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3 December 2021

To: The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS,
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VIA EMAIL: National Treasury (2022AnnexCProp@treasury.gov.za)
SARS (acollins@sars.gov.za)

Dear Colleagues,

ANNEXURE C PROPOSALS FOR BUDGET 2022: VALUE-ADDED TAX

We attach hereto the proposals from the SAIT VAT Technical Work Group (**the WG**) as pertaining to VAT and related matters. We appreciate and value the opportunity to participate in the legislative process and would welcome further dialogue and engagement where appropriate.

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

Yours sincerely

SAIT VAT Technical Work Group

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

1. PROVISION OF ELECTRONIC SERVICES BETWEEN FOREIGN MAIN BUSINESSES AND THEIR LOCAL SA BRANCHES

[Applicable provisions: section 1 of the Income Tax Act, No. 58 of 1962 (**the Income Tax Act**), section 1 of the VAT Act and section 8(9) of the VAT Act].

1.1. Introduction

1.1.1. The provision of services are rapidly moving away from the physical provision of services to the provision of electronic services. As a result of the increase in electronic services, it is becoming more commonplace for an entity in one jurisdiction to render services to an entity in another jurisdiction. These services are typically rendered by means of electronic mail. It is conceded that in addition to entities providing services to each other, it is not uncommon for a foreign main business to conduct business or supply inter alia electronic services to its local, South African branch/ main business.

1.1.2. For ease of reference, we set out the provisions that in our view find application when considering the scenario of electronic services being provided between foreign main businesses and their local branches below:

1.1.3. <u>Group of companies</u>

1.1.3.1. Section 1(1) of the Income Tax Act defines “group of companies” as follows:

> "*two or more **companies** in which one **company** (the 'controlling group company') directly or indirectly holds shares in at least one other **company** (the 'controlled group company') to the extent that -*
> *(a) 70 per cent of the equity shares in each company are directly held by the controlling group **company**, one or more controlled group **companies** or any combination thereof; and*
> (b) *the controlling group **company** directly holds 70 per cent of the equity shares in at least one controlled group **company**.*”

1.1.4. Enterprise

1.1.4.1. Paragraph (ii) of the proviso to the definition of "enterprise" in section 1(1) of the VAT Act 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 such branch or main business is separately identifiable and maintains a separate system of accounting"*

1.1.5. Supply

1.1.5.1. As defined in section 1(1) of the VAT Act, "supply" is widely defined as follows:

> *"includes performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply…and any derivative of 'supply' shall be construed accordingly"*

1.1.6. Recipient

1.1.6.1. A recipient is defined section 1(1) of the VAT Act as:

> *"the **person** to whom the supply is made."*

1.1.7. Person

1.1.7.1. A person is defined in section 1(1) of the VAT Act to include:

> *"body of persons (corporate or unincorporate)"*

1.1.8. The discussion below details our interpretation of these provisions as they apply to the rendering of electronic services between a foreign main business and their local, SA branch.

1.2. The legal nature of the problem

1.2.1. It appears that the *"group of companies"* exclusion (as outlined above) recognises a supply between **companies** and does not address scenarios whereby a foreign main business/branch renders electronic services to its South African branch/main business. At the outset, we accept that in the absence of deeming provisions, legally one cannot make a supply to oneself.

1.2.2. However, paragraph (ii) of the proviso to the definition of "*enterprise*" in section 1(1) of the VAT Act 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 such branch or main business is separately identifiable and maintains a separate system of accounting*"

1.2.3. It has been suggested that this provision is an implicit place of supply rule.

1.2.4. We are of the view that the import of this provision, read together with section 8(9) of the VAT Act, suggests that the two entities (foreign main business and the local South African Branch) are in effect merely and solely deemed to be separate "**persons**" for purposes of the "*enterprise*" definition – as confirmed in the recent *Wenco*[1] decision. In all other instances it is accepted that the main business/local branch are treated as one legal entity and there is general consensus that the provisions of the VAT Act should be applied on this basis.

