South African Institute of Taxation

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31 August 2024

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 (2024AnnexCProp@treasury.gov.za); and
SARS (acollins@sars.gov.za)

RE: DRAFT TAXATION LAWS AMENDMENT BILL, 2024: VALUE-ADDED TAX TECHNICAL WORKGROUP

Dear Colleagues,

We attach the comments from the SAIT Value-Added Tax Technical Work Group (**WG**) on the proposals contained in the draft Taxation Laws Amendment Bill, 2024 (**DTLAB**) as well as the associated draft Regulations.

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.

Value-Added Tax Technical Work Group

All references to the legislation are to the Value-Added Tax Act, No. 89 of 1991 (the VAT Act), the proposals contained in the draft Taxation Laws Amendment bill (DTLAB)

1. Clarifying the VAT treatment of supply of services to non-resident subsidiaries of companies based in the Republic

[Applicable provision: Section 1 of the VAT Act: definition of "resident of the Republic"]

1.1. Government proposal

1.1.1. The proposed amendment is intended to change the definition of "*Resident of the Republic*" to exclude foreign subsidiaries that do not conduct VAT enterprises in South Africa but have their place of effective management in South Africa. In terms of the current wording of the definition, services supplied to such subsidiaries cannot be zero-rated in terms of 11(2)(l) of the VAT Act notwithstanding the fact that the services are consumed outside South Africa.

1.1.2. The proposed amendment is intended to rectify this unintended consequence.

1.2. Analysis of the proposed draft amendment

1.2.1. The unintended consequence is that services supplied to non-resident subsidiaries that have their place of effective management (and are therefore regarded as "resident" for income tax purposes) in South Africa cannot be zero-rated in terms of section 11(2)(l) of the VAT Act notwithstanding the fact that the services are consumed outside South Africa.

1.2.2. The non-resident subsidiary also cannot register as VAT a vendor in South Africa as it does not conduct an enterprise in South Africa for VAT purposes. The VAT charge therefore becomes a cost in the supply chain.

1.2.3. The proposed amendment will remove the unintended consequence with regards to foreign subsidiaries of a local holding company where these foreign subsidiaries are effectively managed in South Africa.

1.3. Recommended solution/Proposal

1.3.1. While the proposed amendment is welcomed, it must be noted that it does not only address subsidiaries that are treated as "resident in the Republic" for VAT purposes by virtue of being a resident for income tax purposes in consequence of having their place of effective management in South Africa. It will also apply where a non-resident company is treated as a resident for tax purposes in consequence of having its place of effective management here but nevertheless does not carry out any vatable supplies in South Africa.

1.3.2. We further recommend that individuals who work outside South Africa but who are still ordinarily resident in South Africa, also be covered by the exception to the extent that the services are supplied to the individuals at the time that they are physically working offshore.

2. Clarifying the VAT treatment of the Mudaraba Islamic financing arrangement

[Applicable provision: Section 8A of the VAT Act]

2.1. Government proposal

2.1.1. It is proposed that the return of the profit from the Mudaraba product be exempt from VAT. This is in line with the treatment of Murabaha and Musharaka Sharia-compliant financing arrangements.

2.2. An analysis of the proposed draft amendment

2.2.1. The proposed amendment aligns the VAT treatment of all Sharia-compliant financing arrangements, which is welcomed.

2.3. Recommended solution/Proposal

2.3.1. The proposed effective date of the amendment is 1 April 2025. The absence of a backdated effective date for the amendment introduces uncertainty regarding the treatment of existing arrangements in the interim period and in relation to their past application.

2.3.2. We recommend that consideration be given to backdating the proposed amendment to the date of the introduction of section 8A of the VAT Act (1 January 2013).

3. Prescription period for input tax claims

[Applicable provision: Paragraph (i) of the proviso to section 16(3) of the VAT Act]

3.1. Government proposal

3.1.1. In terms of proviso (i) to section 16(3) of the VAT Act, a vendor that is allowed a deduction in respect of a tax period, may deduct an amount from output tax attributable to a later tax period, which ends no later than 5 years from the end of a tax period during which –

- the tax invoice should have been issued under section 20(1) of the VAT Act;
- goods were imported in terms of the Customs and Excise Act No 91 of 1964;
- second-hands goods were acquired, or goods were repossessed or surrendered as per section 8(10) of the VAT Act;
- the agent should have issued the statement to the principal as required under section 54(3) of the VAT Act; or
- in any other case, the vendor for the first time became entitled to such deduction, notwithstanding the documentary proof that the vendor must be in possession of in terms of section 16(2) of the VAT Act.

3.1.2. Taxpayers sometimes find themselves in the position where it is discovered that input taxes that should have been deducted in previous tax periods were not deducted timeously. Considering that the VAT Act permits the vendor a 5-year period within which to adjust its records, it has come to government's attention that there has been a practice whereby deductions relating to previous tax periods are claimed sometime after. This practice makes it difficult for vendors to comply as they might lose track of which tax invoices were deducted in the previous tax periods and which were not, which might lead to a risk of double deduction. It is expected of vendors to perform proper reconciliation between the accounting records and the VAT returns in order to ascertain for themselves if the tax invoices were claimed in the proper tax periods. However, Treasury is of the view that this does not often happen in practice.

