

Ref #:

Submission File

23 April 2018

South African Revenue Service
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Mr Allan Wicomb
 Parliamentary Standing Committee of Finance
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BY E-MAIL: Mr Allen Wicomb (awicomb@parliament.gov.za)
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 Mr Zolani Rento (zrento@parliament.gov.za)

Dear Allan

COMMENTS ON THE DRAFT RATES AND MONETARY AMOUNTS AND AMENDMENT OF REVENUE LAWS BILL 2018

1. The National Tax Committee on behalf of the South African Institute of Chartered Accountants (SAICA) welcomes the opportunity to make a submission to National Treasury (NT) and the South African Revenue Service (SARS) on the updated Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill 2018 (Draft Bill) dated 9 March 2018.

SUBMISSION

Removal of the VAT rate in section 7

2. Section 9 of the Draft Bill proposes to increase the value-added tax (VAT) rate from 14% to "the rate specified in subsection (1)" as legislated in section 7(1) of the Value-added Tax Act No 89 of 1991 (VAT Act), subsequent to the announcement made by the Minister of Finance during the 2018 Budget Review on 21 February 2018. The Draft Bill furthermore provides that the rate increase is deemed to come into operation 1 April 2018, as announced during the 2018 Budget Review.
3. Section 7(1) of the VAT Act imposes VAT and currently determines the standard VAT rate at 14% in its various subsections. The proposed amendment however, only makes reference to a "specified rate" within the same sub section, without giving clarity what the increased VAT rate will be.



4. Submission: It is submitted that section 7(1) of the VAT Act should be amended to contain the relevant VAT rate of either 14% or 15%.

Directing relief - Increase in VAT rate

5. SAICA previously acknowledged that the increase in the VAT rate, which NT has resisted for the last few years, was an unfortunate consequence of decisions that created a situation where there was no other way to fund the *fiscus* at the current budgeted income levels. The acknowledgement in the 2018 Budget Review that even "*flogging the dead horse of PAYE*" has not yielded the expected results, with substantial under budget recoveries in the last 2 years for the first time in decades, notwithstanding a marginal tax rate increase to 45% last year, prompted the need for a broader based solution to the budget deficit crisis.
6. The alternative to this would in our view be further budget cuts as no other tax instrument currently in operation could potentially yield such large returns.
7. The detrimental impact on the poor, as a result of the proposed VAT rate increase (or even a decrease in certain spending), cannot be effectively 'cushioned', since VAT is a broad based (and regressive) tax instrument.
8. Section 11(1)(j) of the VAT Act zero-rates the supply of certain foodstuffs set forth in Part B of Schedule 2 to the VAT Act, which includes brown bread, maize meal, samp, mealie rice, dried beans, lentils, canned pilchards or sardines, milk powder, rice, vegetables, fruit, milk and eggs.
9. Submission: SAICA submits that should Parliament pass the VAT increase; an interim consideration should be provided to extending the basic foodstuffs list of zero rated items to lighten the financial burden impacting the poor, though we are cognisant that doing so also provides unintended relief to those that don't need it and increases the fiscal cost.
10. As a more permanent solution, it should be considered whether the estimated R26.9 billion (using 2016 data as base) allocated to zero rated foodstuffs should be reconsidered for a more direct benefit model. For example, using an expanded South African Social Security Agency (SASSA) registration system (for social grant recipients and working poor 2 tier system) to identify beneficiaries of the zero rating or leveraging current retailer loyalty registration systems. This would be similar principles as the repealed VAT relief afforded to the agricultural sector (VAT 103), but may be easier to avoid abuse given the target market. Furthermore, purchase data could be recorded that will enable government to directly identify and benefit those intended for the relief, but also gain insight what grants and other money is spent on to target actual spending items. Lastly, by giving relief "at the till", vendors will not be able to manipulate prices broadly as with the current zero rating, thus preventing any diversion of the zero rating benefit to profits rather than price relief.

Timing of increase – Legislative process

11. Section 7(4) of the VAT Act provides that the alteration of the VAT rate effective from 1 April 2018 as announced by the Minister of Finance continues to apply for a period of 12 months from that date, subject to Parliament passing legislation giving effect to the announcement within the 12 months period.



12. Concern has been expressed that allowing the Minister to have temporary legislative powers that need to be confirmed by Parliament creates a practical challenge where Parliament rejects such increase. This problem is exacerbated with a transactional tax like VAT as there would have to be a general recovery and refund from a multitude of persons.
13. We have requested our colleagues in other countries to confirm the practice in their relevant countries which are as follows:

New Zealand

In New Zealand, rate changes can as principle only occur prospectively with proposals made for the following budgeting cycle. Where an immediate change is required such as for anti-avoidance, the amending Bill is tabled for debate and passing in the house on the date of the announcement.

Australia

Australia in law can only pass rate changes prospectively. However, in practice, rate changes especially for payroll and sin taxes are done on announcement and implemented in good faith until enacted by Parliament. This is usually on a few months later.

United Kingdom

In the UK, legislation needs to be implemented by a Ways and Means Resolution. However, in practice convention exist that rates are adjusted by announcement, but has to be tabled before the Exchequer within 4 months.

United States

All taxation rate increases must as a start be tabled in the House Ways and Means Committee and will only prospectively become law after enactment through Presidential signature. Where rates need to be increased, a resolution of intent may be issued in March of the year to be tabled in September later the year. No tax rate increases can be done without prior enactment.

Canada

Canada in law can only pass rate changes prospectively. However, in practice rate changes are done on announcement and implemented in good faith until enacted by Parliament. This time period by practice never exceeds 3 months.

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| <ol style="list-style-type: none">14. <u>Submission:</u> The extension of interim legislative powers to the Minister has created a legal platform to legally increase tax rates by announcement in the budget. However, concerns remain as to the encroachment of these provisions on the separation of powers embodied in the Constitution and the exclusive legislative mandate of Parliament.15. This approach also practically creates much difficulty as the implementation by taxpayers of rate changes are expected immediately or in short time periods, which does not properly allow for software and process changes. Furthermore, where Parliament does not approve such an increase, this will create much practical hardship especially with transactional taxes where refunding the money may be impossible. |
|--|



16. Though proposals like providing for the tax rate increase to apply permanently at least until the Bill is passed in Parliament creates practical solutions, it will provide legislative powers to the executive which is not Constitutionally compatible in our view.
17. In our view, as seen in many other countries, it may be more appropriate to start the budget consultations earlier in the year with intent to table the Bill with final proposals on Budget day, similar to New Zealand.

Practical issues identified on implementation of the increased VAT rate

18. The implementation of the VAT rate increase from 1 April 2018 has resulted in a multitude of practical problems, as apparent from the submission made by SAICA to SARS on 28 March 2018.
19. **Submission:** SAICA submits that there are practical concerns that need to be attended resulting from the VAT rate increase rate. We have attached our submission called "*Proposal regarding practical issues identified on implementation of the increased VAT rate, effective 1 April 2018*" in this regard as Annexure A.

