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30 November 2022

To: The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS, 299 Bronkhorst Street
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VIA EMAIL: National Treasury (2023AnnexCProp@treasury.gov.za)
SARS (acollins@sars.gov.za)

Dear Colleagues,

ANNEXURE C PROPOSALS FOR BUDGET 2023: VALUE-ADDED TAX

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

In addition to identified tax proposals, we have restated our proposal made in the previous Annexure C cycle as relating to the provision of electronic services between foreign main business and their South African branch (please refer to Annexure A) as this in our view, remains an important item for consideration.

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

Yours sincerely

SAIT Value-Added Tax Work Group

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

1. EXEMPTION OF IMPORTATION OF AGRICULTURAL PRODUCTS LISTED IN PART A OF SCHEDULE 2

1.1. Background

1.1.1. Section 13(3) of the VAT Act exempts from VAT goods set forth in Schedule 1 of the VAT Act. Paragraph 7(a) of Schedule 1 provides, *inter alia*, that goods set forth in Part A of Schedule 2 are exempt, but subject to such conditions as may be prescribed in that Part.

1.1.2. Paragraph 2 of Part A of Schedule 2 provides, *inter alia* that:

"The provisions of paragraph 1 shall apply only if –

(a) the Commissioner, in respect of a vendor registered under this Act, is satisfied that that vendor, <u>being the recipient of any such goods</u>, carries on agricultural, pastoral or other farming operations and has issued to him a notice of registration in which authorization is granted whereby the goods concerned <u>may be supplied to him</u> at the rate of zero per cent:...;

(b) the goods concerned are <u>supplied</u> to a vendor who is in possession of a valid notice of registration as a vendor and an authorization contemplated in paragraph (a);

(c) <u>a tax invoice in respect of the relevant supply is issued</u> containing such particulars as required as required by section 20(4) of this Act;

(d) *<u>the acquisition</u>, disposal, sale or use of the said goods is not prohibited in terms of section 7bis of the Fertilizers, Farm Feed, Agricultural Remedies and Stock Remedies Act, 1947 (Act No. 36 of 1947)*" (Own emphasis).

1.2. Legal nature of the problem

1.2.1. From the said provisions of section 13(3) read with paragraphs 7(a) of Schedule 1 and (2) of Schedule 2, the importation of the goods concerned is only exempt from VAT if the conditions in Paragraph 2 of Part A of Schedule 2 are met. It is evident from the highlighted words and phrases above as contained in the conditions, that no reference is made to importation. Further, since no tax invoice will be issued where such goods are imported, this requirement cannot be met.

1.2.2. For the sake of clarity, it is recommended that paragraph (a) of Paragraph 7 of Schedule 1 be amended to specifically exclude the requirement in paragraph 2(c) of Part A of Schedule 2 and that the word 'imported' be included in paragraphs (a); (b) and (d) of Paragraph 2 of Part A of Schedule 2. It may further be considered whether it is necessary to also include the required documentation necessary in respect of the importation.

1.3. Nature of business/persons impacted

1.3.1. Vendors who carry on agricultural, pastoral or other farming operations that import the said goods.

2. PRECIOUS METAL LOCATION SWAPS, HEDGES AND GOLD LOANS

2.1 Background

2.1.1. *All Precious metals*

2.1.1.1. Precious metal is generally used for two purposes namely, as investments and as commodities used to manufacture other goods. Precious metals (i.e. gold, silver, platinum, palladium, rhodium, ruthenium, iridium, and osmium) are generally high value commodities, the prices of which are determined in global commodity exchanges. Given the volatility in the prices, dealers or manufacturers of goods containing precious metals generally hedge their forward sales and purchases of these commodities to protect them from price fluctuations. From an investment or hedging point of view, one can either buy the physical commodity or a right to receive the value of the commodity at a future date, whereas manufacturers and dealers are required to buy and sell the physical commodity to sell same either as a commodity or as a manufactured product of the commodity.

2.1.1.2. Precious metals go through various processing stages from its extraction before it becomes a final product, measurable in purity, quantum and value. Further, precious metals are generally processed to specified forms and sizes required for specific use or purpose.

