31 August 2020

To: The National Treasury
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0001

The South African Revenue Service
Lehae La SARS, 299 Bronkhorst Street
PRETORIA
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VIA EMAIL: National Treasury (2020AnnexCProp@treasury.gov.za)
SARS (acollins@sars.gov.za)

Dear Colleagues,

RE: DRAFT TAXATION LAWS AMENDMENT BILL, 2020: VALUE-ADDED TAX

We attached the comments from the SAIT VAT Technical Work Group (the WG) on the Draft Taxation Laws Amendment Bill, 2020, as it pertains to VAT and related matters. We value the opportunity to participate in the legislative process and would welcome further engagement where appropriate.

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

Yours sincerely,

SAIT VAT Technical Work Group

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All references are to legislation are to the Value-Added Tax Act, No. 89 of 1991, and proposals contained in the Draft Taxation Laws Amendment Bill, 2020.

1. REVIEWING THE VAT ACCOUNTING BASIS OPTION AVAILABLE FOR AN INTERMEDIARY

[Applicable provision: Sections 15(2)(a)(vii) and 54(2B)]

1.1 Background

1.1.1 The legislation allows VAT vendors to account for VAT on the invoice or cash (payments) basis. However, the SARS system defaults applications under certain circumstances to the payments basis of accounting for VAT purposes.

1.2 Commentary

1.2.1 In terms of the VAT Act, certain supplies made by an underlying foreign electronic services supplier are deemed to be made by the intermediary, who is then required to levy and account for South African VAT on these supplies. Currently, the intermediary may only account for VAT on the invoice basis. It is proposed that an intermediary vendor be allowed to account for VAT on a payment basis.

1.2.2 On a related matter, the WG would like to note from a VAT operational point of view, vendors may elect upon registration to account on the payment or invoice basis. However, in the case of vendors registering in respect of the provision of e-services, the system default and only allows for registration on the payments basis. This anomaly must be rectified, especially since certain accounting systems are not geared to account for VAT on the payment basis.

2. CHANGING THE VAT TREATMENT OF TRANSACTIONS UNDER THE CORPORATE REORGANISATION RULES

[Applicable provision: Sections 8(25) and 11(1)(e)]

2.1 Commentary

2.2.1 The WG notes the proposal, and appreciates the inclusion thereof in the draft TLAB. Since this matter was raised by the WG during response to the request for Annexure C proposals, we offer our support should any assistance be required regarding case studies.

3. CLARIFYING THE VAT TREATMENT OF IRRECOVERABLE DEBTS

[Applicable provision: Proviso (ii) to section 22(3)]

3.1 Commentary

3.1.1 The WG welcomes the proposal, and appreciates the inclusion thereof in the Budget Review.

4. REVIEWING THE SECTION 72 DECISION RELATING TO THE VAT TREATMENT OF INTER-CONNECT SERVICES WITH REGARD TO TELECOMMUNICATION SERVICES

[Applicable provision: Section 11(2)]

4.1 Background

4.1.1 There is no definition of International Communications Services Providers as contained in the Regulation to the Final Acts of the World Conference on International Communications Dubai. There is only a definition of International Communications Services.

4.1.2 The charges between telecommunication service providers referred to, are in respect of roaming. In this regard the service provider of the client who roams get charged two fees on a single invoice by the foreign service provider, or vice versa. The one is called a roaming fee charged for the use by the customer of the other service provider's network and an interconnect fee.

4.1.3 As noted in the Explanatory Memorandum, this amendment is proposed to ensure that telecommunication providers do not have to request section 72 rulings for these charges. The originating course of the rulings, from a South African VAT point of view, is that section 11(2)(l) cannot find application since the foreign service provider's customer is in SA, where a local service provider charges fees to the foreign service provider.

4.1.4 The main concern regarding the proposed section 11(2)(y), is that the wording does not clearly indicate that it is the "services", that are contemplated in the International Telecommunications Regulation. The wording could also be interpreted so that it is the "International Telecommunication Service Providers" that are contemplated in the International Telecommunications Regulation.

4.2 Commentary

4.2.1 To clearly state that the section is to apply specifically to "services", that are contemplated in the International Telecommunications Regulation, we recommend the following change in wording:

> *"the services, as contemplated in the International Telecommunications Union Regulations …, are supplied by Telecommunications Service Providers registered in the Republic in terms of the Electronic Communications Act, 2005, to International Telecommunication Service Providers;"*

5. REVIEWING THE SECTION 72 DECISION WITH REGARD TO THE VAT TREATMENT OF CROSS BORDER LEASES OF FOREIGN-OWNED SHIPS, AIRCRAFT AND OTHER EQUIPMENT FOR USE IN RSA

[Applicable provision: Definition of "enterprise" in section 1(1) and section 23(2)]