Effective date of VAT on E-services

20. Section 8, 11 and 12 of the Draft Bill has reference to the proposed amendments to electronic services for the purpose of the definition of "electronic services" in section 1 of the VAT Act.
21. The Draft Bill provides that the amendments would be deemed to have come into operation on 1 October 2018.
22. The first National Treasury/Taxpayer workshop is scheduled for 25 May 2018 to discuss the comments received on the proposed VAT on electronic services amendments.
23. **Submission:** SAICA also provided a detailed submission on 22 March 2018, in this regard. We attached for ease of reference, our submission called "*Comments on the amendments to Regulations: Electronic services for the purpose of the definition of "electronic services" in section 1 of the Value-added Tax Act*" as Annexure B.
24. If the Draft Bill is promulgated before such time that public comments are held and considered, the current Draft Bill will be legislated as is. The proposed amendments to electronic services would therefore be effective from 1 October 2018 despite taxpayers' public comments, consultation and proposed amendments.
25. **Submission:** SAICA submits that the proposed amendments to electronic services should be deleted from the Draft Bill if the Draft Bill is promulgated before 25 June 2018 to allow for amendments transpiring from the public consultations process.

CONCLUSION

26. We would like to thank SARS for the opportunity to provide constructive comments in relation to the Draft Bill. SAICA believes that a collaborative approach is best suited in seeking actual solutions to complex problems.



Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely

Pieter Faber

SAICA Senior Executive: Tax

The South African Institute of Chartered Accountants

ANNEXURE A

28 March 2018

South African Revenue Service
and The National Treasury

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Dear Madam

PROPOSAL REGARDING PRACTICAL ISSUES IDENTIFIED ON IMPLEMENTATION OF THE INCREASED VAT RATE, EFFECTIVE 1 APRIL 2018

1. Based on interactions with our members, we have identified some practical issues that are anticipated as a result of the 1% increase in the Value-Added Tax (VAT) rate from 14% to 15%, announced in the 2018 Budget speech, with a proposed effective date of 1 April 2018.
2. Given that these issues are not dealt with in the transitional provisions or in the SARS FAQ Guide, on behalf of the South African Institute of Chartered Accountants (SAICA) we would like to collaborate with SARS in proposing practical solutions to address these issues.
3. Annexure A provides a list of identified issues, together with proposals on how to address these.
4. As a broader issue, we would like to note upfront that there are doubts as to whether or not Parliament will sanction the proposed VAT rate increase, given the many concerns raised regarding the impact of such an increase on the majority of South Africans.
5. To this end, Parliament has agreed to bring forward the date for the tabling of the Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2018 to some time in April (the date has not been confirmed), to ensure that a final decision is made in this regard.
6. There are real concerns that, subsequent to vendors and SARS having implementing the increased VAT rate, Parliament may as part of the normal legislative process of twelve months to adopt the Budget proposal to increase the VAT rate, actually reject the rate increase. This will result in VAT refunds having to be paid to affected vendors on the basis that the increase was not promulgated.



7. In light of this, we request that SARS urgently issues guidance to stakeholders as to what will be done if the VAT rate increase is rejected after having been implemented.
8. Should you wish to discuss any aspect of this submission, please contact us.

Yours sincerely

Christo Theron

Chairperson: SAICA VAT Subcommittee

Somaya Khaki

Project Director: Tax



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ANNEXURE A

VAT RATE INCREASE

PRACTICAL ISSUES IDENTIFIED ON IMPLEMENTATION OF THE INCREASED VAT RATE, EFFECTIVE 1 APRIL 2018

Unreasonable time period to implement the new VAT rate gives rise to system challenges

9. An overriding concern raised by vendors is the fact that the amount of time between the announcement of the VAT rate increase and the implementation date thereof, is insufficient to address the system challenges that arise as a result of the rate increase.
10. Many accounting systems apparently do not allow for the use of two different VAT rates for different transactions and manual adjustment will be required. Furthermore, the ability to split reporting by month is also not available in all accounting packages.
11. This may result in many manual adjustments for up to five years after the initial supply and may affect the vendors' ability to timeously submit the related VAT return, without any errors. It is also questionable as to whether SARS' systems/forms will cater for two rates in respect of bad debts written off.
12. Examples of such challenges include the following:
 - 12.1.1.1 **Bad debts written off** on/after 1 April 2018 in respect of sales pre-April 2018 at a VAT rate of 14%.
 - 12.1.1.2 **Credit/debit notes** in respect of invoices issued pre-April 2018
 - 12.1.1.3 VAT period overlapping old and new rate (i.e. March/April 2018)
13. **Submission:** In terms of section 72 of the VAT Act, 1991, if the Commissioner is satisfied that in consequence of the manner in which any vendors/class of vendors conduct their business, trade, or occupation, difficulties, anomalies or incongruities have arisen or may arise as a result of the application of the provisions of the VAT Act, the Commissioner may make arrangements as to how these provisions may be applied to overcome such difficulties, anomalies or incongruities.
14. In light of this and given that many vendors and their consultants have raised concerns regarding the inability for some systems to accommodate two different VAT rates and the potential for errors as a result of manual adjustments in this regard, we propose that SARS apply leniency, in terms of section 72, when they consider any requests for the waiver of penalties/interest relating to any adjustments to be processed that specifically relate to errors made as a result of the VAT rate increase as a result of system or other deficiencies in respect of the above noted issues as well as those specific issues noted separately below.



15. As an alternative to applying the provisions of section 72, we propose a legislative amendment to the Rates and Monetary Bill to provide for a suitable mechanism which will allow for leniency and/or waiver in applying the penalty and interest provisions.
16. Further, we suggest that SARS consider the design of the VAT201 to take into account this issue. For example, the form should allow the use of two different VAT rates to take into account current transactions (at 15%) and bad debts, credit/debit notes etc where the initial sale was accounted for at 14%.
17. With respect to those vendors who have a March/April VAT period, we suggest that SARS perhaps allow a one-month extension in the reporting date for those who are in this position, specifically for the March/April VAT201 submission.
18. Given the short time period before the increase becomes effective, it may be worthwhile including such communication regarding the proposed leniency/extension in the monthly SARS VATConnect newsletter. We are also happy to use our various communication platforms to circulate communication that SARS may wish to issue in this regard.

Credit/debit notes in respect of invoices dated pre-1 April 2018, where a 14/30 day return without proof of purchase is allowed

19. Most retailers also allow for goods to be returned within, for example 14 or 30 days of purchase. In many instances goods are returned and accepted by the retailer without the original till slip. The retailer is accordingly not able to link the return to a specific transaction and or the date and VAT rate applied to the transaction
20. **Submission:** We propose that SARS issues practical guidance as to when goods are returned without reference to the specific date and VAT rate applicable to returns. In the example where retailers allow 14 days for the return of goods, SARS should allow all returns up to 14 April 2018 to be processed at 14% whilst returns on and after 15 April 2018 should be processed at 15%.

Discounts

21. In respect of volume discounts that are calculated over a period of time, it is unclear as to how one would pro rata what belongs in which period. Alternatively, if the discount is a genuine price reduction, the same issues as noted in points 1, 2 and 5 above equally apply here. Most systems utilise stock codes, rather than invoices, and it would therefore be difficult to make the link between the discount and the initial invoice.
22. **Submission:** We request that SARS issues guidance in this regard. In our view, the VAT rate applicable will depend on how the discount/rebate is treated by the supplier, as set out below:
23. If the discount/rebate is treated as 'consideration' for the supply of a service, the rate applicable should be based on the date on invoice for the 'consideration'. If the discount/rebate is treated as a reduction in the purchase price and a credit note is issued, the rebate should first be pro-rated based on volumes sold in each month in the period in question and VAT should be accounted for on that basis.