2.1.1.3. Further, one has to distinguish between so-called paper precious metals (i.e. derivatives) and actual precious metals. These include futures, options, contracts for difference (CDF). The derivative is an asset/paper instrument that reflects the price of the precious metal but is not precious metal itself. Dependent upon the nature of the derivative, there may or may not be an obligation on the part of the seller to supply, or right on the part of the purchaser to acquire physical precious metal on the maturity date of the derivative contract. These trades are done both through regulated exchanges or over the counter (OTC) trades.

2.1.1.4. A further aspect to consider is the difference between precious metal held by an owners/s or investor of precious metal in an allocated vs unallocated account. In essence both these scenarios entail that a third party (e.g. a bank, refiner, trader etc.) acts as the custodian for the safe keeping of the precious metal for the benefit of the buyer or owner of the precious metal. The custodian maintains so-called allocated and allocated accounts for its clients. Where a person owns physical precious metal which can be separately identified in quantum, value and form (e.g. a gold bar in the form of a London Good Delivery Bar), such precious metal is capable of being allocated to a particular owner, and the owner is capable to sell and deliver the physical precious metal to an investor, a bank, manufacturer etc. Unallocated precious metal on the other hand is co-mingled precious metal/material containing precious metal content owned jointly by various owners, such that no specific identifiable metal can be attributed to any one of the co-owners. This generally occur when various depositors of precious metal containing material deposit same with another person for refining or further processing. In this instance each owner is entitled to the specified quantum precious metal deposited but is not able to sell and deliver its undivided portion of the precious metal to another person in a separately identifiable form. However, the co-owners can sell its entitlement to its portion of the unallocated precious metal to another person. In this regard it is important to acknowledge that the custodian will only be able to deliver/release actual precious metal once the metal has been allocated.

2.1.1.5. The Department of Mineral Resources issued a document entitled "THE PRECIOUS METALS TRADE - GENERAL INFORMATION HANDBOOK" in October 2003, from which the following paragraphs are quoted below:

"2.9 GOLD AS A FORM OF MONEY
Gold is unique in that it is both a monetary asset and a commodity. As a commodity it is also fungible, i.e., it is exchangeable, interchangeable, standardised and with a unit price set by the market."

"2.10.4 Delivery of Physical Gold Delivery may be made in several ways, including delivery to the dealer's vault, or a credit to an allocated account, or through the London Bullion Clearing to an unallocated account of the third party. In addition to delivery at its own vault, a dealer may, by prior agreement, arrange delivery to any destination around the world and in any form or any fineness. To enable this service, most bullion dealers have consignment stocks in strategic centres around the world. An allocated account refers to an account held in a client's name, where gold is exclusively held separately from other gold in a vault. This gold does not form part of the bullion bank's assets, but is titled over to the allocated holder. The gold in an allocated account cannot be lent out or used by the vault owner. An unallocated account is basically a debit and credit arrangement, which is backed by the general stock of the bullion dealer where the account is held. If the client wishes to receive physical metal by allocating specific bars or equivalent bullion product, the fine metal content of this is debited from the unallocated account. The physical delivery period is normally two business days after the trade is transacted."
"3.5.4 Storage and delivery The London and Zurich markets have facilities for storage of platinum and palladium in high security vaults. The metals can be held on unallocated or allocated accounts. Many clients do not take delivery of their metal and request the members of the market to open metal accounts in their name. In such unallocated accounts, the specific bars are not set aside and clients have a general entitlement to the metal. This practice is popular because it is convenient and cheap. Allocated accounts are opened for clients who prefer their metal to be physically segregated and need a detailed list of weights and assays." (Own emphasis)

2.1.1.6. The VAT Act deals with barter transactions. From a legal point of view the conventional barter transaction amounts to either a supply of goods in exchange for services or vice versa, or two sale and purchase agreements where ownership in the goods that are exchanged transfers to the parties concerned. Since one of the *essentialia* of a sale agreement is that delivery must be effected, it follows that a barter can only constitute sale agreements where both parties are able to effect delivery, whether constructive or physical delivery.

2.1.1.7. Since precious metal swaps often involve an exchange of precious metal where the one party's precious metal is located outside the Republic and the other party's precious metal is located in the Republic, it is not clear whether the exchange of precious metal held by a vendor outside the Republic with another person, constitutes "exported", as defined (i.e. delivered to a recipient at an address outside the Republic).