5.1 Background

5.1.1 SARS issued numerous section 72 rulings to foreign lessors who supply goods on a rental basis to local lessees. These rulings direct that the foreign lessor is not liable to register as a VAT vendor in South Africa, provided that the local lessee accounts for the VAT on importation of the goods to be leased. On extension of the lease term, the lessee is required to do a voucher of correction to account for VAT on the additional rentals due. The VAT is calculated based on the total rental value of the lease term. These rulings often also direct that disposals of the goods by the foreign lessor whilst the goods are located in South Africa, will not give rise to a VAT registration liability for the foreign lessor. These dispensations have arguably been granted on the basis that the foreign lessors do not have a presence in South Africa (other than for the goods) and since the correct amount of VAT is collected on importation and/or extension of the lease, rendering the registration of the foreign lessor unnecessary for practical purposes.

5.1.2 SARS also issued section 72 rulings that grant dispensation, similar to that described above, where the foreign lessor either disposes of leased goods already imported into South Africa and subject to an existing lease to another foreign lessor, or novates the lease to another foreign lessor. These rulings direct that the new lessor is also not required to register as a vendor in respect of either the lease rentals or the subsequent disposal of the leased goods.

5.2 Commentary

5.2.1 <u>Contentious issues</u>

5.2.1.1 The proposed amendment is contrary to the spirit of the VAT Act and the stated objective of government that the VAT system aims to tax final domestic consumption, since it is clear that the foreign lessors are carrying on an enterprise in South Africa, in the same manner as foreign suppliers who carry on any other enterprise in South Africa.

5.2.1.2 The proposed amendment is also not aligned with the VAT Act and its application. The proposed amendment would, if enacted, take the place of interpreting scenario specific facts to establish whether an "enterprise" exists. The VAT Act must be interpreted to determine various foreign person scenarios. Examples include (i) turnkey projects where a plant is built offshore and imported into South Africa by an agent and supplied to a customer in South Africa.

5.2.1.3 The offshore contractor outsources the installation to a local entity but remains contractually responsible for the warranty, functionality and delivery of the plant to the customer; (ii) commodities trading of goods bought and stored in SA, which are supplied from South Africa to international buyers by the offshore commodities trader; and (iii) leasing of gold in South Africa by offshore banks and exportation of gold by those banks from South Africa.

5.2.1.4 The VAT Act should endeavour to treat local persons and foreigners the same, where appropriate, which the proposed amendment does not adhere to.

5.2.1.5 It is deduced that the dispensation is a practical way of limiting the amount of VAT registrations in South Africa, whilst ensuring that the ultimate tax collected remains the same. The proposed proviso (xiii) also does not require the lessee to be a vendor or that the assets be used to make taxable supplies. There may be VAT leakage for the fiscus if the customs value of the asset is not determined based on the lease payments i.e. asset's customs value is lower than rental value and used for transport of fare-paying passengers by road or rail. This practical approach of reducing VAT registrations by foreign suppliers is not unique to rental enterprises (sections 12(k); 54(2A); 54(2B); 54(6) etc.).

5.2.1.6 A further contentious issue is whether the local lessee is entitled to claim VAT incurred on importation and/or extension of lease, as an input tax deduction, especially if the foreign lessor has not obtained a section 72 ruling as envisaged above. In this regard there are two schools of thought.

5.2.1.7 The one interpretation is that the VAT incurred on importation constitutes "input tax" as defined on the basis that the word "acquired" as used in the proviso to the definition, is not limited to purchases where ownership needs to transfer to the recipient. This interpretation is strengthened as it is commonly accepted that VAT incurred on goods acquired in terms of a rental or lease from a local vendor, constitutes "input tax" if the lessee acquires the goods for purposes of consumption, use or supply in the course of its enterprise.

5.2.1.8 The second interpretation is that the VAT incurred on importation does not constitute "input tax" since the goods are owned by the non-resident who will be using the goods for purposes of on-supplying in terms of a rental agreement, with the result that the VAT constitutes "input tax" for the lessor if the lessor has a VAT registration liability. This interpretation is strengthened as the VAT incurred on importation cannot constitute input tax for both the lessor and lessee. This interpretation is further strengthened if the foreign lessor has a VAT registration liability or is registered as a vendor, but the goods are cleared by the lessee and the VAT incurred claimed as an input tax deduction. The lessee will not be willing to pay an additional amount of VAT on the lease rentals charged by the lessor, even if the lessor issue tax invoices. In such instance the VAT will become a cost to the lessor, which contradicts the principles of the VAT system.

5.2.1.9 In addition to the above, the explanatory memorandum seems to focus on foreign going aircraft, and – ships, and other goods, whilst the proposed amendment seems to take a wider approach, albeit that this could be a perception created.