24. For example, if in a 6 month period from January to June 2018, one is entitled to a 5% discount on purchases of R1 million or more, one would need to determine volumes sold pre - 1 April 2018 and post - 1 April 2018. Say, R600 000 purchases were made pre -1 April 2018 and R400 000 purchases were made on/after 1 April 2018, the discount of R50 000 would be split between R30 000 pre - 1 April 2018 at 14% VAT and R20 000 up to 30 June 2018, at 15% VAT.
25. In terms of the guidance, we propose that Binding General Rulings 5 and 6 be updated to incorporate the transitional provisions in sections 67 and 67A. However, given that this will take some time and guidance is required now, we suggest that in the interim SARS use the monthly SARS VATConnect newsletter to issue such guidance.

Rebates for the provision of services

26. Rebates are rarely billed for in clean monthly or daily segments. It is therefore questionable as to how these will be accounted for and, if pro-rated, what the acceptable practice would be?
27. Submission: We propose that SARS issue guidelines as to what would be acceptable in this regard or in the absence of such guidelines, SARS should be open to such reasonable practice as makes sense for each vendor and should communicate this position to vendors.

Section 67A anti-avoidance provision

28. The anti-avoidance provision built into section 67A provides that if the time of supply of goods falls within the window period between 21 February and 31 March 2018, they should be invoiced at 14%. If, however, these have not been delivered within 21 days from the day after the effective date of the new rate (i.e. by 23 April 2018), the invoice needs to be adjusted to reflect 15%. According to the SARS' FAQ guide, this would apply where the amount is invoiced earlier, in order to avoid having the transaction subject to VAT at the higher rate.
29. However, in many instances these delays are outside the control of the supplier and purchaser – for example, back orders due to no stock availability, manufacturing issues, shipping delays, etc. Some custom cars for example can be invoiced for in full before delivery, yet build time may be over a number of months and delivery will only take place on finalisation and will be spread over a few months.
30. Submission: Whilst it is noted that in certain instances, general business practice will be taken into account in determining the time of supply rule in this instance, perhaps the term 'customary' (as per section 67A(i)) should be extended to delays outside of the control of the supplier, where the supplier was contractually obliged to deliver the goods on or before 23 April 2018.

Invoices post - 1 April 2018 in respect of supplies of goods or services made both pre and post 1 April 2018

31. The fact that goods delivered or services rendered pre - 1 April 2018 must be invoiced at 14% (as set out in the SARS FAQ Guide) is simple, in theory.



32. Practically, however, with respect to supplies of goods it is unlikely that any accounting system will allow one to invoice the same stock code at 14% on one invoice and 15% on another invoice on the same day. It's likely that the same stock items may need to be invoiced at different rates in April 2018 depending on when they were delivered.
 33. With respect to the supply of services in these circumstances, this can also become quite complex from a systems' perspective. For example, let's analyse a tax consultant who has an initial client meeting in the middle of March 2018 and starts work on an objection and finalises submission of the objection in April 2018. Per the rules, this means that the invoice would have to be split. The work done pre - April 2018 must be billed at 14%, with the work done in April 2018 billed at 15%. Again, this is not technically difficult, yet from a systems' point of view it could be very problematic.
34. **Submission:** VAT vendors should be allowed to issue all tax invoices that are issued before 1 April 2018 at the rate of 14%. Any adjustment required thereafter should be effected by the debit and credit note rules contained in section 21 of the VAT Act. In terms of the time of adjustment rules applicable to debit and credit notes (i.e. the tax period that the need for the adjustment becomes apparent), the adjustments would not be required to be made in the original tax period in which the supply had been made, but in the tax period that the need for the adjustment is identified and quantified. In our opinion, this is the correct interpretation of the governing legislation. SARS' reference in the FAQ guide to penalties and interest on subsequent adjustments is, in our opinion, incorrect and does not reflect the law as it stands.
 35. With respect to services in particular, the above proposal relates to those instances where the contract/agreement allows for interim billing.
 36. We propose that the current SARS' FAQ Guide should be reconsidered and amended in respect of this aspect. Alternatively, guidance should be issued in the SARS monthly VATConnect newsletter to ensure that it reaches vendors timely.

IT14SD reconciliations

37. The different VAT rates over a year of assessment will result in further complications in the IT14SD reconciliation process.
38. **Submission:** The design of the IT14SD form should take into account the fact that there will be significantly more reconciling items as a result of the increase in the VAT rate.

Imported services

39. The VAT rate specific rules do not cater for time of supply rules for VAT on imported services. For local services, the concession is granted for instances where the VAT rate is linked to the time the services were performed (i.e. services rendered before 1 April 2018, but billed after 1 April 2018, the VAT rate of 14% applies). For the same scenario, when a foreign supplier provides services, the time of supply will remain the earlier of invoice or payment, notwithstanding the fact that the services may have been rendered in an earlier period (i.e. before 1 April 2018). VAT at 15% will be triggered if the invoice is issued or payment is made in a later period.

- 40. Submission: We propose that section 67A of the VAT Act be amended to include the treatment of imported services in terms of section 7(1)(c) and its time of supply rules dealt with in section 14(2) of the VAT Act.
- 41. Further to this we propose clear guidance in section 67A of when services are deemed to be supplied, as the VAT Act provides guidance in section 67A when goods are deemed to be delivered, but is not very clear on services rendered.

Disclosure on invoices

- 42. Fees charged annually (1 January 2018 – 31 December 2018) based on outperforming the benchmark in terms of section 67A may be apportioned between 14% and 15% for the respective periods. It is unclear as to whether vendors need to issue two invoices reflecting the different VAT rates applied, or if they may issue one invoice reflecting both rates on a line-by-line basis.
- 43. Submission: We request that SARS provides guidance as to the manner in which the various categories of supplies must be disclosed on tax invoices. We propose that SARS should confirm that using two rates on one invoice will be acceptable during this transitional period, as long as these two categories of supplies are clearly indicated on the invoice.
- 44. Guidance in this regard could be issued in the SARS monthly VATConnect newsletter to ensure that it reaches vendors timely.

Rental agreements – Commercial Property

- 45. It is common practice for a commercial property rental agreement for payments to be due on the 1st of the month for rental in advance (i.e. rent for April to be payable at the beginning of April). In this instance the time-of-supply and delivery of the goods coincide in the month of April and VAT at 15% should be applicable, irrespective of whether the supplier issues a tax invoice, invoice or other written notice prior to the due date of the payment. Such invoice or notice is typically issued during the preceding month.
- 46. Where the agreement provides that services (electricity, rates, etc.) will be payable in arrears, the difficulty arises as to the VAT rate applicable to services included in the payment which is due on 1 April.
- 47. This is typically shown separately on the monthly tax invoice, invoice or other written notice which is issued to the lessee.
- 48. Lessors are unsure of the VAT rate applicable and the details which should be included in the tax invoice, invoice or other notice.
- 49. Submission: We propose that SARS confirm that a single invoice may be issued with the rental and the utilities split on the invoice, to allow for 15% on the rental cost and 14% on the utilities for the first affected month after the rate change.