2.1.1.8. Given the risk of loss, price risk and/or costs involved in moving precious metals between locations, it has become practice that parties often enter into so-called location swaps. The location swap essentially amounts to a barter transaction where one party has allocated or unallocated precious metal of a particular quality and quantum located at one location, which is swapped/exchanged with another party who has identical quality and quantum of allocated or unallocated precious metal located at a different location.

2.1.1.9. These swaps are in certain instances entered into where the form of the precious metal held by the first mentioned party (e.g. allocated or unallocated or palladium plates or ingots) is different to the form held by the other party and the parties wish to exchange the different forms and location. To illustrate, a local manufacturer of a precious metal products receives an order from a non-resident to manufacture a certain product. The non-resident client has the sufficient quantum of allocated or unallocated precious metal but same is physically located offshore. An arrangement is made in terms of which the local manufacturer acquires the relevant quantum of precious metal from a local supplier and swaps same with the non-resident's allocated or unallocated precious metal located offshore. Once the products are manufactured, a manufacturing fee is charged by the local manufacturer to the non-resident and the manufactured goods are exported to the non-resident. The local manufacturer may decide to sell the allocated or unallocated precious metal located offshore, to fund the cost of the precious metal acquired locally. In this scenario the buyer and seller may further decide to hedge their respective positions until the manufactured products are delivered. The swaps are generally recorded in the allocated or unallocated accounts maintained by the third party custodian. This is done by debiting and crediting the allocated or unallocated accounts of the respective parties. Debit entries mean that the custodian reduces a specific quantum of precious metal it owed to the one party and crediting means the custodian increases the same quantum of precious metal it now owes to the other party.

2.1.1.10. As mentioned, a custodian is only able to deliver/release actual precious metal to the acquirer of unallocated metal, once the metal has been allocated. This is important, considering that one of the *essentialia* of a sale agreement is delivery. In other words, if the holder of unallocated metal swaps the metal with an owner of precious metal in an allocated account and the holder of unallocated metal is unable to effect delivery of actual precious metal, the supply by it was not a supply of goods (i.e. not a real right in goods) but rather services, whereas the supplier of the precious metal via the allocated account makes a supply of goods. This means that goods are supplied in exchange for services. On this basis, if the owner of actual precious metal is in the Republic and the holder of unallocated metal is outside the Republic, the supplier in the Republic can supply and export the goods at the zero rate in terms of section 11(1)(a), and proof of payment will be the unallocated metal it received.

2.1.1.11. Equally, if the owner of actual precious metal is a non-resident whose metal is located in the Republic, and the holder of unallocated metal is a vendor whose unallocated metal is held by a foreign custodian, the vendor will supply a service (i.e. the right to unallocated metal) to the non-resident, as envisaged in section 11(2)(l) in return for actual precious metal as payment. In this scenario the potential

exists that the non-resident may become liable for VAT registration if such activities are carried on continuously or regularly in the Republic.

2.1.1.12. Alternatively, if the non-resident and vendor both have allocated precious metal, both will be supplying goods. Hence if the vendor exchanges its metal located in the Republic for the metal located offshore, the vendor is liable to levy standard rate VAT unless the metal is exported to the non-resident or another zero rate provision finds application such as section 11(1)(f). If the vendor swaps its allocated precious metal located outside the Republic with allocated precious metal of the non-resident located in the Republic, the vendor will have sold precious metal which has been "exported" and hence make a zero rated supply in terms of section 11(1)(a). The vendor will not be entitled to any input or notional input tax in respect of the precious metal acquired from the non-resident, unless the non-resident is a vendor who issued a tax invoice. As mentioned, the non-resident may have a registration liability if such activities are carried on continuously or regularly.

2.1.1.13. To complicate matters further, where both parties are registered VAT vendors and the precious metal consists of gold containing goods, the provisions of the regulation dealing with domestic reverse charge VAT (DRC) may find application, unless one of the exclusions apply (e.g. the party supplying the gold located in the Republic is a mine or the supply is made to a registered bank, the SA Mint or the South African Reserve Bank).

