class of vendors) experiences difficulties, anomalies or incongruities in applying any provisions of the VAT law as a result of the manner in which its enterprise is conducted, the SARS may issue a ruling to overcome such difficulties, anomalies or incongruities.

1.1.2 Following a review, section 72 was amended (effective 1 July 2019). In March 2020, SARS noted that the reason for the amendment included factors to:

- Limit the Commissioner's discretion in making a decision under section 72
- Clarify the circumstances for which section 72 can be used
- Align the wording of section 72 with the policy intent of the VAT law as a whole, as well as the intention behind any specific provisions in the law that might be applicable.

1.1.3 All existing rulings issued prior to 21 July 2019—and that cease to be effective between 21 July 2019 and 31 December 2021—are subject to transitional rules introduced by SARS but can, in certain instances, be reconfirmed. However, all rulings and reconfirmed rulings will expire no later than 31 December 2021.

1.1.4 In order to provide certainty, and to assist with the process, the WG is starting a project to gather information regarding existing rulings that various industries are currently relying on. The intention is to create a list of priority rulings that should be considered as part of the Annexure C process.

1.1.5 The WG requests engagement with National Treasury in order to define the scope of rulings that may be considered for inclusion into Legislation.

2. SECTION 45

[Applicable provision: Section 45 of the Income Tax Act, No. 58 of 1962]

2.1. The legal nature of the problem

2.1.1. Section 8(25) of the VAT Act provides for rollover relief for entities that embark on a restructure or reorganisation in terms of the so-called corporate rules, as long as the supplier entity and recipient entity are vendors and the requirements in terms of the Income Tax Act are complied with. However, in terms of a section 42 (asset for share) or section 45 (intra-group) transaction, section 8(25) requires that a going concern be supplied//disposed of, for the transaction to qualify for VAT rollover relief.

2.1.2. In instances where trading stock or a capital asset (e.g. fixed property) is transferred in terms of section 42 or section 45, the rollover relief would not apply as no going concern or business is being transferred (refer to the proviso to section 8(25)) – this leads to a cash flow issue as the supplier entity has to levy VAT at the standard rate of 15% on the transfer of the assets to the recipient entity.

2.2. Detailed factual description

2.2.1 A company may embark on a restructure for various commercial reasons e.g. grouping core business functions, streamlining businesses to achieve savings, ensuring optimal asset utilisation, and so forth – these transactions do not always entail the transfer of a business (lock stock and barrel) or a standalone business, in order to achieve the desired outcomes. Currently, income tax rollover relief exists for these types of transactions but the VAT Act has a stringent requirement in that for rollover relief to apply (to a section 42 or section 45 transaction), a whole business / stand-alone business must be transferred (i.e. the disposal of a “going concern”).

2.2.2 The Transfer Duty Act (where VAT does not apply) also provides for rollover relief for single transfers of fixed property in terms of section 42 or section 45, but if this transfer was a taxable supply, VAT would apply to the transfer/supply at the standard rate of 15%. Notwithstanding the fact that there is a “supply” by the supplier entity for VAT purposes, economically, there is no “consumption” of any goods that takes place by the recipient entity within the group.

2.2.3 There is no tax avoidance, scheme for obtaining an undue tax benefit, or consumption that occurs if VAT rollover relief was granted for asset transactions in terms of section 42 or section 45, where there was no disposal of a going concern.

2.3 The nature of the businesses impacted

2.3.1 Group entities that embark on a restructure/ reorganisation for commercial reasons.

2.4 Proposal

2.4.1 We propose that the going concern proviso be deleted.

3. BINDING GENERAL RULING (VALUE-ADDED TAX) 55: SALE OF DWELLINGS BY FIXED PROPERTY DEVELOPERS FOLLOWING A CHANGE IN USE ADJUSTMENT UNDER SECTION 18(1) or 18B(3)

[Applicable provision: Section 18(1) and 18(3)]

3.1 Legal nature of the problem

3.1.1 The BGR provides the following in paragraph 3: *"The subsequent sale of a dwelling in respect of which the developer was required to have declared the deemed supply under section 18(1) or 18B(3), is not subject to VAT. The purchaser will be liable for transfer duty on the acquisition of such dwelling."*

3.1.2 Section 18B came into operation with the intention to provide relief to developers that:

- constructed, extended or improved dwellings for the purpose of sale; and
- subsequently applied such dwellings for exempt supplies under section 12(c)(i), namely, supplying accommodation in a dwelling under an agreement for the letting and hiring thereof, on a temporary basis. The temporary relief was initially intended to expire on 1 January 2015. However, the relief period was extended until 31 December 2017.