50. Guidance in this regard could be issued in the SARS monthly VATConnect newsletter to ensure that it reaches vendors timeously.

ANNEXURE B

Ref #:

Submission File

22 March 2018

National Treasury
South African Revenue Service

BY E-MAIL: aneesa.baig@treasury.gov.za
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Dear Aneesa and Adele

COMMENTS ON THE AMENDMENTS TO REGULATIONS: ELECTRONIC SERVICES FOR THE PURPOSE OF THE DEFINITION OF “ELECTRONIC SERVICES” IN SECTION 1 OF THE VALUE-ADDED TAX ACT

1. We refer to your request for comments on the draft Regulation on Electronic services for purposes of the definition of “electronic services” in section 1 of the Value Added Tax Act, No 89 of 1991 (VAT Act) issued on 21 February 2018.
2. We herewith present our comments on behalf of the South African Institute of Chartered Accounts (SAICA) VAT Sub-Committee on the draft Regulation on Electronic Services released by the South African Revenue Service (SARS).
3. Please refer to Annexure A that contains our observations and recommendations.
4. We would like to thank National Treasury and SARS for the opportunity to provide constructive comments in relation to the draft Regulation. SAICA believes that a collaborative approach is best suited in seeking actual solutions to complex problems.

Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely

Christo Theron

Chairperson: SAICA VAT Subcommittee

Madelein Grobler

Project Manager: Tax



ANNEXURE A

GENERAL OBSERVATIONS

5. SARS and National Treasury mentioned during workshops held in relation to the initial introduction of the electronic services regulation and VAT legislation in 2014 and 2015, that the intention was always to extend the definition of electronic services to include a wider range of services.
6. The comments to follow are based on the draft Regulation, the explanatory memorandum to the draft Regulation and the sections of the VAT Act impacted by the Draft Rates and Monetary Amounts Amendment of Revenue Laws Bill of 21 February 2018.
7. The draft explanatory memorandum to the Regulation states that the intention with the new law dealing with electronic services is to "*include software and other electronic services and to broaden the scope of electronic services*". It further states that the intention is "*to widen the scope of the Regulation to apply to all "services" as defined in the VAT Act that are provided by means of an electronic agent, electronic communication or the internet for any consideration.*"
8. The above objectives are aimed at reducing the risk of distortions in trade between foreign and domestic suppliers where VAT is one of the reasons for such distortions.
9. To achieve the above desired results the definition of "enterprise" in section 1(1) of the VAT Act has been extended by the introduction of a new paragraph (vii), including in the definition of "enterprise" "*the activities of any intermediary*" and a new definition of "*intermediary*".
10. A new section 54(2B) of the VAT Act was also introduced deeming intermediaries to be carrying on the South African VAT enterprise on behalf of a non-resident supplier of electronic services under certain circumstances.
11. National Treasury also issued a new draft Regulation setting out the ambit of "*electronic service*" as defined in section 1(1) of the VAT Act.
12. Essentially the new draft Regulation includes all services supplied by way of electronic means as electronic services, excluding "*telecommunication services*" as defined in the draft Regulation and certain educational services.

Davis Committee Report

13. Further to the above the Davis Committee, Value-Added Tax: First Interim Report (Davis VAT Report) includes comments in relation to VAT and electronic services.
14. As stated in paragraph 7.6 of the Davis VAT Report, both Canada and the European Union (EU) has moved to "*categories*" of what constitute electronic services and it is recommended that South Africa follows suit. It is further recommended that the "*categories*" should then be further explained in a guide or interpretation note. As an



alternative, should an exhaustive list be the preferred route, the Regulations should specify that the list must be reviewed and updated, for example every 2 years.

15. Other recommendations included in the Davis VAT Report in relation to the definition of electronic services are:
 - 15.1 The Organisation for Economic Co-operation and Development (OECD) recommendations and guidelines should be followed and cognisance should be taken of other jurisdictions' application of definitions.
 - 15.2 The manipulation of the list of qualifying electronic services should not be allowed in order to make a distinction between business-to-business (B2B) and business-to-consumer (B2C) transactions.
 - 15.3 Although the current legislation may be sufficient to include on-line advertising (e.g. the supply of still images or a subscription to a web site) a guide should be published to clarify this and other issues.
 - 15.4 A distinction must be made in respect of "*telecommunication services*", and, in harmony with other VAT jurisdictions, South Africa should incorporate specific provisions addressing "*telecommunication services*".
16. The Davis VAT Report also provides detailed comments in relation to the impact of the distinction between B2B and B2C transactions, including the consideration of OECD recommendations. It was noted that there is ultimately a cash flow benefit if B2B transactions were to be excluded as the South African customer will have a cash flow motivation to transact with a foreign supplier as it will not have to wait up to 2 – 3 months to obtain the input tax deduction benefit if it transacted with a local South African supplier.
17. It is further stated, *inter alia*, that taking VAT neutrality into account for B2B transactions would mean a discrepancy in the VAT obligations between foreign and local suppliers and an undue benefit is granted to foreign suppliers. If a similar benefit is to be granted to local suppliers (i.e. not to register for VAT as a result of B2B VAT neutral transactions) it would mean a change in the core VAT system globally.
18. Further, OECD recommendations are noted in relation to the benefits of introducing a reverse charge mechanism for B2B transactions where the recipient is liable to account for VAT.
19. Lastly of particular interest is the recognition that although the B2B and B2C distinction is prevalent in the EU, that it does not mean that it is the most effective, but rather the legacy of aged privileges.

EU VAT Legislation

20. The European VAT legislation in this regard has evolved over a number of years from a relatively simple to an extensive list of services included in the current definition of "*electronic services*". However, the definitions are not exhaustive and it is necessary to take account of fast-moving technological developments, the difficulty of identifying all



existing services, and relevant legislative changes. For further clarity (in so far possible) and to ensure that Member States apply VAT consistently, telecommunications and broadcasting services are also defined as there are often confusion in relation to the aforementioned services in particular. Furthermore, included in these definitions are examples of services that do not qualify as either telecommunication, broadcasting or electronic services.

21. In addition to the EU VAT legislation and regulations that contain these extensive definitions, the EU also published, *inter alia*, a detailed explanatory note on the EU VAT changes effected in 2015. Most Member States have also published guidelines in relation to electronic, telecommunication and broadcasting services and the impact any uncertainty may have. Although the EU has other complexities due to e.g. place of supply rules the EU rules nevertheless tries to create certainty and consistency in so far possible.