3.1.3. To ease the administrative burden on both taxpayers and SARS, it is proposed that the VAT Act be amended in relation to the tax period in which any past unclaimed input credits may be claimed. To ensure ease of audit functions and clarity of returns in this regard, it is proposed that the act be amended such that past deductions will be required to be made in the tax period in which the entitlement to that deduction arose. Therefore, where a vendor wishes to make deductions relating to previous tax periods it will need to re-open the returns relating to these periods in order to claim the additional deductions. We assume that this means that SARS will implement a process whereby the vendor will allowed to increase the deductions for that period.

3.1.4. The amendment proposes that input tax will only be claimable in the tax period in which a vendor first becomes entitled to the deduction.

3.1.5. The general rule is that input tax is deductible in the tax period in which a supply of goods or services has been made to a recipient, provided that the recipient is in possession of the relevant supporting documentation (normally a tax invoice) by the time that the VAT return in which the claim is made, is submitted.

3.2. An analysis of the proposed draft amendment

3.2.1. As we understand the proposed amendment, where vendors become entitled to a deduction in a tax period and that deduction is not claimed in the tax period in which the invoice is dated, the vendor will be required to re-open that tax period in which the vendor became entitled to the deduction in order to claim that deduction. The requirement remains that the deduction must be made with 5 years from the events laid down in the proviso.

3.2.2. Practical application

3.2.2.1. In this section we raise practical concerns regarding the application of the proposed rule and make certain recommendations/proposals in 3.3.

3.2.2.1.1. Vendors who receive tax invoices but process them in later tax periods:

3.2.2.1.1.1. A vendor receives tax invoices from both local and foreign suppliers but due to internal processes, system cut-offs and procurements controls is only able to process the invoices in a later tax period. Therefore, tax invoices received towards the end of the month may only be captured on the system on the following month or even some months thereafter where there is a dispute. It also often happens that suppliers process tax invoices towards the end of the month but only issue them to recipients some in the next month. This means the recipient will receive a tax invoice dated the previous month but will process the tax invoice in the current month. New suppliers often issue invoices which are non-compliant (i.e. Recipient VAT registration number not reflected) and taxpayers are required to request re-issues which delays the submission of the claim. Taking all of the above into consideration, this means that per the new rule the vendor will on a continuous basis need to re-open multiple past tax periods in order claim legitimate deductions. This may even result in one tax period having to be re-opened multiple times to submit input tax deductions relating to it. We believe that this will place an enormous and unintended additional compliance burden on both SARS and the taxpayer.

3.2.2.1.2. *Where claims are high in volume but low in value vendors will generally process the claimable amounts periodically (quarterly, 6 monthly or annually)*

3.2.2.1.2.1. Vendors would generally claim the VAT on petty cash, travel, accommodation and general office expenses only after reviewing the source documents and therefore process the deduction at a later stage. This often occurs where non-financial employees process transactions on the accounting system and to ensure proper risk management, the VAT deduction is only claimed once verified by the financial team.

3.2.2.1.2.2. In addition, change in use adjustments generally involve detailed calculations and are labor intensive. This is generally a claim that arises in the tax period in which the change in use occurred or at the end of a financial period. Also, Binding General Ruling 16 issued by SARS and other apportionment rulings issued by SARS would allow a period of between 6 and 9 months to claim the additional input tax (where applicable). Essentially this means that the additional input tax may be claimed in any month after the tax period in which the vendor became entitled to the deduction up the end of the period allowed by SARS.

3.2.2.1.3. SARS system constraints, administration burden and interest

3.2.2.1.3.1. Currently the SARS system does not allow vendors to process any increase in input deductions or a reduction in output tax in respect of a past tax period. The proposed change will therefore require a system change as well as a clearly defined process which will place an administrative burden on both taxpayers and SARS.

3.2.2.1.3.2. In addition, where SARS issue verification requests and later on an assessment is issued disallowing certain input deductions, the vendor, once it is satisfied that the supporting documentation is in order, will need to re-open that tax period in order to re-claim those deductions. It must be considered whether the SARS system will be able to accommodate this process before the rule is implemented. Further, this will inevitably result in additional verifications and/or audits by SARS seeing that amended returns are filed which will place an enormous additional burden on both SARS and taxpayers.

3.2.2.1.3.3. It is also not clear if vendors will be entitled to interest as the proposed approach will result in refunds being due in multiple earlier tax refunds.