1.2.5. If the aforementioned were not in fact the case, we are of the view that section 8(9) of the VAT Act would appear to be unnecessary. The provisions of section 8(9) of the VAT Act provides that supplies made by the **local** branch/main business to the **foreign** main business/branch are deemed to be made in the course or furtherance of the **local branch's/main business' (i.e. SA Branch)** enterprise.

1.2.6. To the extent that the SA branch and foreign main business were to be treated as separate persons for all purposes of the VAT Act, the "*supply*" by the local branch (SA Branch) to the foreign main business would have constituted a "*supply*" by the local branch to the foreign main business in the course or furtherance of its enterprise, and no deeming provisions would have been necessary. To this end, there is also general agreement that the deemed supply rule appears to operate one way, i.e., from the local branch (SA Branch) to foreign main business and not from the foreign main business to the local branch.

1.2.7. The interpretation of the above provisions questions whether it can be said that a foreign main business has made a supply of electronic services to its local branch (SA Branch).

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[1] Wenco International Mining Systems Ltd and Another v Commissioner for the South African Revenue Service (59922/2019) [2021] ZAGPPHC 70 (19 January 2021)

1.2.8. Paragraph (*b*)(vi) of the definition of "*enterprise*" includes:

> *"the **supply** of electronic services **by a person** from a place in an export country" to a **recipient** in South Africa or where payment for the services is made via a South African bank"*

1.2.9. On the basis that the deeming provisions of section 8(9) of the VAT Act do not apply as the services are being provided by the foreign main business, the foreign main business must in the first instance make a "supply" as defined in section 1(1) of the VAT Act to the local branch (SA Branch).

1.2.10. According to South African VAT law, it appears that in order to fulfil the "*supply*" requirement as outlined in the VAT Act requires a supply from one **person** to another. Paragraph (b)(vi) of the definition of "*enterprise*" and the definition of "*recipient*" also clearly contemplate the supply of one **person** to another.

1.2.11. While "*person*" is defined (**section 1(1) of the VAT Act**) as including a "*body of persons (corporate or unincorporate*)", a branch does not constitute a "*person*" as defined in its own right. It is therefore arguable that where a foreign main business provides "*electronic service*" type services to its local branch (SA Branch), no "*supply*" has been made to any other "*person*" and no charge to South African VAT arises as no "*electronic services*" will be supplied to SA Branch *qua* separate legal person.

1.2.12. It is recommended that to put the matter beyond doubt and dispute an exclusion similar to that applies where the parties are companies should be adopted.

1.3. Detailed factual description

1.3.1. A company established in the United Kingdom (**UKCo**) has a branch operation in South Africa that is a VAT vendor (**SA Branch**). UKCo provides various "electronic "services to SA Branch exceeding R1 million per annum. There is an argument that as such services constitute "electronic services" and the group of companies exclusion does not apply, UKCo is required to register as a vendor in SA.

1.3.2. There does not seem to be any policy imperative that requires main business/branch transactions of this nature to be subject to SA VAT in the hands of the non-resident main business/branch. Of course, to the extent that these services are utilised by SA Branch for making non-taxable supplies, the electronic services would constitute "imported services" in the hands of SA Branch.

1.4. The nature of the business / persons impacted

1.4.1. Foreign main businesses or foreign branches that renders electronic services to their South African branch/main business.

1.5. Proposal

1.5.1. It appears that the provisions of the VAT Act do not presently recognise foreign branches as separate from their foreign main business for VAT purposes (other than for the purposes of the definition of "enterprise" (as discussed above).

1.5.2. Therefore, the foreign main business and its SA branches are one and the same person for South African VAT purposes and no supply of "electronic services" should be triggered.

1.5.3. On this basis, it is proposed that the law and provisions that relate to the provision of electronic services between foreign main businesses and their branches be amended in cognisance of the discussion outlined above. We recommend that the regulations relating to the aforementioned clearly stipulate the above and should mirror the exclusion provided for a group of companies.

1.5.4. A provision along the following lines is recommended:

Electronic Services Regulations

Regulation 2(c): For the purposes...other than –
(a) ...
(b) ...
(c) ...
(d) services supplied by a branch or main business contemplated in paragraph (ii) of the proviso to the definition of "enterprise" to a branch or main business established in the Republic and those services are supplied to such branch or main business exclusively for the purposes of consumption of these services by that branch or main business.