SPECIFIC OBSERVATIONS

Persons required to register for VAT (Part A of the explanatory memorandum and section 23(1A) of the VAT Act)

Registration requirements

22. Section 23(1A) of the VAT Act will be amended to require suppliers of electronic services to register as VAT vendors where the total value of the taxable supplies made by that person in the Republic has exceeded R50 000 within any consecutive 12-month period.
23. The consecutive 12-month period, consistent with the compulsory VAT registration threshold time frame, is welcomed, as it does not make logical sense not to fix a time period within which the threshold limit must be reached. The amendment abates the uncertainty regarding whether a person who supplies electronic services is required to register for VAT as soon as the R 50 000 threshold is reached, since the inception of its supplies, or whether registration is required if R 50 000 is reached within 12 months.
24. As a general comment, it is doubtful, without a specific place of supply rule, whether it could be held that the electronic services are supplied "*in the Republic*" as required by section 23(1A) of the VAT Act. Were the services supplied "*in the Republic*" the normal VAT enterprise rules would have applied (i.e. any activity carried on regularly or continuously in or partly in South Africa) and there would have been no need for paragraph (b)(vi) to the definition of "enterprise" in section 1(1) of the VAT Act.
25. If the services can be held to be supplied in the Republic, we are of the view that the R50 000 annual turnover registration threshold is no longer relevant as suppliers of electronic services would now essentially be taxed on all supplies of electronic services made in South Africa (with the exception of two specific categories of supplies). There is therefore, in our opinion, no basis to apply a differentiated compulsory registration threshold to suppliers of electronic services.
26. **Submission:** We propose that the normal compulsory and voluntary registration thresholds be applied to suppliers of electronic services.



Registration Threshold

27. In view of the broad definition of “*electronic services*” as proposed in the draft regulation, it is expected that a substantial number of foreign suppliers will be required to register for VAT in South Africa especially given the R50 000 threshold. This will not only increase the administration burden of the foreign suppliers, but also that of SARS with regard to the registration process and the administration, processing and reviewing of monthly returns.
28. The explanatory memorandum sets out that the intention of the amendment is to widen the scope of electronic services to ensure fairness is created between all suppliers, whether locally or internationally based. This is in line with the OECD guidelines of neutrality in that taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.
29. The registration requirements of R50 000 for non-resident suppliers in a period of 12 months compared to the compulsory VAT registration threshold of R1 000 000, is however in contradiction of both the intention of the explanatory memorandum and the OCED guidelines.
30. **Submission:** We recommend that the registration threshold applicable to non-resident electronic service suppliers should be the same as local suppliers, i.e. R1 million for a 12-month period.

Reverse charge mechanism

31. Where a supplier is not required to register, the recipient must declare output tax on imported services – South Africa imported services not being in line with the United Kingdom (UK) reverse charge definition.
32. The “*imported services*” definition in section 1 of the VAT Act states where a vendor receives services from a non-resident relating to the making of non-taxable supplies, the vendor must declare output tax to the extent that the services cannot be directly attributable to making taxable supplies.
33. The EU reverse charge aims to eliminate the registration requirements on non-resident suppliers, furthermore where the resident recipient is liable for VAT in its country, the implications of the reverse charge result in a VAT neutral position for the vendor (i.e. declaration of output tax and input tax deduction).
34. However the proposed amendments require the non-resident supplier to register for VAT where its supply is more than R50 000 and two of the requirements set out in the definition of “*enterprise*” in section 1 are met.
35. **Submission:** Clarity should be provided on whether the onus to prove VAT registration is on the recipient or non-resident supplier and where the recipient cannot prove the VAT status of the non-resident supplier, what the appropriate VAT treatment will be. Furthermore clarity should be provided as to what remedy is available in the event that both recipient and supplier declare VAT on the same supply.



Classification of supplies

36. You indicate in the explanatory memorandum that “*Supplies that are exempt for VAT in the Republic or subject to the zero-rating provisions in the Republic will be equally applicable to the supply of “electronic services” as defined in section 1(1) of the VAT Act.*”
37. We are not clear under which circumstances electronic services supplied in South Africa can be zero-rated or exempt. In this regard kindly note that the exemption applicable to imported services of R100 per instance does not extend to the supply of electronic services supplied by a VAT vendor.
38. We are concerned that the reference to zero-rated supplies may be interpreted as referring to supplies made outside South Africa by suppliers of electronic services based on the definition of “*enterprise*” (activities carried in or partly in South Africa). If this is the case non-resident suppliers of electronic services might be required to declare their world-wide supplies on their VAT returns.
39. **Submission:** We propose that the relevance of the paragraph in the explanatory memorandum be explained or that the paragraph be removed from the explanatory memorandum.

Total value of taxable supplies: abnormal circumstances

40. The proviso to section 23(1) of the VAT Act excludes abnormal circumstances of a temporary nature from the value of taxable supplies to determine whether the registration threshold is exceeded. It should be clarified whether the same exclusion applies to the supply of electronic services.
41. Submission: We recommend that the same exclusion is made available to suppliers of electronic services.

Exclusions (Part B of the explanatory memorandum and amendment of regulation 1 and 2)

42. The current regulations consist of positive tests to determine when a service constitutes electronic services. From a policy design perspective, we welcome the negative tests that scopes certain services out of the ambit of electronic services definitively.

Telecommunication services

43. The meaning and ambit of “*telecommunication services*” are critical to the new legislation, but is not been dealt with in the draft explanatory memorandum.
44. **Submission:** We recommend that the nature and identification, together with supporting examples, be dealt with in the final explanatory memorandum. This is a critical exclusion to the general ambit of electronic services and likely to result in confusion in practice.
45. We note that “*telecommunication services*” as defined in the draft Regulation is to be excluded from the term “*electronic services*”.



46. The implication is that broadcasting services and radio transmission services will be excluded from the VAT net. This is a typical B2B transaction that would result in a vendor recipient merely claiming the VAT incurred as an input tax deduction. The exclusion from the South African VAT system is appropriate in curbing unnecessary VAT registrations.
 47. **Submission:** We agree that the supply of telecommunications content should be included as an electronic service, albeit that these are typically B2B supplies.
 48. The imposition of the words “*relating to*” at the beginning of the definition arguably creates scope for installation of transmission systems/infrastructure to also be excluded from the ambit of electronic services.
 49. **Submission:** We submit that clarity should be provided if this is the intention of the legislator.
 50. The specific inclusion in the definition of the phrase “*access to global information networks*” implies that selling access to the internet (a global information network) and server/cloud storage services will also be excluded from the VAT net. We are of the view that this may incentivise South African suppliers of these services to merely register entities outside South Africa so the supply falls within this exclusion.
 51. The definition of “*telecommunications services*” specifically excludes “*content of telecommunications*”. However, no guidance or definition of what the phrase of “*content of the telecommunications*” is provided.
 52. **Submission:** We recommend that a definition or a description of what is meant by the phrase “*content of the telecommunications*” be included in the regulation to clarify this aspect.
- Educational services**
53. This amendment has the same effect as the current Regulation 3. This exclusion places a non-resident making supplies of educational services in the same economic position as a local supplier of educational services – that is, excluded from the South African VAT net.
 54. As “*telecommunication services*” is defined, the draft Regulation should also contain a definition of “*educational services*” as there is currently no guidance regarding the meaning of “*educational services*”.
 55. This definition would also be necessary to ascribe a meaning to educational services for the purposes of section 12(h) and section 14(5)(c) of the VAT Act. A non-resident may provide a combination of training programmes, some of which are regulated by an authority and others not.
 56. **Submission:** We recommend that in order to create certainty the term “*educational services*” be defined in, either in section 1 of the VAT Act or in an interpretation note.



Intermediaries and Platforms (Paragraph C of the explanatory memorandum, section 1 and 54(2B) of the VAT Act)

57. The last paragraph under Paragraph C of the explanatory memorandum states the following:

"The definition of "services" in section 1(1) of the VAT Act encompasses "anything done or to be done, including the granting, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods ...". Hence, where a person provides the use of a platform and meets the requirements discussed in "A" above, such person will be required to register for VAT in the Republic."