3.2.2.1.4. The onus of proof proposed by Treasury

3.2.2.1.4.1. It would appear based on the Explanatory Memorandum that vendors would be expected *"to perform a proper reconciliation between the accounting records and the VAT returns to ascertain for themselves if the tax invoices were claimed in the proper tax periods"*. It seems clear that the intention is to lessen the administration burden on SARS by ensuring that all input deductions attributable to a particular tax period would be claimable in that tax period. We understand that the requirement will be for the vendor to perform a full reconciliation between the accounting records (income and expenses) and output tax and input tax for that particular tax period when it submits the additional input claim. Where electronic accounting systems are utilized, the risk of duplicating claims are almost impossible as it is system driven. This will result in taxpayers having to analyse monthly system generated tax reports and manually

excluding invoices dated in prior months whereafter manual adjustments will have to be made for prior tax periods.

3.3. Recommended solution/Proposal

3.3.1. Based on our above comments we respectfully request Treasury to implement the following approach instead:

3.3.1.1. Taxpayer System and process constraints causes continuous late claims

3.3.1.1.1. We recommend that the proposed rule to re-open prior periods is **not** implemented but rather to require vendors to declare unclaimed input VAT not claimed within six (6) months from when the vendor became entitled to the deduction in a separate field in a current VAT return, with due regard to the 5 year prescription period. This means vendors may include part input claims in a current return provided the claim process will have 6 months from the end of the tax period in which the vendor first became entitled to the deduction.

3.3.1.1.2. Claims older than 6 months may be claimed in a current return but in a dedicated separate field in the VAT return. SARS will then be able to verify the additional claim through its verification process in terms of s46 of the TAA. We rather recommend that the ability to load a clarification letter be made part of the process for submitting additional claims which will provide SARS with the details it requires in order to assess the additional claim.

3.3.1.2. SARS system changes and process

3.3.1.2.1. If Treasury proposes to proceed with the amendment, we recommend that the SARS e-filing system be adapted to cater for the proposed changes. That means that a vendor should be able to submit claims older than 6 months in a separate field in a current VAT return. Should the vendor be required to open an historic VAT return it will be necessary to adapt the current SARS processes on e-filing. We propose that the additional input VAT simply form part of the normal VAT return submission process which means SARS may verify the additional claim in terms of s 46 of the of the Tax Administration Act, 2011.

3.3.1.2.2. Also refer above suggestion regarding submission of a detailed clarification letter.

3.3.1.3. Change in use and apportionment related adjustments

3.3.1.3.1. Since these adjustments may take time to prepare and validate it is proposed that these adjustments also be included in a separate field in a current VAT return accompanied by a clarification letter.

3.3.1.4. De-minimis value for small claims and a concession to submit a consolidated claim for a claim that span multiple tax periods

3.3.1.4.1. Where Treasury decides to proceed with the amendment, we request that Treasury/SARS –

- to consider excluding individual claims below a certain value, and

- allow vendors to submit consolidated claims where the claims are in respect of the same transaction

and a detailed explanation accompanies the claim.

4. Supplies by educational institutions to third parties

[Applicable provisions: Sections 8,12(h)(ii) and the insertion of section 40E of the VAT Act]

4.1. Government proposal

4.1.1. It is proposed that section 12(h)(ii) of the VAT Act be amended to read as follows:

> *"the supply by a school, university, technikon or college of goods or services (including domestic goods and services) necessary for or subordinate or incidental to the supply of services referred to in subparagraph (i) of this paragraph".*

4.2. An analysis of the proposed draft amendment

4.2.1. The proposal is not quite clear, but it seems to be aimed at requiring educational institutions to apply the exemption in respect of all supplies made in terms of section 12(h)(ii) of the VAT Act, irrespective of whether or not it is made to a student or is funded from school fees, tuition fees, etc. .

4.2.2. The explanatory memorandum suggests that the wording of the old section resulted in varying interpretations, with one interpretation concluding that the supply of goods or services by a school Technikon, University or College to third parties , is subject to VAT at the standard rate of 15% in terms of section 7(1)(a) of the VAT Act and another interpretation concluding that such supplies qualify for exemption under section 12(h)(ii) of the VAT Act.

4.2.3. The explanatory memorandum further suggests that the view which concluded that such supply of goods or services are subject to VAT at the standard rate of 15% was mainly on the premise that the consideration for such was not in the form of tuition fees, or a school fees. This is not withstanding the fact that in certain instances such goods or services may be mainly or solely for the benefit of learners or students and further, be necessary for and subordinate and incidental to the supply of educational services.

4.2.4. It appears that the proposed amendment is aimed at addressing this uncertainty with the VAT treatment of the supply of goods and services made by the school, Technikon, University or College, which are principally made to 3rd parties.

4.2.5. However, it is our view that the deletion of the following criteria in the provision may create further uncertainties and be interpreted to broaden the scope of what can be classified as exempt, potentially allowing a wide range of goods and services to qualify as exempt.

4.2.6. <u>Meaning of solely or mainly for the benefit of its learners or students</u>

4.2.6.1. It is our understanding that the purpose of section 12(h)(ii) was for all intents and purposes to ensure that goods or services supplied by the school, Technikon, University or College solely or mainly for the benefit of learners or students qualify for exemption in order to create harmony with the exemption applied in section 12(h)(i), primarily to ensure learners and students do not bear an additional VAT cost. It is our view that the difficulty was mostly created by a further requirement that exemption would only apply to the extent that such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for lodging or board and lodging. The insertion of this further requirement meant that even if services were supplied by school, Technikon, University or College which are solely and mainly for the benefit of

learners or students and which are necessary for and subordinate and incidental, such supply would not qualify for exempt if such fee is charged to, for example, a 3rd party.

