SAIT | Summit Place Business Park | Building 3, Ground Floor
221 Garsfontein Road | Menlyn | South Africa | 0081

www.thesait.org.za

9 June 2023

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

Via email: SARS acollins@sars.gov.za; rulings@sars.gov.za

RE: SAIT SUBMISSION ON MATTERS ARISING FROM THE VAT INTERACTIVE WORKSHOP

Dear Colleagues,

We refer to the VAT interactive workshop that was held on 5 May 2023. Following on from the aforementioned workshop, it is our understanding that SARS is in the process of drafting a GBR to amend the way in which the standard turnover based method ("STBM") will be applied.

At the aforementioned workshop a request was made that we (as the SAIT VAT Technical workgroup) provide input and examples on situations where specific receipts/income/revenue should be excluded and/or only partially included for the purposes of calculating apportionment.

We have also provided commentary on the treatment and calculation of apportionment in respect of specific income/revenue for businesses who are actively involved with investment activities.

We thank you for the opportunity to provide this commentary and look forward to further engagement where appropriate.

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

Yours Sincerely,

SAIT VAT Tax Technical Workgroup

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

1. GENERAL COMMENTS REGARDING NON-PASSIVE AND PASSIVE INTEREST INCOME

At the outset we propose that a distinction must be made between passive interest income and non-passive interest income.

It is our experience that SARS have on various occasions, ruled that interest earned on current accounts as part of operating a business may be excluded in the apportionment computation, presumably on the basis that no identifiable activity is conducted to earn the interest.

With regards to interest earned as a result of any fund management action, performed by the vendor, that precedes the earning of exempt income (for example in transferring funds into an investment instrument) this is generally regarded as non-passive interest income and should in some form be included in the apportionment computation.

If the above classification is accepted as correctly reflecting the difference between passive and non-passive interest income, the issue remaining for consideration is the extent to which non-passive interest must be included in the apportionment computation.

In this regard we submit that it is common cause that the earning of interest in respect of the managing of funds within an organisation that is not a financial institution is minimal compared to the general operating activities in terms of which the company makes taxable supplies.

As a general apportionment principle, the apportionment percentage computed should mirror the activities resulting in the earning of various categories of income. Where significant amounts of interest are earned as a result of a company investing excess funds at any particular point in time, the activities to invest such funds and earn interest will not increase but the percentage exempt supplies will increase disproportionate to the extent of the activities involved in earning the interest. Furthermore, a moneylender (e.g. a bank) is generally allowed to include its interest margin in (b) of the formula whereas a passive investor of funds with a financial institution is required to include the gross interest received in the calculation. These distortions and the potential solution or resolution of this impasse are the reasons for the proposed STBM to be issued by SARS in this regard.

We set out below specific aspects relating to the above:

1.1 Exclusion of passive interest income for non-financial institutions in the STBM

We recommend that the STBM should make a clear distinction between non-passive and passive interest income and how it will apply to financial institutions and institutions that are not financial institutions.

Based on the current SARS practice, we recommend that any passive interest earned from current, notice or operational accounts are excluded from the STBM calculation for non-financial institutions.

1.2 The treatment of non-passive interest income in the apportionment computation for non-financial institutions

With regards to the amount of non-passive interest income that must be included in the apportionment computation, it appears that SARS is looking for a simple method that can be applied across most vendors earning non-passive interest income.

It appears to be common cause that including the gross amount of interest does not provide a fair and equitable result as it does not fairly reflect the level of activity conducted with regards to the earning of interest. It therefore appears that the general practice is to include only a margin relating to gross interest earned. It must be noted that this manner of computing the margin is a cumbersome exercise in practice.

Furthermore, SARS currently applies various methods, however, most of these methods are difficult to apply in practice and in certain instances are subject to different interpretations.

1.2.1 Recommendation

To aid in devising a simpler method that can be applied across all industries we propose the following recommendation:

It is our experience that SARS generally accepts the role of a financier as an intermediary throughout the lending process and therefore allows a net interest inclusion. It is recommended that this be extended to the STBM as follows: The greater of either -

- The actual interest rate charged by the vendor to the borrower less the actual interest rate charged to the vendor by the lender (i.e., the differences in interest rates charged by versus to the vendor); or
- In the case where a vendor uses (or partially uses) its own funds to place with financial institutions, the prime interest rate less JIBAR

The Prime Interest Rate to be used is the rate applicable on the last business day of the financial year. Whilst the JIBAR rate is the prevailing 12-month discount term rate quoted on the last day of the financial year.

Even though interest earned on various investment accounts is exempt for VAT purposes, however, it remains important to review and consider the impact of including such revenue in full in the methodology keeping in mind the purpose and intention of section 17(1).