2. PERMISSIBLE DEDUCTIONS IN RESPECT OF INPUT TAX - SECTION 17(1) OF THE VAT ACT

2.1. Introduction

2.1.1. One of the critical pillars of VAT is that VAT, as a tax, should not become a cost to a business unless specifically provided for in law. For example, the denial of VAT on entertainment expenses. Anything less results in tax cascading, which ultimately impacts the price of goods or services that businesses will pass on as a cost to its customers.

2.2. The legal nature of the problem

2.2.1. It is commonplace that the VAT Act allows a vendor 5 years to deduct input tax. In the case of apportionment (which is a necessary factor to deduct the input tax), a vendor only has a year to resolve a method.

2.2.2. In the *Mukuru Africa (Pty) Ltd v The Commissioner for the South African Revenue Services* (Case no 520/2020) [2021] ZASCA 116 that was delivered on 16 September 2021 (**Mukuru decision**) it was confirmed that SARS cannot approve an alternative method of apportionment retrospectively (i.e., for periods earlier than the year of assessment (**FY**) within which the vendor applies for this method to SARS).

2.2.3. In view of this judgment by the Supreme Court of Appeal (**SCA**) the current legislation has a negative impact on the mechanics and application of a VAT system. It follows that the SCA judgment effectively denies a vendor from deducting the appropriate amount of input tax which is contrary to the objective of the VAT Act and which, objectively, is unfair on an "involuntary tax collector" resulting in SARS ultimately collecting more tax than what is due by a taxpayer.

2.2.4. Previously, SARS had the discretion to approve a method of apportionment for retrospective and prospective tax periods where it was satisfied that the alternative method of apportionment was equitable or fair and reasonable. Under this approach, the normal 5-year prescription rule for input tax was applicable, that is, not unduly denying input tax. This approach accorded to the principles and objectives of a VAT system.

2.2.5. The purpose of the subsequent amendment to section 17(1) was, as stated in the explanatory memorandum, not to change this approach but rather to prevent taxpayers from applying to SARS to continuously change their already approved alternative methods of apportionment and prevent such methods from being retrospectively applicable.

2.3 Proposal

2.3.1. We recommend that SARS and National Treasury consider this outcome and amend the VAT Act to ensure that an "involuntary tax collector" only pays what tax is due in accordance with the structure and accepted principles of a VAT.

2.3.2. Our recommendation is to amend the proviso to make it clear that an alternative method will not be amended retrospectively. However, when a taxpayer first approaches SARS due to the standard turnover-based method not being appropriate, such first alternative method may be approved retrospectively, being limited to the 5-year prescription rule for input tax.

3. INTEREST ON DELAYED VALUE-ADDED TAX REFUNDS

3.1. Introduction

3.1.1. As part of the 2017 and 2018 Annexure C legislative cycle, we had previously submitted comments regarding the interest that is levied on delayed vat refunds. The below is a reiteration of the comments made in these submissions.

3.2. The legal nature of the problem

3.2.1. Interest payable by SARS on delayed VAT refunds is legislated in section 45 of the VAT Act. Section 45 of the VAT Act currently contains requirements that are not consistent with the requirements in section 187 of the Tax Administration Act, No. 28 of 2011 (**TAA**) that apply to the other forms of taxes.

3.3. Detailed factual description

3.2.1 SARS has 21 business days after the date on which the VAT return for a specific tax period was received, to refund any amount refundable. If SARS does not refund the taxpayer within this period, interest will accrue on the refund amount at the prescribed rate commencing on the 22nd business day, provided that a number of requirements that are more onerous than section 187 of the TAA are met.

3.2.2 For example, section 45(1)(iA) of the VAT Act provides for interest not to be paid where the vendor is in default, under any Act administered by the Commissioner, to furnish a return. This is not consistent with section 187 of the TAA and does not apply similarly from an Income Tax perspective. Interest should be calculated and paid on delayed VAT refunds even though other tax returns may be outstanding. There are specific sections in the TAA which has its own penalties and procedures for the late filing of tax returns. As a result, writing off the interest for delayed VAT refunds may result in a duplication of penalties.