58. In our view the above paragraph sets out the nature of one of the categories of services that would constitute "*electronic services*" and that would require the non-resident supplier to register as a VAT vendor in South Africa.
59. The above issue should be dealt with under paragraph (A) of the draft Regulation explaining the framework of services falling within the ambit of the definition of "*electronic services*" in section 1(1) of the VAT Act, as it does not deal with intermediaries.

60. **Submission:** We propose that the last paragraph under the heading "*Intermediaries and Platforms*" be moved to the heading "*Persons required to register for VAT*".
61. We further propose that a new heading be added to the explanatory memorandum providing examples of the various potential categories of supplies that will be considered "*electronic services*". This does not need to be exhaustive, but needs to provide a framework within which affected.

Definition of "intermediary"

62. Intermediaries are deemed to be the supplier only if invoices and payments are administered by them, excluding intermediaries only responsible for providing payment platforms.
63. The current VAT Act does not define "*agent*" or "*intermediary*". In practice, the legal definition is used, therefore an agent/intermediary may issue invoices and collect payments on behalf of its principal under an agreement without taking over the principal's legal obligations.
64. The proposed amendments therefore contradict the legal definition and deems the agent/intermediary to be the supplier and therefore liable for the output tax declaration and payment.
65. **Submission:** Clarity is required on whether a definition in the VAT Act will be added to cater for this amendment and address the possibility of double taxation where the intermediary/agent cannot prove VAT registration of the non-resident supplier.
66. In the event that an intermediary/agent is responsible for providing a payment platform and administration of invoicing and collections, guidance will also be required as to



whether such intermediary will be allowed to apportion the output tax on the deemed supply.

Section 54(2B) of the VAT Act

67. Section 54(2B) of the VAT Act could potentially apply in different scenarios. Firstly, where a non-resident parent entity supplies “*electronic services*” to its local VAT registered subsidiary for on-supply to the market, the section deems the supply to be made by the intermediary and as a result the non-resident is not required to account for VAT on the basis that it (the principal) does not make the supply.
68. Another scenario is where the operator of a global platform, which is already registered for VAT in South Africa as an electronic services supplier, also facilitates the supply of content of various other non-resident electronic services suppliers to South African customers. In these circumstances, the South African intermediary would need to ascertain and keep track of the VAT status of each non-resident supplier.
69. Based on the wording of section 54(2B) of the VAT Act the intermediary will be required to account for the VAT where the principal chooses not to register for VAT. This places a burden on the intermediary to ascertain whether the principal honours its VAT obligations.
70. It is proposed that where an “*intermediary*” is involved that it would be the intermediary’s responsibility to account for the VAT. The non-resident supplier (principal) needs to be informed to ensure that the non-resident deregisters for VAT (provided the non-resident supplier is not registered for other reasons).
71. It is therefore proposed that where the non-resident is registered for VAT for other supplies, but an intermediary accounts for the VAT on electronic services, the foreign registered vendor should not be required to account for the electronic services VAT.
72. Furthermore, it should be clarified whether the concessions applicable to electronic services suppliers will also apply to intermediaries and whether the intermediary will be entitled to input tax deductions relating to costs incurred on behalf of the non-resident principal.
73. In addition, it should be clarified that where the intermediary renders services to a VAT registered principal, the services would qualify for zero rating in terms of section 11(2)(l) of the VAT Act on the basis that the services are supplied to a non-resident who is not in South Africa.
74. Submission: Based on our above comments we recommend that:
 - 74.1 National Treasury clarifies the application of section 54(2B) of the VAT Act where the intermediary acts for various principals who may or may not be registered for VAT;
 - 74.2 The concessions applicable to electronic services suppliers should also apply to intermediaries; and



- 74.3 The intermediary will be entitled to input tax deductions in relation to costs incurred on behalf of the non-resident principal.

Proposed implementation of 1 October 2018 is not feasible

75. Given the scale of the proposed changes, the timeline for implementation is not feasible as system update projects generally take between 6 to 8 months at minimum. It can also not be expected from electronic services suppliers to base major system updates on proposed amendments and sufficient time should be granted after finalisation of the proposed amendments for suppliers to implement the necessary changes.
76. Submission: We propose an implementation date of 6 months after the legislation is finalised.

Local supplier of electronic services

77. The implication of this amendment is that a non-resident, non-vendor electronic services supplier is able to shift its registration liability to the intermediary, which is deemed to be the principal supplier.
78. Submission: We recommend that consideration be given to the position of a local supplier of e-commerce services who is not registered for VAT, nor required to be registered for VAT who may want to utilise the services of an intermediary which appears to be on the increase in other jurisdictions.

The principal not making a taxable supply the extent that the intermediary is deemed to make the supply

79. Section 23(1A) of the VAT Act requires non-resident suppliers of “electronic services” to register for VAT in South Africa. To the extent that the provision of section 54(2B) of the VAT Act applies, and the intermediary is required to account for VAT, the non-resident supplier should be deemed not to carry on an enterprise in South Africa. Practically, in terms of the proposed legislation the intermediary would need to be aware of the VAT and residency status of the “principal” in order to assess whether there is a requirement to register and account for VAT on the supplies made by the non-resident.
80. Submission: We recommend that the legislation is amended to specifically exclude the non-resident electronic services supplier from the VAT net to the extent that the intermediary is required to account for VAT in terms of section 54(2B).

Compliance (Part D of the explanatory memorandum)

81. It is stated in the explanatory memorandum that “*Electronic Service Suppliers may register for VAT in the Republic using the simplified registration procedures as provided for in the SARS (South African Revenue Service) VAT Registration guide for Foreign Suppliers of Electronic Services.*”
82. The VAT registration form requires the company registration number. Under the applicants’ details for a company/trust/partnership and other entities of the VAT registration guide, it states that only the club, collective investments schemes, a



partnership or body of persons that can leave the registration number blank, as it is not applicable.

83. The VAT registration guide further states that the company registration number is the number supplied by Companies and Intellectual Property Commission (CIPC) or Master of High Court on successful registration of the entity.
84. This implies that the nature of entity not mentioned to leave the registration number blank will have to first obtain the South African registration number before they can register for VAT. In practice once the company (local/foreign) is registered with the CIPC the income tax number is automatically issued, thus creating the administrative process and compliance burden with other taxes.
85. **Submission:** We submit that consideration be given not to create inappropriate compliance burden for businesses to comply with VAT registration, that the companies/other entities be able to also leave the company registration blank, especially those companies that would just exceed the minimum total value of taxable supplies required.

Amendments to Regulation 1

Deletion of the definition of “electronic services supplier”

86. It is noted that the current Regulation 1 does not define the term “*electronic services supplier*”. Accordingly, there is no definition to be deleted.
87. **Submission:** We recommend that the term “*electronic services supplier*” be inserted as a definition in section 1(1) of the VAT Act, in line with the draft amendment of the VAT Act.

Deletion of the definitions “internet-based auctions service” and “web site”

88. The deletion of these definitions is appropriate in light of the repeal of Regulations 3 to 7, which make reference to the definitions, but will no longer be relevant upon repeal.