4.2.6.2. A case in such example, would be contract research supplied by a university to a 3rd party service provider where students are involved and where it could be argued that it is necessary for, and subordinate and incidental to the supply of educational services. The proposed amendment may also suggest that even contract research where there is no student involvement, such research could be argued to be exempt under the proposed provisions.

4.2.6.3. The proposed amendment of section 12(h)(ii), in our view, will create further ambiguity on the nature of services that could qualify for exemption and those that would be subject to VAT at the standard rate of 15%. It is our view that the proposed section 12(h)(ii) is too wide and further risks unintentionally widening the scope of exempt goods or services especially with the removal of the requirement that such goods or services must be solely or mainly for the benefit of students. The unintended consequence is that a wide range of goods or services supplied by a school, University, Technikon or College would be read within the interpretation of exemption and thus disqualifying some of these institutions from qualifying to register for VAT purposes and thus limiting their entitlement to input tax.

4.2.6.4. Many educational institutions will have claimed input tax relief on the basis that certain of the goods or services supplied by them were taxable, usually on the basis of apportionment. Such input tax deductions could have applied to immovable property. The widening of the exemption will, as anticipated in the proposed amendments, result in the educational institution ceasing to be vendors. They will accordingly have to claw-back part of the VAT previously deducted as prescribed by section 8(2). While provision has been made to only require affected educational institutions to do so over 12-months, it is apparent that the proposed amendment could place significant financial stress on affected educational institutions.

4.2.7. <u>The higher education sector impact</u>

4.2.7.1. The explanatory memorandum issued by NT suggests that the proposed legislative amendments were included to reflect the policy intent which was that <u>*schools*</u> were to be excluded from having to account for VAT as the registration of thousands of entities would increase the administrative costs on institutions which are not geared to comply with taxation laws, without any net gain to the Fisc. However, the proposed amendments include a Higher Education ("HE") institution, which is contrary to the policy intent which indicates that the intention was to exclude a school from the VAT net and not a HE institution.

4.2.7.2. There are significant differences between the educational services and commercial activities performed by a HE institution and a school, adding to the complexities of the proposed amendments.

4.2.7.3. It is also noted that the higher education landscape changed significantly from when the exemption was first introduced in 1991. While the primary objective for a university remains the supply of educational services, due to economic conditions, a declining Government subsidy and pressure on tuition fees, universities have no option other than to pursue additional revenue sources and as a result perform more commercial

activities. This of course results in a change in the VAT profile and more VAT being incurred in order to provide goods and services other than the supply of traditional educational services.

4.2.7.4. This was also recognized by SARS and NT when the VAT reform that effected certain public authorities, public entities and municipalities (2006) by excluding them from the VAT net but including commercial activities.

4.2.7.5. Not only do these amendments significantly broaden the scope of goods and services to which section 12(h)(ii) will apply, it fundamentally changes the construct of the VAT Act. The proposed amendment in its current form appears to be inconsistent with the policy adopted by National Treasury when implementing VAT changes to public authorities, public entities and municipalities (2006).

4.2.7.6. The proposed amendment has a fundamental impact (and which we believe was unintended) on the HE Sector and the way it operates from a VAT perspective. This will also have a downstream effect through the economy. If the commercial activities are VAT exempt this will in our view create tax cascading especially when these supplies are made to VAT registered businesses. We highlight the anticipated impact of the proposed changes that has been identified to date:

4.2.7.7. Enterprise

4.2.7.7.1. The following activities constitute taxable activities and form part of the HE institution's enterprise activities under the existing legislation (this list is not exhaustive):

- Contract research / research funding;
- Rental of premises on campus to third party vendors such as coffee shops, book stores, ATMs for banks, theaters, etc.;
- Conferences hosted by third party vendors;
- Event sponsorships;
- Consulting work conducted by lecturers to third parties;
- Rental of lecture halls or conference centers;
- Accommodation provided during holiday time for sports tours etc;
- Rental of sports equipment or sport grounds to third parties;
- Campus parking;
- Sale of textbooks, university merchandise, stationary etc. by the university;
- Membership to the university's gym or other sports clubs.

4.2.7.8. The proposed wording to the section results in these types of services and income streams now also falling into the ambit of the exemption, i.e., being incidental to the supply of educational services.

4.2.7.9. This will result in unequal VAT treatment between suppliers and may be advantageous or disadvantageous to universities, depending on the outcome. For example, if this exemption creates a lower price outcome for universities, then it results in universities enjoying a preferential treatment whereas if it creates a higher price outcome it is disadvantageous to universities as they would be priced higher than their competitors or the private sector supplying the same goods or services.