3.2.3. The current legislation results in a disadvantage to the taxpayer, being a delay in the refund amount as well as a loss of interest.

3.4. The nature of the businesses impacted

3.3.1 All vendors who are in a refund position, or who will claim a refund from SARS in future could be affected.

3.5. Proposal

3.5.1. The proposed substitution of section 45 of the VAT Act will more closely align the interest on VAT refunds with Chapter 12 of the TAA and should be brought into effect.

4. ELECTRONIC SERVICES

[Applicable provisions: Section 1(1) of the VAT Act]

4.1. Introduction

4.1.1. In our view, SARS' approach regarding its interpretation of "electronic services" is contrary to the policy intent expressed by Government. Since the approach creates an undue VAT registration and tax liability for non-resident suppliers of such services, we anticipate that this interpretation will give rise to many disputes between SARS and taxpayers.

4.1.2. We provide our rationale below, and request that in order to give effect to the background and context to the amendment, consideration be given to amending the wording of relevant Regulation 2 to clearly indicate the intention that only services which are dependent on information technology and/or which are automated, i.e. services which are electronic in its nature and not merely delivered electronically (own emphasis) falls within the ambit of the Regulations.

4.2. Legal nature of the problem

4.2.1. Prior to 2014, South African residents acquiring services from a non-resident supplier, had to declare and pay VAT on imported services to SARS. However, this was only applicable to the extent that such services were used for purposes other than to make taxable supplies.

4.2.2. During March 2014, Regulations No.R221 was published in Government Gazette No. 37489 (the Regulations) , which prescribed the electronic services that fell within the definition of "*electronic services*" in section 1(1) of the VAT Act.

4.2.3. The Regulations changed the way certain electronic services acquired from non-residents were taxed, i.e. effectively requiring the non-resident supplier to register for VAT in South Africa and levy and pay VAT on such services to SARS.

4.2.4. The Regulations were subsequently amended in March 2019 to capture all services provided by means of an electronic agent, electronic communication or the internet for any consideration. As confirmed in the Explanatory Memorandum (EM) published on 18 March 2019, the amendment was effectively aimed at levelling the playing field between local and foreign suppliers of electronic services (the EM refers to the reduction of a distortion in trade between foreign and local suppliers where VAT is one of the reasons for such distortion).

4.3. Detailed factual description

4.3.1. National Treasury confirmed the policy intent of the above amendment, i.e. that the Regulations are intended to only capture those services where "minimal human intervention" (own emphasis) is required in order to provide such services. The EM further clarified what type of services it envisaged as not falling within the above by way of an example of legal advice (e.g. an opinion) prepared by a non-resident outside of South Africa and merely emailed to a local recipient, i.e. these are not electronic services falling within the ambit of the Regulations.

4.3.2. The above principle is reiterated and confirmed in the FAQs published by SARS. In question 43, SARS provides an example of architectural services merely being delivered via email and clearly states that this is not an electronic service as it requires substantial human intervention. Furthermore, the response states that the service is not dependent on information technology and is not automated (as such, is not an electronic service). SARS, reiterates that the services intended to be addressed by the updated Regulations should be *electronic in nature* (own emphasis) and not merely delivered via an electronic means like email.

4.3.3. In addition to this, SARS also indicates in question 7 of the FAQs that: *"Simply put, this means that from 1 April 2019, you will have to pay VAT on a much wider scope of electronic services (that is,* ***digital content supplied by electronic means*** *as set out above)"*. The analysis given by SARS in this response is clear and in line with the context of the amendment to the regulation, i.e. to capture digital content supplied electronically. This means that, in order for the services being supplied to fall within the ambit of the Regulations, it must, in its nature, be an electronic/digital service and (own emphasis) be supplied by an electronic means.

4.3.4. Despite the above, SARS has recently issued a ruling (attached) determining that the supply of legal and or similar advice by a non-resident supplier, which is emailed to the South African recipient constitutes "electronic services" as defined and falls within the ambit of the Regulations. As a result, SARS indicated that such supplier must register as a vendor in South Africa, levy and account for VAT.