Amendment of Regulation 2

Ambit of the definition of “electronic services”

89. The current Regulation provides for a specific list of services which fall within the ambit of “*electronic services*” as defined. As some of the terms used in the current Regulation are not defined, it creates uncertainty amongst non-residents as to whether their services qualify as “*electronic services*” in South Africa.
90. The definition of “*electronic services*” contained in the draft Regulation seems to mirror the classification of electronic services as seen in certain other jurisdictions. The broad definition of “*electronic services*” could lead to double taxation of services where the services are taxed, both in the foreign and local jurisdiction. An example is the broadcast of a live event which takes place in the EU the supply is taxed in the EU.



91. The ambit of the definition of “*electronic services*” is extremely wide, and no clear guidance as to the type of services which are included or excluded is provided. To simply include a reference to the Electronic Communications and Transactions Act in respect of the definitions of “*electronic agent*” and “*electronic communication*” is not helpful, as it does not provide any guidance with regard to the specific services to be included. Foreign suppliers may not have access to the Electronic Communications and Transactions Act or be in apposition to properly interpret the provision of that Act.
92. **Submission:** We recommend that instead of merely referring to definitions in the Electronic Communications and Transactions Act, that the specific categories of services which are to be included in the definition of “*electronic services*” be described in the Regulation.

The meaning of “supplied by means of”

93. Clear guidance should be given to the interpretation of the phrase “*any services supplied by means of an electronic agent, electronic communication or the internet for a consideration*”. In this regard the distinction between a stand-alone service, the outcome of which is delivered by electronic means, and the actual supply of a “*by means of*” must be explained and examples given on how the distinction must be made in practice.
94. With the advancement in technology over the years, an increasingly wide array of services are being provided via electronic means.
95. For example, if a London based attorney prepares a legal opinion in London and sends the opinion to a client in South Africa in a PDF file format, is the supply an electronic service supplied by means of an electronic agent, or has the outcome of an independent service merely been delivered by electronic means? To take the enquiry to the next level, if for example the opinion is not delivered in the form of a PDF file, but merely a written email, does this change the situation?
96. The Regulation should clarify whether professional or consulting services would constitute “*electronic services*” simply because the written advice or report is emailed to the recipient.
97. Another example is on-line auctioneering platforms. If a non-resident supplies the use of the platform to a South African on-line auctioneering enterprise for a consideration, it is clear that the supply is an electronic service supplied by the non-resident to the South African user. Where the South African auctioneering company in turn charges a fee to participants in an on-line auction, the South African auctioneering company could be viewed as an “*intermediary*” of the non-resident supplier. This is clearly not the case based on the wording of the proposed legislation and the draft Regulation, but causes uncertainty in the relevant industries. The confusion is exacerbated by the paragraph in the draft explanatory memorandum being included under the heading “*Intermediaries and Platforms*” in the explanatory memorandum.
98. **Submission:** We propose that the application of the phrase “*any services supplied by means of*” be explained and examples be provided on how it will be applied in practice.



99. We further recommend that the regulation clarifies the meaning of “*electronic agent, electronic communication or the internet*” by including practical examples of included and excluded mediums, as well as examples of services that would typically be included.

Use of the term “includes”

100. The current Regulation 2 presently reads as follows:

“These regulations prescribe those services that are electronic services for the purpose of the definition of “electronic services” in section 1(1) of the Act” (our emphasis)

101. The amendment to Regulation 2 proposes the following:

“For the purposes of the definition of “electronic services” in section 1(1) of the Act, “electronic services” includes any services supplied by means of [...]” (our emphasis)

102. It appears that the current Regulations have the effect of prescribing an exhaustive list of services which are prescribed as electronic services, with Regulations 3 to 7 specifically stipulating the scope of services within categories.
103. Whereas the draft amendment, by imposing the word “*includes*”, appears to broaden the scope of electronic services to beyond the draft Regulation. That is, where a service does not fall within the requirements of the draft Regulation, the service may still be regarded as electronic services in the ordinary sense of the term. We envisage this consequence as misaligned to the intention of the legislator.

104. Submission: We recommend that the phrasing of this amendment be revised to reflect the intention of the legislator in a clear and certain manner.

Amendments to Regulations 3 to 7

105. The repeal of Regulations 3 to 7 *in lieu* of broadening of the electronic services envisaged in the draft Regulation is in line with National Treasury’s intention to broaden South African VAT base.

Distinction between Business-to-business (B2B) and Business-to-consumer (B2C) supplies

106. The introduction of the requirement for foreign suppliers of electronic services to register for VAT in South Africa has ensured that VAT is efficiently collected and paid on the value of electronic services consumed in South Africa, as the requirement for recipients to account for VAT in terms of section 7(1)(c) was difficult to enforce.
107. The proposed significant broadening of the Regulations with regard to the supply of electronic services and the low registration threshold is expected to result in a substantial number of foreign suppliers to come within the South African VAT net. The administration in relation to the registration of these suppliers and the submission and processing of VAT returns is expected to place a significant burden on both the suppliers concerned and on SARS.



108. When drawing a distinction between B2B and B2C transaction, B2B activities will always result in a neutral position as the non-resident would levy VAT and account for the output in their VAT return and the South African recipient would be able to claim an input tax deduction in their VAT return.
109. B2C transactions is where the problem lies as the non-resident electronic service supplier would levy VAT at 14% and include this in their VAT return. As the consumer may be a non-VAT vendor and may not be able to claim an input tax deduction on the electronic service purchase, the VAT would become a cost to the consumer, and this is where the revenue authorities would benefit.
110. To the extent that the suppliers render their services to VAT registered vendors in South Africa, it will not result in any additional revenue for the *fiscus* as any VAT payable will be deductible in total by the recipients, yet both the suppliers and SARS will be burdened with the associated administration. The current electronic services treatment is very wide and may be creating an unnecessary administrative burden by charging VAT, which the consumer would ultimately be able to claim back when dealing with B2B transaction. It may furthermore also have a negative impact on foreign companies considering conducting business in South Africa.
111. The OECD has acknowledged the compliance burden and obligation of businesses having a VAT registration liability in other jurisdictions, which often becomes burdensome. This has led to the OECD using B2B and B2C to distinguish between the place of supply and tax obligation.
112. The OECD recommends the following general place of supply rules to distinguish between B2B and B2C transactions. For B2B transactions the place of supply will be in the country in which the recipient belongs, and B2C the place of supply will be the country in which the supplier belongs. Therefore with B2C transactions you must account for VAT, regardless of where the customer resides.
113. One method put forward by the OECD was a simplified registration and compliance regime for B2C supplies, which states that there will be a much higher level of compliance by foreign suppliers where the tax obligations are limited to what is strictly necessary for the effective collection of the tax. This is especially important for businesses that trade in multiple jurisdictions. The OECD further points out that "*complexity may create an uneven playing field between foreign and domestic suppliers resulting in market distortions and, ultimately, substantial impacts on governments' VAT revenues.*"
114. It is expected that if a distinction is made between B2B transactions and B2C transactions, then a substantial number of cross-border inter-company transactions will be excluded, where the recipient company is either entitled to a full input tax deduction, or where compliance with section 7(1)(c) of the VAT Act is simpler to enforce than in the case of B2C transactions.
115. If B2B transactions were not to be included in the electronic service Regulations they will fall back into the VAT net as imported services where the recipient's revenue consist of exempt income exceeding 5%, the reverse charge mechanism would then be



applicable. This will also result in the compliance burden falling on the South African recipient and not the non-resident.