2.1.2. Gold specific

2.1.2.1. As is evident from the extract of paragraph 2.10.4 of THE PRECIOUS METALS TRADE - GENERAL INFORMATION HANDBOOK, gold traded through the London Bullion Clearing to an unallocated account of the third party, is also considered to be delivered.

2.1.2.2. Further, gold is also used as money in certain instances, for example gold loans, where the loan attracts interest payable either in money or in gold.

2.2 Legal Nature of the Problem

2.2.1. Our experience is that vendors who enter into precious metal swaps and hedges generally treat these as sales of goods transactions, without having regard as to whether or not the swap or hedge is in respect of allocated or unallocated metal. In historic section 72 rulings issued by SARS, they too had no regard as to whether or not the transactions were in respect of allocated or unallocated accounts. SARS found it necessary to issue section 72 rulings, on the basis that physical delivery does not take place, disregarding the concept of constructive delivery and the fact that no requirement exists that for goods to be "exported" it is not a requirement that the goods must be transported/removed from the Republic to an export country, hence the zero rate in section 11(1)(a) cannot apply. SARS' historic view was thus that a difficulty or an anomaly existed, which necessitated a section 72 ruling to overcome the difficulty. The rulings effectively permitted the vendor to disregard these "paper transactions". Following the amendment of section 72, SARS was not prepared to re-confirm the section 72 rulings issued. It further seemed that SARS changed their mind at the time and regarded these transactions as standard rated sales where the vendor traded with foreign located metal, on the basis that the goods have not been physically delivered.

2.2.2. Further, we are not aware of any non-resident counterparts who considered it relevant or necessary to register as VAT vendors, presumably on the basis that they have no actual activity in the Republic.

2.2.3. The said approaches and interpretations by vendors, SARS and non-resident parties are not unique in the global VAT landscape. In this regard the UK issued VAT Notice 701/9 on 18 October 2011, entitled, Guidance: VAT treatment of transactions in commodities, commodity derivatives and terminal markets. Without having done a detailed study of this document, it seems as if one important distinguishing factor was whether the commodities are in fact delivered (presumably include trades with allocated metal), in which case they are treated as sales. Other countries like Germany, India, Australia, New Zealand etc. have also introduced specific VAT rules dealing with commodity trades, both physical and through derivatives.

2.2.4. Given the significant size and value of the precious metal industry in South Africa, it is proposed that:

- specific legislation or regulation be introduced to provide clarity on the correct VAT treatment to be followed in respect of precious metal traded through allocated and unallocated accounts for example, that these supplies are only supplies of goods delivered, where the trade is in respect of allocated metal, with the exception of gold traded through the London Bullion Clearing to an unallocated account which is a supply of goods being delivered. One option could be to:
    - specifically include allocated precious metal, other than gold traded through the London Bullion clearing to unallocated accounts, in the definition of "goods" or to exclude unallocated precious metal, other than gold traded through the London Bullion clearing to unallocated accounts, from the definition of "goods" and
    - to expand the reference to "delivered" in the definition of "exported"; and
    - to specifically exclude non-residents who trade with precious metal through allocated and unallocated metal accounts from the definition of 'enterprise'; and
    - To amend section 11(1)(f) to include gold supplied to the institutions envisaged in that section by virtue of a transfer to an unallocated account; and
    - To exclude from the definition of 'valuable metal' envisaged in the DRC regulation, the supply of valuable metal by virtue of an unallocated account; and
    - To specifically include gold loans in section 2 as a financial service where the interest is paid in gold.

2.3 Nature of Business/Persons Impacted

2.3.1. Persons who are investors, manufacturers and traders in precious metals are impacted.

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

3.1. Introduction

3.1.1. 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.

3.2. The legal nature of the problem

3.2.1. 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 and in some cases only a few weeks or days where dividends are received.

3.2.2. 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).

3.2.3. 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. This in turn result in an increased cost base that puts the vendor at a disadvantage to its competitors.

3.2.4. 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.

3.2.5. 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.

3.3. Proposal

3.3.1. 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.

3.3.2. Our recommendation is to amend the proviso to give the taxpayer 6 months from the end of its financial year in which to request permission to use an alternative

method. Once approved that new method can then be applied from the start of that financial year.