3.1.3 The intention of the developer must therefore be the construction, improvement etc. for the purpose of sale before it would qualify for the relief in section 18B. After expiry of section 18B, the normal rules will apply as envisaged in section 18(1) and the requirement remains that the intention of the developer should be for the purposes of making taxable supplies. The change in use occurs as a result of i.e. adverse economic conditions which results in the developer having to delay its taxable supplies until market conditions improve.

3.2 A detailed factual description

3.3.1. A Developer constructs a dwelling for the purpose of sale on 1 February 2017 and incurs the following costs:

- Building material – R 11 500 (inclusive of VAT)
- Labour/wages – R50 000 (no VAT applicable)

3.3.2. The Developer claims an input tax deduction of R 1 500 in its 2017/02 VAT return in respect of the building materials.

3.3.3. On 1 July 2017, the Developer realises that the dwelling remains unsold at an asking price/open market value of R115 000 (including VAT) due to adverse economic conditions and starts letting the dwelling for a 36 month period under section 12(c)(i). The Developer applies section 18B(2) which results in it not having to declare output tax as the change in use will not be deemed to be a taxable supply and no adjustments are required in terms of section 18(1).

3.3.4. 36 months later, on 30 June 2020, the Developer is still letting the dwelling as the economic conditions remains the same and the asking price of R115 000 is still unattainable. An output tax adjustment is now required in terms of section 18B(3) read with section 10(7) as follows:
Deemed supply @ Open market value: 115 000 x 15/115 = R15 000.

3.3.5. The above will result in the Developer having to pay R15 000, as opposed to the R1 500 initially claimed. a nett amount of R 13 500 over to SARS (R15 000 – R 1 500). It is evident that the value determination in 10(7) will have the unintended consequence of recovering more VAT than was initially claimed by the Developer. It will also result in severe cash flow implications as the Developer will have to finance the VAT without having actually received it from a third party.

3.3.6. We recommend that only the input tax initially claimed by the Developer be paid back i.e. R 1 500.

3.3.7. With reference to 3.1.1 above, the BGR further incorrectly requires the actual sale not to be subject to VAT but for transfer duty to be payable. This will result in double taxation and the Developers will be unable to compete with its peers as its ultimate sale price will be unduly inflated: ~
Open market Value R115 000 plus transfer duty = Cost of acquisition.

3.3.8. The intention of the Developer has not changed and the actual sale will be subject to VAT at 15% and not transfer duty as stated in the BGR. The Developer will have to make an input tax adjustment for the R15 000 output already declared and thereafter declare the R15 000 output tax (or actual consideration received) again on transfer of the property in terms of section 9(3)(d).

3.3 The nature of the businesses impacted

3.4.1. Residential property Developers – retrospectively and prospectively.

3.4 Proposal

3.4.1 We recommend that only the initial input tax deduction be repaid to SARS until such time as the supply is made to a third party whereafter a 16(3)(h) adjustment can be claimed together with the output tax liability in terms of section 7(1)(a).

4. VDP UNIT'S VIEW ON PRESCRIPTION

[Applicable provision: Various sections of the Tax Administration Act, No. 26 of 2011]

4.1 Legal nature of the problem

4.1.1 The purpose of the voluntary disclosure provisions is to encourage taxpayers to disclose their defaults where such defaults are identified at a later stage. This is done by, *inter alia*, reducing the understatement penalties and waiving administrative penalties where the taxpayer voluntarily discloses its default.

4.1.2 Currently, there is no explicit provision in the TA Act that states that the prescription rules as contemplated in section 99 of the TA Act are not applicable to VDP. However, SARS is of the view that the VDP provisions overrule the prescription provisions as VDP assessments are issued in terms of section 232 of Chapter 16 of the TA Act and therefore section 99 in Chapter 8 of the TA Act is not applicable. This is contrary to the purpose and scheme of the VDP and the objective of prescription in any event, section 232 only functions to give effect to the voluntary disclosure agreement envisaged in section 230, with the result that it cannot function to assess a taxpayer otherwise than to give effect to the agreement.

4.1.3 This further discourages vendors from making a VDP application to SARS. In this regard it is submitted that, if the TA Act is interpreted as such that the prescription rules do not apply in respect of the voluntary disclosure programme, it will in many instances be more beneficial for the taxpayer, where a default has occurred over a long period of time not to make use of the voluntary disclosure programme but to rather amend the return previously submitted to SARS, i.e. VAT201 returns for the past 5 years on the basis that the previous periods have been prescribed and where the behaviours as set out in 99(2) of the TA Act are not applicable. In practice, SARS does not impose any understatement penalty when these corrections are made, leaving the taxpayer liable for the administrative penalty and interest. In our view, this outcome defeats the purpose of the voluntary disclosure programme.