5.2.2 <u>Proposed amendment</u>

5.2.2.1 The proposed amendment intends to yield the same result as the section 72 rulings, which will ensure that no further section 72 rulings will be required, assuming that the proviso will remain in its current or a revised form, after December 2021, when all section 72 rulings lose their binding effect. We do, however, not believe that the current wording of the proviso will give effect to the intended result. The amendment also does not address the contentious issues of the spirit of the VAT Act and the intent of the VAT Act to tax final domestic consumption, and the claiming of VAT incurred on importation as an input tax deduction.

5.2.2.2 Although the intention of the reference to "delivery" of the goods outside South Africa is clear, we believe that the wording may not give effect to the intention. Contracting parties agree Incoterms which often dictate the party responsible for clearance, duties, and VAT. As a result, delivery outside South Africa does not determine who is liable for the VAT on importation. The requirement that the parties agree that the lessee will clear the goods, account for the VAT and that the lessor will not reimburse the VAT paid by the lessee, could be contrary to the agreed Incoterm, where such terms require the foreign lessor to clear the goods (e.g. DDP). If the lessor is contractually liable to clear the goods and pay the VAT, the requirements of the proposed proviso will not be met, and the lessor will remain liable to register as a VAT vendor.

5.2.2.3 We are consequently of the opinion that the reference to "delivery" outside South Africa will not achieve its intended purpose. Since one of the requirements is that the parties must agree that the lessee will be liable to clear the goods and pay the VAT without being reimbursed by the lessor, it is our view that this requirement on its own is sufficient without the requirement of delivery outside South Africa. It will still be required that the Incoterm agreed on, allow the lessee to be responsible for the clearance and the VAT. In other words, supplies on e.g. DDP will be excluded from the ambit of the relief intended in the proposed proviso. Assuming that this result was not intended, we recommend that wording be introduced that the liability on the lessee to clear the goods and pay the VAT, could either be in the capacity as agent for the foreign lessor or as principal. Such an amendment will be required since the provisions of section 54(2A)(b) will not apply. The two schools of thought on "acquired" for "input tax" purposes will still need to be considered to ensure that the legislator allows an input tax deduction in the hands of the lessee.

5.2.2.4 Further, the proviso does not seem to address the scenarios where the lessor disposes of the goods and cedes the lease. In this instance it could be argued that since a rental is a progressive supply, delivery by the new lessor takes place in South Africa. This potential uncertainty may be addressed by, for example, removing the reference to delivery outside South Africa, as recommended above.

5.2.3 <u>Conclusions and recommendations</u>

5.2.3.1 We understand that the proposed amendment aims to limit foreign VAT registrations if they have no direct financial benefit to the fiscus. We recommend as follows:

5.2.3.2 We recommend that strong consideration be given to not introduce proviso (xiii) as it is against the spirit of the law and government's stated objective that the VAT system seeks to tax final domestic consumption through subjecting vendors' supplies to VAT; the VAT Act should be applied and interpreted to a set of facts to determine whether an "enterprise" exists; and the VAT Act should endeavour to treat local persons and foreigners the same, where appropriate. However, should government decide to continue with the amendment, we comment as follows (paragraphs 5.2.3.3 – 5.2.3.10).

5.2.3.3 We recommend that strong consideration be giving to not affect the proposed changes in the definition of "enterprise" itself, as it in effect contradicts the spirit of the law and intention of the definition and the VAT system.

5.2.3.4 We recommend that the reference to "delivery" in the proposal be removed, as it may contradict agreed upon Incoterms.

5.2.3.5 We recommend that the proviso should require the lessee to be a vendor and/or that the assets be used to make taxable supplies.

5.2.3.6 We recommend that the width of the types of supplies that may be impacted by the proposal be reconsidered. The current wording of the proposal is very wide and may have unintended consequences.

5.2.3.7 We recommend that specific provisions be included to cater for extended leases, to put it beyond doubt that the lessee is also required to account for the additional VAT payable on importation.

5.2.3.8 We recommend as utmost import to specifically address the claiming of input tax deductions, where the foreign lessor qualifies for the exclusion from "enterprise" in terms of the proviso, and also where it does not qualify and is liable to be VAT registered.

5.2.3.9 We recommend that the two interpretations on "acquired" for "input tax" purposes need to be considered to ensure that the legislator allows an input tax deduction in the hands of the lessee, where required to do so.

5.2.3.10 We recommend for sake of prudency to provide for transitional provisions since no agreement, as envisaged in the proviso, may currently be in place between the parties, which will have the effect that once the existing section 72 ruling expires, the lessor will by implication be liable to be registered.

5.2.3.11 We recommend that wording be introduced that the liability on the lessee to clear the goods and pay the VAT, could either be in the capacity as agent for the foreign lessor or as principal. Such an amendment will be necessary since the provisions of section 54(2A)(b) will not apply.

End.