4.2.7.10. By broadening the scope of the exempt nature of supplies made by an educational institution, most if not all of the universities' activities will no longer constitute activities conducted for purposes of its enterprise and the universities will be required to deregister for VAT purposes.

4.2.7.11. Zero-rated grants

4.2.7.11.1. Section 8(5A) read with section 11(2)(t) makes provision for "grants" received by universities to be zero-rated in relation to the deemed supply made by the university to the funder, with the corresponding input tax to be deducted. The deeming provision in section 8(5A) works on the premise that the recipient of the grant is a vendor. Since universities may now be removed from the VAT net by virtue of the proposed amendment, the universities will no longer be able to apply section 8(5A) and 11(2)(t) and it would effectively have a "VAT cost" in respect of a grant. However, other businesses receiving the same grant will enjoy the VAT benefits applicable to grants. This will create inequality between universities, as well as other grant recipients.

4.2.7.12. Timing of proposed amendment

4.2.7.12.1. Due to the major changes that the proposed amendment will bring for universities, the sector will need to make significant changes to systems and processes in order to correctly implement the proposed changes if it comes into effect on 1 January 2025. Agreements with third parties would also need to be renegotiated in terms of price, taking into account that output tax may no longer be levied and the irrecoverable VAT portion that should be included in the costing of the supply.

4.2.7.12.2. It is therefore proposed that this amendment be postponed subject to further consultation with the sector. Given the complexities of VAT accounting in the sector, previous reforms were subject to lengthy consultations for periods longer than 18 months. To prepare for this change and be compliant, the sector will have to:

- Identify affected income streams;
- Determine the financial impact of the amendments including change in use (difficulties with change in use discussed below), costing, renegotiations of agreements with third parties (*list not exhaustive);*
- Train and upskill the relevant staff on the changes;
- Make the necessary system changes which include both output tax accounting and input tax recovery.

4.2.7.13. Change in use (section 18(1)) or deemed supply (section 8(2))

4.2.7.13.1. As per our submissions above, the proposed amendment will result in multiple universities no longer conducting an enterprise and deregistering for VAT. It is therefore crucial NT and SARS engage in consultation with the sector prior to the promulgation of the proposed amendments. For the reasons discussed above, the proposed implementation date of 1 January 2025, realistically will not be possible.

4.2.7.13.2. In addition to the difficulties highlighted above, further anomalies have been identified (which is not in the legislation or proposed amendments). One of these is there may be a requirement to perform a change in use adjustment as a result of the amendments which will have detrimental financial implications.

4.2.7.13.3. The new proposed section 8(2H) further provides relief for vendors that cease to be a vendor by virtue of the amendment to section 12(h)(ii), allowing them to pay the liability over a period of 12 equal monthly instalments or so many instalments as the Commissioner may allow. No similar relief exists for vendors that had not deregistered but had to account for VAT under the change in use provisions in section 18(1) by virtue of it no longer utilising the assets wholly or partially for purposes of making taxable supplies.

4.2.7.13.4. When the VAT reform in respect of certain aspects relating to the VAT enterprise carried on by a public authority, a public entity or a municipality was implemented (during 2005 and 2006), amendments were introduced to regulate the adjustments. Effectively:

- no adjustments were required for a change in use, on the basis that the VAT cost of goods or services acquired prior to the effective date of the VAT reform was already taken into account when the quantum of a subsidy payable to the public authority, public entity or municipality was determined, namely on the assumption that the State already compensated the public authority, public entity or municipality for the VAT cost.

4.2.7.13.5. The Draft Bill does not provide for any similar amendments, to ensure a neutral result in respect of the change in use of buildings by a university, in respect of goods or services acquired prior to 1 January 2025. While it might be arguable that government subsidies do not cover all VAT costs incurred by universities, in view of universities' other income from, inter alia, student fees (the supply of public goods and/or services), the same principle would also apply to public authorities, public entities and municipalities.

4.2.7.13.6. In light of the above, it is recommended that a concession relating to the potential change in use adjustments be considered. This could be a combination of:

- Exclusion for plant, property and equipment donated.
- Exclusion for plant, property and equipment where no input tax was recovered in relation to the acquisition and/or additions of a capital nature.
- Limiting the value of the change in use adjustment to the lower of cost or market value where market value may apply.

4.3. **Recommended solution/ proposal**

4.3.1. If the policy position is not to grant exemption on all goods or services supplied by the schools / higher education institutions, but to rather ensure that the goods or services supplied by the school, university, Technikon or college to students do not create an additional VAT cost burden to students, we proposed that the amendment be as follows:

> "the supply by a school, University, Technikon or College **solely or mainly for the benefit of its learners or students** of goods or services (including domestic goods and services) necessary for or subordinate or incidental to the supply of services referred to in subparagraph (i) of this paragraph".

4.3.2. The proposal is to retain "*solely or mainly for the benefit of its learners or students*" in the proposed amendment.