4.1.4 In addition, the VDP disclosure must be full and complete in all material respects. In order to do this, the taxpayer must have the relevant records. In this regard, section 55 of the VAT Act provides which documents must be retained by a taxpayer in addition to those documents that have to be kept in terms of the records required under Part A of Chapter 4 of the of the Tax Administration Act. Section 29(1) of the TA Act provides that a person must keep the records, books of account or documents that will enable the person to observe the requirements of a tax Act, that are specifically required under a tax Act; and that will enable SARS to be satisfied that the person has observed these requirements. Section 29(3) provides that these records need not be retained by the person after a period of five years from the date of the submission of the return.

4.1.5 If prescription rules are not applied under VDP and taxpayers are required to disclose a liability in excess of five years with no full and complete records to substantiate this liability, there is the risk that the disclosure will not be full and complete.

4.1.6 In response to the above, SARS is of the view that in the event the taxpayer does not have documentary evidence for prescribed periods, SARS will accept reasonable estimates in this regard. This in our view is not a full and complete disclosure and not a sustainable approach. The assessments under these circumstances are arguably invalid assessments.

4.2 Proposal

4.2.1 In order to eliminate this interpretation and ensure alignment throughout the TA Act, an amendment is proposed to specifically provide that VDP assessments are subject to Chapter 8 of the TA Act.

5. THE REGISTRATION OF A BRANCH OF A FOREIGN BUSINESS FOR VAT IN SOUTH AFRICA

[Applicable provisions: Section 1: Definition of "enterprise" – Par (a) and proviso (ii); section 8(9), and section 11(2)(o)]

5.1 Policy rationale

5.1.1 The specific issue arises when the branch of a foreign business wishes to register for VAT on the basis of certain activities performed to or for the benefit of its main business outside South Africa.

5.1.2 Proviso (ii) to definition of "enterprise" - Wording prior to 24 January 2005

"(ii) 'the supply outside the Republic of goods or services by any concern from any branch or main business thereof where such branch or main business in permanently located at premises outside the Republic—
(aa) the branch or main business can be separately identified; and
(bb) an independent system of accounting is maintained by the concern in respect of the branch or main business,
shall be deemed not to be affected in the course of furtherance of any enterprise or activity carried on by such concern;"

5.1.3 Proviso (ii) to definition of "enterprise" - Wording after 24 January 2005

"(ii) 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) the branch or main business can be separately identified; and
(bb) an independent system of accounting is maintained by the concern in respect of the branch or main business;"

5.1.4 As discussed below, the above amendment was inserted to cause the branch/main business in SA and the main business/branch outside SA to be deemed separate persons for VAT purposes in order to facilitate the supply of goods and services between the local enterprise and the foreign main business/branch. Therefore, the consignment or delivery of goods or the provision of services to or for the purposes of a main business/branch outside SA are deemed to be taxable supplies in terms of section 8(9).

5.2 Legal nature of the problem

5.2.1 Background

5.2.1.1 Apart from the amendments to section 11(2)(o) in 1993 and 2006, which were aimed at bring the zero-rating provision in line with the changes to section 11(2)(l), an amendment to proviso (ii) to the definition of "enterprise" was promulgated on 24 January 2005. In terms of this amendment the explanatory memorandum issued by Treasury stated the following:

"The Act provides that supplies made by a branch or main business of an enterprise situated outside South Africa shall not be regarded as supplies made by the South African enterprise. It is proposed that the non-South African enterprise be regarded as a separate person for VAT purposes to ensure that the normal rules relating to exports and imports as well as of the supply of services will apply to the foreign branches or main businesses."

5.2.1.2 An amendment to section 8(9) was promulgated in 2004 in terms of which Treasury stated the following in its explanatory memorandum:

"Under current law where goods are transferred by a vendor to his or her branch or main business outside the Republic the vendor is deemed to supply goods in the course or furtherance of his or her enterprise. The current use of the word "transfers" leads to abuse where the ownership title in the goods was transferred to an entity outside the Republic (at the zero rate) without the physical transfer/export of the goods. It is proposed that section 8(9) of the Act be amended to provide that the goods must be consigned or delivered to a branch or main business of a vendor at an address which is outside South Africa. This amendment is to ensure that the zero-rating will apply only if the goods or services are consigned or delivered to such branch or main business. "

5.2.1.3 There were no other significant changes to the abovementioned sections.

5.2.2 Change in interpretation by SARS

5.2.2.1 Prior to 2020, the South African Revenue Service ("SARS") issued rulings confirming that, where a foreign business set-up an office in SA to perform certain functions (e.g. business support, administration or sales & marketing activities) for its business outside SA, such business or activities in SA would constitute an enterprise for VAT purposes separate from its head office or branch at premises outside of SA, and accordingly would be able to register for VAT in terms of section 23.

