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27 August 2021

To: The National Treasury
240 Madiba Street
PRETORIA
0001

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

Via email: National Treasury (2020AnnexCProp@treasury.gov.za)
SARS (acollins@sars.gov.za)

RE: DRAFT TAXATION LAWS AMENDMENT BILL, 2021: VALUE-ADDED TAX

Dear Colleagues,

We attach the comments from the SAIT VAT Technical Work Group (the WG) on the proposals contained in the draft Taxation Laws Amendment Bill, 2021, 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

All references to the legislation are to the Value-Added Tax Act, No. 89 of 1991, and proposals contained in the draft Taxation Laws Amendment Bill, 2021.

1. VAT treatment of temporary letting of immovable property

[Applicable provisions: New section 18D, new section 10(29) and section 9(6) of the VAT Act]

1.1 Background

Section 18D and the related value and time of supply rules contained in sections 9(6) and 10(29) respectively, are aimed at providing relief to developers of residential property (dwellings) who are not in a position to immediately supply the properties by way of sale and accordingly rent the properties to tenants in the interim.

The section applies where developed properties are temporarily supplied by the developers to tenants in terms of agreements for the letting or hiring thereof.
The purpose of the section is to avoid an adjustment in terms of section 18(1) of the VAT Act whereby output tax becomes payable on the market value of the property once it is rented out, hence the wording of section 18B(2) "*Notwithstanding the provisions of section 18(1) …*".

1.2 Current practical understanding

Regarding developers of residential property temporarily supplied for rental: Our view is that as long as the vendor's intention is to sell the property, it will carry on an enterprise. The onus of proof is on the vendor to prove such intention. This change in intention will also be required to be reflected for income tax purposes, since the property will change from trading stock to that of a capital asset, if the intention changes to that of rental of dwellings. Temporarily is therefore linked to the intention of the vendor.

However, we acknowledge that since intention is subjective, uncertainty is created, especially under these circumstances. As such, a time limit as a proxy for intention, similar to that in section 18B, will assist in providing certainty.

That stated, to the extent to which the property is sold for the purpose envisaged in subsection (2)(a), the supply will constitute a taxable supply. However, there may be an issue where the vendor is only engaged in developments that are subject to section 18D. This may require the developer to deregister where taxable income drops below R 50k in any consecutive 12 -month period. The question is then whether a subsequent sale, which is deemed to be a taxable supply by that vendor (section 18D(3)) require the vendor to reregister as it will in the interim have deregistered as a vendor?

We discuss these and other matters below.

1.3 Problem statement

Based on the current proposed wording of the section, the section does not contain a definition or timeframe within which property will be regarded as being temporarily applied for rental purposes.

The proposed section 18D(2) determines that if "*such fixed property is subsequently temporarily applied by that vendor for supplying accommodation in a dwelling under an agreement for the letting of hiring thereof, the supply of such property shall be deemed to have been supplied by the vendor by way of a taxable supply for a consideration as contemplated in section 10(29) and shall take place in accordance with section 9(6)".*

From the above wording it can be deduced that the property, once it has been deemed to have been supplied by way of a taxable supply, no longer forms part of the VAT enterprise carried on by the VAT vendor.

The above interpretation is supported by the wording of the proposed section 18D(3) that deems the subsequent sale of property to be *"deemed to be a taxable supply in the course or furtherance of the vendor's enterprise and shall take place …".* This section effectively brings the property back into the enterprise when ultimately disposed of by deeming the supply to be a supply in the course of the enterprise carried on by the VAT vendor.

The above provisions serve their purpose provided that the impacted properties are sold to a third person while the rental activities are still carried on.

That stated, as mentioned above, for as long as the intention is to sell, the supply is taxable and does not require a deeming provision. In this regard it could perhaps be stated that to the extent to which the property is sold for the purpose envisaged in subsection (2)(a), the supply constitutes a taxable supply.

However, based on the current proposed wording of the relevant sections, no provision is made for circumstances where a VAT vendor takes a conscious decision to no longer hold the properties as trading stock, but as capital assets what would in future only be rented out (change in intention). In other words how should section 18(1) be applied.

It should also be clarified how VAT should be accounted for when the developer seeks to deregister for VAT on the basis that it no longer meets the minimum threshold (i.e. R 50k) requirement.

1.4 Some illustrative examples

The impact of the above challenges can be demonstrated by the following example.