4.3.3. Further this will ensure that service providers who provide similar goods or services (e.g. letting of accommodation, hiring of venues etc.) are not prejudiced by creating an unfair competitive regime, to the extent that the school, University, Technikon or College is not supplying such goods or services solely or mainly for the benefit of its learners or students.

4.3.4. In addition, clarity is needed with regards to what would constitute services that are "necessary for or subordinate or incidental to" the supply of educational services. The interpretation becomes challenging when such goods or services are not supplied to students or learners.

4.3.5. As noted above, the impact on the relevant educational institutions must also be carefully considered. It may result in significant input tax draw back adjustments in terms of sections 18(1), 18(2) or section 8(2) of the VAT Act. The 12-month payment regime may not be sufficient assistance and a longer time period should be considered.

4.3.6. We recommend that the proposed amendment be reconsidered and that an interpretation note be prepared before any future adjustments to section 12(h) of the VAT Act. In so doing, we recommend that inputs from the educational industry be obtained before any amendment is made to section 12(h) of the VAT Act.

4.3.7. We recommend that as part of the process the apportionment method agreed with the educational industry also be reconsidered in its entirety.

5. Reviewing the foreign donor funded project regime

[Applicable provision: Section 50 of the VAT Act]

5.1. Government proposal

5.1.1. To ease the administrative burden on the implementing agents, Government is proposing that implementing agents register one branch for VAT purposes that encompasses all FDFPs that such implementing agency is responsible to "implement, operate, administer or manage".

5.2. WG response

5.2.1. We understand that the main objective of the proposal is to ease the administrative burden on the implementing agents where implementing agents will be allowed to register one branch for VAT purposes that encompasses all FDFPs that such implementing agency is responsible to "implement, operate, administer or manage".

5.2.2. However, in addition to the normal requirements, implementing agents are required to have an independent system of accounting for each foreign donor funded project. We understand that this requirement will provide sufficient proof of all transactions per each project. However, the implementing agent also has to provide a reconciliation of the values submitted for each return of the separately registered branch with the values of each foreign donor funded project respectively.

5.3. Recommended solution/ proposal

5.3.1. We are the view that the latter requirement is a duplication of the already stringent requirement of the independent system of accounting. We recommend that this requirement be removed.

5.3.2. In the case that National Treasury opts to retain this requirement, we strongly recommend supplying further details on the precise format and content required for the reconciliation.

6. Draft Regulations on Electronic Services for the purpose of the definition of electronic services

6.1. The B2B exclusion

6.1.1. The proposed amendment to the definition of "electronic services" introduce another exclusion under regulation 2(d) which relates to services provided from a place in an export country by a non-resident person. This exclusion applies to suppliers that make supplies ***"solely"*** to vendors registered for VAT in South Africa ("SA"). The explanation provided for this proposed amendment is that government has reconsidered its position on this exclusion to ensure that the VAT regime is as simplified as possible for non-resident suppliers without a physical presence in South Africa. The policy rationale behind this is to ease the administrative burden on such suppliers and recipients where there is little or no gain to the fiscus.

6.2. Effect and practical application

6.2.1. Whilst this B2B exclusion and Intermediary proposed amendments are truly welcomed we believe the below should be considered to ensure and enhance the effectiveness:

- A non-resident electronic services supplier would have to deregister for VAT where it makes supplies solely to VAT registered vendors in SA. It would have no choice to stay a VAT vendor, despite the fact that it may be incurring expenses subject to VAT. It would also need to monitor its client base daily as their VAT registration status could change regularly. This may require a VAT vendor to deregister and then again register for VAT repeatedly.
- Deregistering for VAT may lead to an unintended section 8(2) adjustments.
- If a non-resident electronic services supplier makes supplies to registered vendors in South Africa, it is unclear to what extent the non-resident will be required to retain documentary proof to evidence the right to apply the proposed exclusion under regulation 2(d).
- Where a non-resident supplies electronic services mainly to registered SA VAT vendors and makes a very limited number of supplies to non-VAT registered recipients in South Africa it will be required register and account for VAT on all its supplies.
- Where a non-resident supplies electronic services solely to registered SA VAT vendors and also conducts a "normal" (not electronic services) enterprise, the question manifests:
  - whether the electronic service supplies will fall outside its SA VAT enterprise completely with no VAT reporting liability nor consequence, or
  - whether the "normal" supplies will taint the entire VAT position of the non-resident supplier and require the non-resident supplier to account for VAT on all its supplies, or
  - if a single consideration is charged, would this make part of the charge subject to VAT and part a non-supply requiring apportionment of VAT on expenses.

6.3. A detailed factual description of the affected transaction

6.3.1. As stated above, the purpose of this amendment is to ensure that the VAT regime in South Africa is as simplified as possible for non-resident suppliers, especially in an industry which is constantly evolving. Many non-resident electronic services suppliers are already registered vendors in South Africa and by charging and collecting VAT in respect of all

supplies could, in certain circumstances, create more certainty, control and a clear audit trail.