4. REVIEWING THE SECTION 72 DECISION WITH REGARD TO THE VAT TREATMENT OF THE REGISTRATION OF CERTAIN FOREIGN SUPPLIERS (INSERTION OF SECTION 23A AND ELECTRONIC SERVICES)

4.1. The legal nature of the problem

4.1.1. At the time the draft legislation was issued for comment, the WG requested that clarification be provided on how supplies made between the various non-resident entities that are included in the single branch registration be treated, that is, how intra-branch supplies would be dealt with. By way of illustration:

- Five non-resident entities form part of the same group of companies (i.e., Companies A, B, C, D and E). They are registered as a single branch (SA Branch) of a local VAT vendor.
- Non-resident Company A makes a taxable supply of services to Company B.

4.1.2. The WG noted that the provision as then drafted could arguably result in the supply by Company A to Company B being subject to VAT in SA and thereby result in Company A having to register notwithstanding its inclusion in the single registration. The issue arose because the then draft provisions did not provide that the branch was a separate person. That is, arguably intra-branch supplies (not supplies to third persons) could still attract VAT as the **supplies will have been made by a person "*to any other person* *for a consideration*"** as contemplated in the definition of "*enterprise*" in section 1(1) of the VAT Act **- as the companies are not deemed to be one and the same person** (as would be the case under section 50).

4.1.3. We note that Section 23(2A) has been amended by the latest TLAB [B26 – 2022] as follows by way of the addition of paragraphs to the proviso to the section:

> *"(iii) the branch shall be **treated as a separate person** from the main registered vendor for the purposes of this Act; (iv**) for the purposes of supplies made in the Republic between persons within the same branch registration, such supplies and acquisitions must be accounted for in that branch registration***."

4.1.4. In our view, it is evident that the WG's request and proposal regarding treating the local branch as a **separate person** has been adopted (paragraph (iii) of the proviso).

4.1.5. As regards supplies made between non-residents forming part of the same branch registration, paragraph (iv) of the proviso, it would appear, recognises that such supplies will be taxable and should be accounted for as such within the separate person/branch. Should Company A make a supply of goods or services to Company B, as in the example above, that would be taxable in SA and output tax would need to be accounted for by the separately registered local branch (the proviso refers to "***supplies made in the Republic*** *between persons within the same branch registration*"). The local branch would in turn be entitled to claim a corresponding input tax deduction on the basis that the taxable supply was made to Company B that also forms part of the local branch registration

4.1.6. A vendor who makes taxable supply to a **recipient** (being the **person** to whom the supply is made) is required to issue a valid tax invoice to the **recipient** in relation to such supply (section 20(1) of the VAT Act). The tax invoice is required to meet reflect

certain details (section 20(4) or (5) of the VAT Act). It is not clear if the local branch would need to issue tax invoices in respect of intra-branch supplies as it is regarded as a separate person. That is, there is no recipient.

4.2. Proposal

4.2.1. We propose that a provision be made to specify that where an intra-branch supply is made it is not required that the local branch issue invoices to a member of the branch, and that the branch may claim input tax relief notwithstanding a valid tax invoice has not been issued in these circumstances.

5. FOREIGN SUPPLIERS OF ELECTRONIC SERVICES

5.1. The legal nature of the problem

5.1.1. The VAT Act imposes VAT on electronic services[1]. Electronic services include any services supplied by means of an electronic agent, electronic communication or the internet for any consideration[2].

5.1.2. Foreign suppliers of electronic services ("FESS") to South Africa that are regarded as carrying on an enterprise for VAT purposes are required to register for VAT in South Africa within 21 days of the total value of electronic services supplied to persons in South Africa exceeding the VAT registration threshold of R1 million in a consecutive 12-month period ("registration threshold)[3].

5.1.3. A VAT-registered intermediary[4] may account for, and pay over, the VAT on supplies facilitated by it on behalf of a FESS only to the extent that the FESS is not yet registered for VAT in South Africa[5]. Once the FESS is VAT registered, the intermediary may no longer account for the VAT and must, in line with the normal agent / principal rules in the VAT Act, provide the FESS with the necessary information to enable the FESS to account for its own VAT in its own VAT returns[6].