Cost of developing property	Cost excluding VAT	VAT	Cost including VAT
Land	500 000	75 000	575 000
Plant hire, materials, etc.	600 000	90 000	690 000
Labour	800 000	-	800 000
Total cost of development	**1 900 000**	**165 000**	**2 065 000**
Sales price/ Market value	**3 500 000**	**525 000**	**4 025 000**
Net VAT payable		**360 000**	

Scenario 1 – Property is sold without interim renting (i.e. 18D does not apply)

Output tax	**525 000**
Input tax	(165 000)
Net amount payable to SARS	**R360 000**

Scenario 2 – Property is sold after interim renting (supplier is still a VAT vendor)

Output tax due	**525 000**
Adjusted cost adjustment (Section 18D(4)	**(165 000)**
Net amount payable to SARS	**R360 000**

Scenario 3 – Property developer decides to rent out a property permanently (Change in intention) – section 18(1) of the VAT Act

Scenario 4 – Property is permanently used as a rental asset (i.e., section 18D no longer applies)

Output tax – section 18(D)	**R165 000**
Output tax – section 18(1) – refer below comments	**R525 000**
Total output tax payable to SARS	**R690 000**

To preserve the integrity of the VAT system, an exit provision (exit from the proposed 18D regime) is required under circumstances where there is a change in intention from temporary to permanent use. The application of section 18(1) should be similar to where the property is sold in terms of section 18(D) where the balance (if any) of output tax, which will be based on the open market value, should be accounted for to SARS. As the proposed amendment currently reads the vendor will be required to account for the section 18(D) adjustment and then again on the open market value of the property when section 18(1) becomes applicable.

Deregistration

Scenario 5 – Vendor deregisters during temporary letting period – section 8(2)

Output tax – section 18(D)	**R165 000**
Output tax – section 8(2) (lower of cost or open market value) – see below comment	**R165 000**
Total output tax payable to SARS	**R330 000**

The proposed section does not deal with the situation where the vendor deregisters as a VAT vendor should its supplies drop below R1m. It is not clear on what value output tax should be accounted for in terms of section 8(2) in view of the output tax adjustment already made in terms of section 18(D).

1.5 Recommendations

1.5.1 We recommend that clarity be provided with regards to what is regarded as a temporary rental.

1.5.2 We recommend that additional wording be introduced to deal with a permanent change to non-taxable use (refer section 18(1)) and where the vendor deregisters for VAT whilst still letting the property on a temporary basis (refer section 8(2)).

2. Reviewing the section 72 arrangement with regard to telecommunications services

[Applicable Provision: Section 11(2)(y) of the VAT Act]

2.1. Background

In 2019 changes were made to section 72 of the VAT Act, which deals with the SARS Commissioner's discretion to make arrangements or decisions regarding the application of the VAT Act to specific situations where the manner in which a vendor or class of vendors conducts their business leads to difficulties, anomalies or incongruities. These changes had an impact on the arrangements or decisions made before 21 July 2019. To address these concerns, in the 2020 Budget Review, government agreed to review the impact and the role of these arrangements and decisions to ascertain whether they should be discontinued or extended in accordance with the new provisions of section 72.

One of the arrangements and decisions made in terms of section 72 of the VAT Act, which was impacted by these changes is the VAT treatment of telecommunication services. South Africa is a signatory to the International Telecommunications Regulations that were concluded at the World Administrative Telegraph and Telephone Conference, Melbourne 1988 (the Melbourne ITR). South Africa is also a signatory to the International Telecommunication Regulations that were concluded at the World Conference on International Telecommunication held in Dubai (Dubai ITR) which was effective from January 2015.

2.2. Recommendations

From our understanding the proposed amendment is required because the current legislation is limited to 'roaming' services.

From the current section, it follows that the zero rate only applies to roaming services. The proposed wording of the section seems to suggest that the zero rate will apply to all services envisaged in the ITR which are supplied by local telecommunications providers to foreign communications providers. However, where the services are supplied directly to a branch, main business or customer of the foreign telecommunications supplier, where the said persons are in the Republic at the time the services are rendered, the zero rate will only apply if the services supplied are roaming services.

Based on the above, it thus seems as if the services which the legislator intend including in the zero rate provision, are services which would otherwise not be included in the ambit of section 11(2)(l) for example, services supplied directly in connection with land or improvement thereto or directly in connection with moveable property in the Republic, but to the extent that the services are those envisaged in the ITR.

We require clarity as what other services (i.e. other than roaming services) would qualify for zero rating in terms of the proposed section when supplied to a foreign telecommunications supplier who has no presence in the Republic.

End.