6.3.2. If the legislation includes the word "solely" as part of regulation 2(d), with no option to stay on the register, it may result in non-resident suppliers having a liability to register as a result of minimal supplies to non-VAT registered vendors. It would also lead to their registration status changing from one month to the other.

6.3.3. We thus recommend, a *de minims* rule (where a certain percentage of supplies can be made to non-VAT registered recipients before the exclusion under 2(d) kicks in).

6.3.4. There should also be an option where, by application to the Commissioner, the suppliers can stay on the register.

6.3.5. Updating systems to cater for a change in the VAT registration status and VAT treatment of supplies and monitoring the residency status of recipients (see intermediary rules below) will be a costly and time-consuming exercise. In addition, some suppliers, even though they may only make supplies to VAT registered recipients currently and may be excluded under regulation 2(d), cannot exclude the eventually that supplies may be made to non-VAT registered recipients in future. This would lead to further complexities to deregister and then reactivate VAT registrations regularly.

6.3.6. The legislation should provide clarity on how the ZAR 1 million threshold as per section 23(1A) should be calculated and whether the calculation is limited to supplies to non-VAT registered recipients in South Africa. In this regard the legislation should make it clear what the nature of the supplies to registered vendors are, and whether these fall outside scope completely with no VAT consequence.

6.3.7. The legislation should provide for no section 8(2) adjustment or for the value to be nil in circumstances where deregistration is required as a result of this legislative change.

6.3.8. These proposals are articulated below as well.

6.4. Recommended solution/ proposal

6.4.1. With regard the B2B exclusion, a de minimis threshold where the electronic services supplier will not provide electronic services within the ambit of the regulation where supplies to non-VAT registered vendors do not exceed R 1m in any 12 month period.

6.4.2. An option where, by application to the Commissioner, the suppliers can request to register or remain on the register.

6.4.3. The legislation should clearly provide that no section 8(2) adjustment will be required where electronic service providers deregister for VAT. This provision should be similar to the proposed amendment to section 8(2) in respect of foreign lessors of ships, aircraft or rolling stock having to deregister for VAT because of the change in legislation.

6.4.4. Confirmation that a foreign supplier that carries on a normal enterprise in South Africa but also qualifies for the B2B electronic services exclusion, will carry on an enterprise only in respect of its normal (non-electronic services) enterprise activities.

6.5. Amendment to intermediaries' provision in section 54 of the VAT Act

This proposed change to the legislation aims to ease the administrative burden on the principal and prevent double accounting of VAT on the same supply. The proposed amendment removes the VAT registration status of the non-resident principal supplier as a determining factor. The proposed amendment also requires the intermediary and the principal supplier to agree in writing that the supply will be treated as being made by the intermediary and includes the concept of joint and several liability for both the principal and the intermediary.

6.5.1. The legal nature of the problem

6.5.1.1. Intermediaries act as marketplace operators, not only for vendors and non-vendors but also for residents and non-residents. In addition, intermediaries could have supplies, as principal, in their own right.

6.5.1.2. Limiting the application of the intermediary provisions to only apply to non-residents will create added complexities for intermediaries and will not achieve the purpose of the amendment, which is to ease the administrative burden.

6.5.2. A detailed factual description

6.5.2.1. Intermediaries are currently required to determine the VAT registration status of non-residents supplying electronic services via its marketplace. The proposed amendment, will merely shift the evaluation from the VAT registration status to the residency status of the supplier, thus not alleviating the administrative burden on marketplace operators.

6.5.2.2. Intermediaries will be required to monitor compliance with the exclusion as provided for in paragraph 2(d) of the regulation (as detailed above), in order to determine whether VAT is required to be accounted for in respect of each specific supply, being in respect of their own supplies but also that of the suppliers on their marketplace. This will require very sophisticated and expensive system capabilities that can isolate these transactions and "turn certain supplies on and off". This also creates significant room for error where only some transactions are accounted for, whilst others need to be excluded.

6.5.2.3. In terms of section 54(1) and (2) of the VAT Act, although an agent may issue or receive tax invoices, debit notes and credit notes, the supply is still deemed to be made by the principal. Therefore, a similar problem arises for persons acting as auctioneers. However, having regard to the practical implications of the basic rule regarding agents, legislation was passed making an exception to the normal agent-principal rules for auctioneers.

6.5.2.4. Pooling arrangements create a similar precedent in section 52 of the VAT Act. In practice, the pools, while being agents, were treated as separate entities. The Value-Added Tax Committee (VATCOM) was requested to recommend to government that the pools be treated as entities separate from the participating farmers. The section that was introduced provided that the pools may be treated as principals for VAT purposes. The same can be said of rental pools in section 52(2). Allowing the "pools" to operate in this manner, eliminates the practical difficulties which the manager of the rental pool scheme would have experienced if some supplies of accommodation were taxable (where the owner or shareholder is a vendor) whilst others were non-taxable (where the owner or shareholder is not a vendor). The main purpose of section 52(2) was to create a situation where the operator is regarded as the principal and not the agent of the owners of the

units. This allowed the input tax and output tax to be accounted for by the operator under one VAT registration, instead of by each owner under a number of VAT registrations.