4.3.5. We understand that SARS is basing its current view on a literal and narrow interpretation of the wording of Regulation 2, i.e. "any services supplied via electronic means". In our view, this interpretation disregards the background and context to the amendment as outlined in the EM.

4.3.6. Furthermore, this interpretive approach by SARS further disregards the approach adopted by the South African judiciary in arriving at certain recent tax judgments, that is, the courts took into consideration the relevant EMs (if any are available) in order to understand the context and background to the making of amendments. This can be observed in the following cases:

- In *CSARS v Respublica (Pty) Ltd*, the court considered the relevant EM in order to understand/interpret certain applicable definitions.

- In *XO Africa Safaris v CSARS*, the court stated that *the cardinal consideration in determining the intention of the legislature is to interpret the provision in the context of the Act as a whole, and its history and the explanatory memoranda in the event of any uncertainty*. The court also referenced and referred to the Natal case for the rules/guidance on how to interpret statutes.

- In *Master Currency v CSARS*, the court also considered the EMs in order to understand certain amendments to section 11(2)(l).

4.3.7. In our view, SARS' approach is contrary to the policy intent and creates an undue VAT registration and tax liability for non-resident suppliers of such services. From our perspective, this interpretation will give rise to many disputes between SARS and taxpayers.

4.4. The nature of the businesses impacted

4.4.1. All taxpayers that acquire electronic services from non-resident suppliers.

4.5. Proposal

4.5.1. In light of the facts outlined above and in order to give effect to the background and context to the amendment, we request that consideration be given to amending the wording of Regulation 2 to clearly indicate the intention that only services which are dependent on information technology and/or which are automated, i.e. <u>services which are electronic in its nature and not merely delivered electronically</u> (own emphasis) falls within the ambit of the Regulations.

5. REQUEST FOR CONTINUATION OR RE-ISSUE OF BINDING GENERAL RULING (VAT) 14 (ISSUE 3)

5.1. Reference is made to the submission made by members of the South African Insurance Association regarding the VAT treatment of third-party supply of goods or services to insurer (for indemnity) and insured (for excess).

5.2. Briefly, the submitted comments and tax proposals relate to the VAT treatment under the VAT Act as pertaining to indemnity payments made under non-life insurance contracts and proposed changes to the VAT Act.

5.3. Having had sight of the aforementioned submitted proposals and proposed changes to the VAT Act, as members of the WG, principally we are in agreement with the comments contained therein.

6. TECHNICAL AMENDMENTS

6.1. VAT TREATMENT OF TEMPORARY LETTING OF IMMOVABLE PROPERTY

[Applicable provisions: New section 10(29) of the VAT Act]

6.1.1. The legal nature of the problem

6.1.1.1. The new section 10(29) of the VAT Act will typically apply to the construction, extension or improvement of fixed property. We note that the newly inserted section will state the following:

> *"Where goods are deemed to be supplied by a vendor in terms of section 18D(2), the supply shall be deemed to be made for a consideration in money equal to the adjusted cost to the vendor of the construction, extension or improvement of such fixed property or portion of such fixed property so supplied."*.

6.1.2. Proposal

6.1.2.1. Upon a reading of the aforementioned section, we note that section 10(29) of the VAT Act appears not to address the acquisition of the property, e.g. developer buys a property, extends or improves it for resale and then temporary lets it out.

6.1.2.2. Given that the application of property is not addressed, it is unclear whether the acquisition of fixed property will be subject to section 18(1) of the VAT Act at the open market value.

6.1.2.3. We therefore propose that the word "acquisition" be included in the newly inserted section discussed above.

6.2. WORDING OF SECTION 18D(5)(B) OF THE VAT ACT

6.2.1. Legal nature of the problem

6.2.1.1. Upon a reading of the proposed amendment to the VAT Act contained in section 18D(5)(b), we note a grammatical error whereby the phrase 'temporary applied' is used.

6.2.2. Proposal

6.2.2.1. We recommend that this be amended to '**temporarily** applied'.

End.