5.1.4. A failure to register for VAT is regarded a criminal offence in relation to non-compliance[7] and attracts penalties in terms of the Tax Administration Act 28 of 2011 ("TA Act"), which include the possibility of a fine or imprisonment of up to two years. Non-compliance with the requirements of South African laws may also have unintended legal consequences for FESS in other jurisdictions[8].

5.2. A detailed factual description

5.2.1. X LLC ("X") is a FESS who supplies various digital content. X contracts with AB (Pty) Ltd ("AB"), a VAT registered intermediary who operates an electronic platform through which persons in South Africa may download the digital content that X supplies, X does not make supplies of electronic services, i.e. it does not make the digital content it supplies available, to persons in South Africa other than through AB, its intermediary. AB is an intermediary for many other FESS', and has developed a system through which it invoices persons in South Africa for the digital content downloaded via its platform, to receive the relevant payment and to calculate the VAT due on all services supplied as a globular amount, with a single amount being paid to SARS on behalf of all of its customers.

5.2.2. In month 1, X's sales of electronic services (digital content) do not meet the registration threshold of R1 million. In month 2, X's sales of electronic services through

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[1] Section 7(1)(a) of the VAT Act read with section 1 of the VAT Act word definition "enterprise" par (vi) t
[2] Section 1 of the VAT Act, word definition "electronic services" read with Regulation 3 of Government Notice 429 dated March 2019
[3] Section 23(1A) of the VAT Act
[4] As defined in section 1 of the VAT Act, word definition "intermediary"
[5] Supply is deemed to be made by the intermediary in terms of section 54(2B) of the VAT Act
[6] Assumed, as this is not specifically indicated or addressed in the VAT Act
[7] Section 234(2)(a) of the TA Act
[8] Refer certain in-country laws such as the SEC Regulations in the US which requires listed entities to fully comply with all global laws.

AB's platform exceed the R1 million threshold. X is therefore required to register for VAT from month 2, and to submit its own VAT returns.

5.2.3. To enable it to do so, X requires AB to provide it with a statement of all supplies made by AB during that particular month on X's behalf in order to enable X to account for the VAT due on its supplies. However, AB's systems are not set up to keep records of the taxable supplies made in respect of each FESS that it represents, and AB can therefore not provide X with the information necessary to allow it to file its VAT return.

5.2.4. Without having the relevant information to file a return and considering the VAT has already been accounted for and paid by AB in its VAT return, X files a nil VAT returns and does not pay any further amount of VAT thus making a false statement in its VAT return that it had not made any taxable supplies during the relevant tax period[9].

5.3. The nature of the business/ persons affected

5.3.1. Foreign suppliers of electronic services who utilize intermediaries to supply their electronic services.

5.4. Proposal

5.4.1. An amendment to the VAT legislation to the effect that where a FESS supplies electronic services through an intermediary, with an agreement between the parties to the effect that the intermediary will submit the relevant data to SARS and will pay the relevant VAT over to SARS, the FESS does not need to apply for registration as a VAT vendor in South Africa.

5.4.2. This will be limited to FESS' that utilize the services of an intermediary given that FESS' that provide electronic services directly into South Africa are able to account for these sales and would therefore be able to comply with the respective legislative requirements.

End.

[9] Refer section 234(1)(a) of the TA Act

ANNEXURE A

1. PROVISION OF ELECTRONIC SERVICES BETWEEN FOREIGN MAIN BUSINESS AND SOUTH AFRICAN BRANCH

We have included the proposal made regarding the supply of electronic services by a foreign main business to its South African branch (as per the last Annexure C cycle). For ease of reference, we include the previous submission below.

1.1. Background

1.1.1. The provision of services is 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. 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:

Group of companies

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.”

Enterprise

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".

Supply

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”

Recipient

A recipient is defined section 1(1) of the VAT Act as "the person to whom the supply is made."

Person

A person is defined in section 1(1) of the VAT Act to include "body of persons (corporate or unincorporate)".

1.1.3. 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* 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 above was 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).

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.

3.5.4. 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.

3.5.5. Essentially, we are of the view that it would be more beneficial if “electronic services” are specifically excluded from the aforementioned Regulation as per the wording above. This will then align with the “group of companies” currently in the Regulation.

End.