6.5.2.5. The same mechanism should exist for intermediaries/agents making supplies on behalf of a principal to ensure that the output tax is declared (and related input tax is claimed) regardless of registration status of the principal, the resident status of the principal or the place where the supply takes place. This would limit the risk of non-compliance and relieve the practical difficulties experienced, with the benefit of making South Africa the destination of choice to serve as the "hub" for supplies of this nature into Africa.

6.5.3. Recommended solution/proposal

6.5.3.1. We recommend that the proposed intermediary provisions be widened so that where the intermediary/agent facilitates a supply, issues the invoice and collects the payment for this supply, it is, upon agreement with the principal, deemed to make this supply and is liable for and entitled to the output and input tax in relation to this supply:

- Whether or not the principal is a resident of the Republic;
- Whether the supply takes place within or outside the Republic
- Whether this constitutes a supply of goods or services.

6.5.3.2. The mechanism of the amendment requested will limit the risk that the suppliers do not account for VAT and addresses the risk that the imported services VAT is not accounted for. It simplifies who is held accountable for the transactions, creates more certainty and a clear audit trail.

6.5.3.3. These intermediary provisions should also not be limited to electronic services being supplied in this manner, but should be open to all VAT vendors and in respect of all supplies.

6.5.3.4. The nature of the business(es) impacted.

6.5.3.4.1. Electronic services suppliers, marketplace operators / intermediaries and resident suppliers which supply through a marketplace.

6.6. General comment regarding "minimal human intervention" in the comments to the draft regulations

6.6.1. The Explanatory Memorandum, issued together with the 2024 proposed amendments, discusses the concept of "minimal human intervention" as this was first mentioned in the explanatory memorandum which accompanied the 2019 amendments. The concept of "minimal human intervention" was never formally introduced in the VAT Act or the regulations. The 2024 Explanatory Memorandum explains that the intention was for the interpretation of these provisions to be done within the spirit of minimal human intervention. However, it had come to light that the concept was interpreted too broadly, contrary to the initial intention. In light of this, the 2024 Explanatory Memorandum proposes that the interpretation of which services fall within the regulations and the VAT Act should be as wide as possible, with no regard to the words "minimal human intervention."

6.6.2. This extremely wide interpretation leads to impractical application where services, which by their very nature are not electronic but are delivered by some electronic means (for example an opinion compiled by a human and sent via e-mail) are interpreted by SARS,

under the above mandate, to be electronic services. It would be important to provide guidance making it clear that the service rendered as well as how it is delivered should be electronic for it to constitute an electronic service as defined. The solitary act of delivering a service using some electronic agent to effect such delivery does not turn this service into an electronic service.

Lastly, the phrase "*services supplied **by means of** an electronic agent, electronic communication or the internet ….*" suggests that the electronic element cannot simply refer to how the content is communicated or transmitted to the recipient, but rather ***how*** the services are supplied by **way of** or **with the help of** an electronic medium.

6.7. 'Group of companies' exclusion

6.7.1. The exemption in respect of "group of companies" must be deleted. There is no necessity for it and it is in conflict with the proposed B2B exclusion. There is no reason for limiting intra-group supplies in the manner provided for, and proposed. Intra-group companies would in any case qualify for the proposed B2B exclusion.

7. Miscellaneous

Section 21(1)(d) of the VAT Act – Goods or services returned

7.1. Background and problem statement

7.1.1. Where a VAT vendor acquires a going concern and goods or services supplied to the previous owner of the concern are returned, the supply is deemed to have been made to the new owner and the new owner may make an adjustment in terms of section 21 of the VAT Act.

7.1.2. Section 21(1)(d) of the VAT Act allows a deduction where goods or services have been "*returned*" to the new owner.

7.1.3. There are also various instances where the goods or services would not have been returned, but an adjustment to the price previously charged would still be warranted. An example would be where VAT has been charged at the standard rate and it should have been charged at the zero rate or a discount is granted to the recipient. The services were clearly not returned; only the consideration for the supply is being altered. As the service was not originally supplied by the new owner of the going concern, the other sub-paragraphs of section 21(1) of the VAT ((a), (b), (c), and (e) would not apply. The only recourse to the vendor is section 21(1)(d) of the VAT Act if it could be argued that the services have been returned.

7.1.4. The purpose of section 21(1)(d) of the VAT Act is, in our opinion, to ensure a VAT neutral position where output tax has been declared on a supply and the output tax on the supply is subsequently reduced. Section 21(1)(d) of the VAT Act ensures that the adjustment can be made by the new owner of the business.

7.1.5. When regard is had to the broad structure and context of the VAT Act, we are of the view that the new owner should in principle be in a position to issue a debit or credit note to effect an adjustment to the consideration charged by the previous owner.

7.2. Recommended solution/Proposal

7.2.1. We recommend that National Treasury amend section 21(1)(d) of the VAT Act to allow the new owner to effect an adjustment to the consideration charged for a supply made by the previous owner.

End.