As these investments are usually used to manage vendors' cash flows and are not necessarily done to earn interest per se and to ensure that cash is readily available and accessible, it is used to run its business. The primary purpose is to use these investments for operational purposes and the earning of interest is a secondary purpose.

Consideration should also be given to excluding such interest in totality from the STBM as it distorts the ratio.

In many instances vendors earn other amounts of interest such as interest from SARS on the late payment of refunds or other late payment interest from debtors. It is recommended that these amounts be excluded from the STBM as minimal to no resources, expenses, time and effort are expended by vendors to earn this income.

Furthermore, we recommend that the repayment of loan capital to be excluded as it is distortive.

2. Other general comments regarding turnover-based rulings

We set out below and reiterate the most common aspects submitted by our Members which we recommend should form part of BGR 16 for both vendors who are not financial service providers and those who are financial services providers but who may not use the "BASA" method.

2.1 Recommendations regarding the aspects of BGR 16

2.1.1 Non-financial services providers

. *Interest*:

- Interest earned on accounts to run the day-to-day business operations such as current accounts should be excluded from the calculation;
- Where money is borrowed at interest in order to on-lend the funds at interest, only the net interest amount should be included;
- Where net interest amounts to a loss, same should be used as an absolute, except where the interest cost cannot be attributed to the earning of a margin;
- No imputed interest income should be included in respect of interest free loans;
- Where money is lent with interest but no money was borrowed and hence no interest expense was incurred in order to earn interest, imputed interest expense based on a specified JIBAR rate (e.g. the 12-month discount term rate quoted on the last day of the financial year) should be calculated and deducted so as to only include an imputed net interest factor; and
- Interest expenses incurred to earn both exempt and zero-rated interest, should be calculated based on the ratio in which zero rated/exempt interest received bears to total interest received.

. *Dividends:*

- In groups of companies, where dividends are declared to a shareholder company which on-declares dividends to its shareholders, the dividends should be netted off in the company who received and on-declared the dividend;
- Where a group company supplies management/admin services to subsidiaries for which fees are charged and also earns dividends from the subsidiaries, the dividend receipts to be included in the calculation should be calculated by applying the difference between specified Prime and JIBAR rates to dividends received. The prime interest rate and JIBAR rate to be used is the 12-month discount term rate quoted on the last day of the financial year.

Other extraordinary receipts

- Insurance indemnity payments received should not be included since these are incidental, and extraordinary receipts;
- Section 47 of the Income Tax Act, No. 58 of 1962 (the ITA) dividends on liquidation should be excluded since these are once-off and extraordinary receipts; and
- To exclude forex gains and losses not subject to hedging. Where subject to hedging, to only include the net profit/loss received. Where a net loss, same to be included as an absolute.

2.1.2 Financial service providers

- The relevant suggested treatment referred to above, to equally apply to financial services providers.

2.1.3. Apportionment principles applicable to all vendors

- To specify that vendors may either use monthly ratios and do an annual adjustment based on the average annual ratio or use previous year's ratio and do annual adjustment once current year's financials are finalised;
- Where no prior year ratio exists (e.g. a new company), to default to monthly ratio's being utilised with an annual adjustment. Thereafter, one of the above may be elected.

2.2 Other matters for consideration

The limitation of interest is not the only factor that results in a distortion of the STBM and there are other amounts of income that should be considered.

The inclusion of exceptional or extraordinary income generally results in a distortion as the income is rarely in correlation with the expenses, effort and resources applied by the vendor in course of its enterprise or business as a whole and should be considered to be excluded.

These transactions, whether capital in nature or not, are generally of a once-off nature, unique or exceptional and do not occur regularly. Provided that the vendor retains sufficient evidence of this, we propose that the BGR 16 STBM excludes such income from the method to prevent a distortive result.

Capital goods or services, including investments disposed of (otherwise than for trading purposes) are currently excluded from the calculation. We recommend and request that guidance be provided as to what will constitute capital goods or services and where these receipts should be included.

It is recommended that the inclusion of dividend income in the formula be limited to *Dividends received x (prime interest rate less JIBAR)* to prevent any distortion of the formula and ratio.

We also recommend that securitisation transactions be dealt with by SARS to ensure that vendors who operate in this space are able to achieve an appropriate ratio by including a limited amount earned on securitisation.

It is also proposed that other amounts like payments for damages, SITA grants etc. that require minimal effort and resources be excluded from the STBM.

We accept that realised foreign exchange gains or losses must be excluded where this is not actively pursued (for example. exporters earning income from this but not necessarily trading in foreign exchange).

Lastly, consideration should be given to issuing rulings to the following industries:

- Welfare organizations (we reiterate that it is important to issue a ruling to welfare organisations to ensure that the correct ratio is applied by vendors in this industry);
- Banks / financial services providers;
- Short-term and long-term insurers;
- Municipalities; and
- Universities.

End.