5.2.2.2 However, based on recent correspondence with SARS it would appear that this policy has now changed. SARS is now of the view that where the foreign business does not make supplies which are subject to SA VAT (i.e. on the basis that such supplies are not made in or partly in SA), any branch established in SA would not be making taxable supplies for VAT purposes and therefore will not be allowed to register for VAT in SA in terms of proviso (ii) to the definition of 'enterprise' in section 1(1) of the VAT Act. In SARS' view the purpose of proviso (ii) is to ensure that the foreign business' business activities outside the Republic do not form part of any enterprise carried on in SA. Where the branch in SA does not make supplies to any other person apart from the foreign branch or head office, SARS is of the view that such SA branch is not carrying on an enterprise and therefore not entitled to register independently from its head office from VAT.

5.2.2.3 SARS has furthermore indicated that where the foreign branch/head office supplies services to third parties, the legal entity as a whole must register for VAT on the basis that the supplies are made partly in SA, by virtue of the SA branch performing administration, management or sales and marketing activities.

5.2.2.4 In commentary that seems contrary to the views expressed in previous rulings, SARS' interpretation of the abovementioned provisions is that proviso (ii) cannot be applied in order to regard the branch enterprise as a separate person from its main business situated permanently outside the Republic, where the foreign business does not carry on an enterprise as envisaged in paragraph (a) of the definition.

5.2.2.5 This approach appears incongruous with the intention of proviso (ii) to the definition of "enterprise" in section 1(1) of the VAT Act, as well as section 8(9) and results in a number of substantial practical difficulties for the vendor. On this interpretation, a foreign branch/head office making supplies to a third party would be required to issue a SA VAT invoice as well as a foreign VAT invoice for its supplies. SA VAT would need to be accounted for either at the zero-rate or at the standard rate in respect of the SA VAT invoice to the third party to the extent of the activities performed by its branch SA. Where such activities are 'internal' or 'back office' activities to support the main branch/head office and such as administration, management, sales and marketing support activities are recovered on a cost-plus basis, this effectively results in the vendor disclosing to third parties its internal costing. This approach also gives rise to additional complexity and reconciling differences as the vendor would most likely be required to account for foreign VAT/GST (in this case South African VAT) based on the full value of the supplies made to third parties.

5.3 A detailed factual description

5.3.1 Refer above.

5.4 The nature of the businesses impacted

5.4.1 Refer above.

5.5 Proposal

5.5.1 We require Treasury to confirm the intention of the abovementioned provisions in view of the sudden change in interpretation by SARS. We request that the intention of the legislation be investigated and if required, be amended to provide clarity as to whether the branch of a foreign business may register for VAT based on the goods or services it provides to or for the purposes of its main business or branch outside SA.

5.5.2 In its comments to the amendment of proviso (ii) Treasury has stated that the branch and its main business outside the Republic with effect from 2005 is to be regarded as separate persons for VAT purposes. This is to ensure that the branch would supply goods or services as a person separate from its main business and which includes supplies to its main business as envisaged in section 8(9).

5.5.3 The wording of the legislation suggests that the supplies made by a branch should be treated the same as if the foreign business incorporated a subsidiary in SA to perform the same functions in SA. It is therefore submitted that the branch and the subsidiary should equally be able to supply goods or services as taxable supplies to the main business.

5.5.5 It is therefore unclear as to why SARS has changed its policy and is now of the view that the branch would not be regarded as carrying on an enterprise where it engages solely in the activities envisaged in section 8(9).

5.5.6 There are many factors that foreign entities consider before deciding whether to establish a subsidiary or a branch of the foreign entity in South Africa. Either of these options could provide the same administration, management, marketing and support services for the purposes of the foreign entity. Based on SARS' current view, a subsidiary providing the same services as a branch would be able to register for VAT, deduct input tax incurred and possibly zero rate the supply in terms of section 11(2)(l), whereas the branch is not allowed to register for VAT. This has clearly resulted in a disparity when comparing a branch with a subsidiary providing the same services. Therefore, a supply between a SA branch and its main business is not treated in the same manner as a supply between the subsidiary and its holding company (i.e. main business).

5.5.7 This has a significant impact on foreign businesses that venture into South Africa, as the decision to register a branch will have unwarranted cost implications whilst a subsidiary would not.

5.5.8 In the interest of applying the rules equally to all foreign businesses operating in SA we respectfully request Treasury to intervene and provide clear guidelines regarding the intention of the legislation.

End.