- 116. **Submission:** We recommend that a distinction be made between B2B transactions and B2C transactions. Such a distinction is also recommended by the OECD where such treatment is consistent with the overall design of a national consumption tax system. The application of the rules to B2B transactions would alleviate the significant and unnecessary administrative burden for foreign suppliers, as well as for SARS.
 - 117. VAT registration would be applicable to B2C participants, as well as participants dealing with both B2C and B2B transaction.
 - 118. B2B transactions would need to be substantiated by proof of the consumers VAT registration in South Africa to exclude these transactions from forming part of the VAT net.
 - 119. Alternatively, in the absence of the aforementioned consideration to implement rules that distinguish between B2B and B2C transactions, we submit that National Treasury and SARS consider the introduction of a reverse charge mechanism in line with the EU rules.
 - 120. In the meantime we submit that SARS should hold off on the introduction of the new draft Regulation until all due consideration could be taken into account and a conclusion could be reached. In our view the benefits would result in alleviating the VAT registration administration burden for both foreign suppliers and SARS, the difficulty in collecting the VAT from foreign suppliers etc.
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- 121. We are aware that this issue has been raised in the past, but in our view it needs to be reconsidered in the light of the potential significant impact the proposed legislation might have on the liability of foreign enterprises to register as VAT vendors in South Africa.
 - 122. While there may be merit to not exclude B2B supplies on a blanket basis, consideration should be given to the introduction of group relief. In many instances international group holding companies may be required to register as VAT vendors solely for the reason that they supply electronic services to their South African entities. Where the South African entities would be entitled to full input tax deductions in respect of charges by international holding companies, the VAT registration of such companies in South Africa will not result in any additional revenue for the *fiscus*, but will result in potentially significantly more administrative efforts to SARS.
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- 123. **Submission:** We propose that in addition to the consideration to be given to general relief with regard to B2B supplies as a future policy issue, immediate consideration should be given to group relief where the South African entities will be entitled to full input tax credits.

Software and other user royalties

- 124. In the past SARS ruled that where a South African user of intellectual property pays royalties or similar fees to a non-resident, being the owner of the intellectual property, the non-resident will not be required to register as a VAT vendor in South Africa,



provided that the non-resident has no presence in South Africa and conducts no other enterprise activities in South Africa.

125. The new proposed rules governing electronic services will effectively negate the above policy. This will be of particular relevance to users of internationally owned software and may result in a significant number of registration requirements without any benefit for the *fiscus*.

126. **Submission:** We propose that if this course of action is pursued, suppliers affected by the previous policy, be advised of the change in policy in time to decide on appropriate remedial action.

Additional comments

Exemptions from Services

127. Given the proposed amendment and widening of the scope of an “*electronic service*”, a “service” as defined in section 1 of the VAT Act which falls within the ambit of an “*electronic service*” may have a dual application in terms of the VAT Act. For example, a service falling within the ambit of “*electronic services*” may also be an exempt “*financial service*” as envisaged in section 12(a) read with section 2 of the VAT Act. Once it has been established that a non-resident supplier of electronic services is conducting an “*enterprise*” as envisaged in paragraph (b)(vi) of the definition of “*enterprise*” in section 1 of the VAT Act, the next question is whether proviso (v) to the definition of “*enterprise*” in section 1 of the VAT Act, that specifically provides for any “*activity*”, will deem the exempt supply (albeit an “*electronic service*”) not to form part of the non-resident supplier’s enterprise. Currently the proposed Regulation does not deal with the scenario where an electronic service may have a dual purpose.

128. Section 14(5) of the VAT Act provides for specific exemptions from VAT imposed of in terms of section 7(1)(c) of the VAT Act. In this regard section 14(5)(b) of the VAT Act makes provision that if that supply was made in South Africa and would be charged with tax at the rate of zero per cent applicable in terms of section 11 or would be exempt from tax in terms of section 12 of the VAT Act it will not be subject to VAT at in terms of section 7(1)(c) of the VAT Act.

129. **Submission:** We propose the inclusion of a specific exemption provision in the Regulation similar to the exemptions in section 14(5)(b) of the VAT Act, to specifically exclude supplies of electronic services which would, if supplied by a registered vendor in South Africa, be charged with tax at the rate of zero per cent applicable in terms of section 11 or would be exempt from tax in terms of section 12 of the VAT Act.

Online subscription platforms and advertising services

130. In addition to on-line advertising services as mentioned in the Davis VAT Report, subscription services, in particular proved to be a challenge under the current Regulation. For example, a foreign supplier’s VAT registration obligations could depend on the interpretation of “*subscription services*” and what constitutes consideration for these services. Although some guidance was provided in this regard in the Davis VAT Report, in practice, it remained a contentious issue for clients.



131. One example on the complexities relating to advertising and subscription services as well as consideration for the services is what is known as “*Pay Per Click*” (PPC) advertising. Under the PPC advertising model, a foreign supplier provides e.g. electronic/digital global job websites on a PPC model on which potential employees are directed to the website of an advertiser (i.e. direct employers, recruiting agencies etc.) The foreign supplier of the website receives a fee when its customer’s (the advertiser) advertisement is clicked by a potential employee. There are two main models to determine fees under the PPC model, i.e. a fixed rate or bid-based rate model. The bid-based rate model is quite complex and the fees are based on the maximum bid amount by the advertiser and the amount of clicks on its advertisements. Furthermore, advertisers may also place adverts for free.
132. Another example is the provision of a global online marketplace via a website whereby third party suppliers can sell their range of products. Customers worldwide can purchase a South African or foreign third party supplier’s goods through the foreign supplier’s website. The products are manufactured by third party manufacturers (outside South Africa). No fee is charged by the foreign supplier solely for the use of the website by the third party suppliers or their customers.
 - 132.1 However the foreign supplier enters into Service Agreements with the South African and foreign third party suppliers for the provision of certain services for which it receives a service fee. The said services are provided by the foreign supplier as an independent contractor to the third party suppliers and include, *inter alia*:
 - The facilitation of the sale of the goods on behalf of the third party supplier including the marketing and processing of customers’ orders;
 - The facilitation and arranging of the manufacturing of the goods by an independent third party (outside South Africa) as agent on behalf of the third party supplier;
 - The use of the online marketplace by the third party supplier; and
 - Other support services provided to the third party suppliers such as payment collection and customer support.
 - 132.2 The foreign supplier does not own or become the owner of any of the designs or finished goods and merely acts as agent for the facilitation of the sale and the manufacturing of the goods on behalf of the third party suppliers.
 - 132.3 The service fee charged by the foreign supplier to the third party suppliers include the following:
 - Hosting of the marketplace; and
 - Facilitation of the transaction on behalf of the third party supplier, i.e. the sale and manufacture of the goods.
 - 132.4 Furthermore, the foreign supplier is contractually liable in terms of the service agreement to provide delivery of the goods to the Customers for which the Customers pay a delivery fee.
133. A final example is also in relation to the provision of web applications by foreign suppliers where the term “*subscription service*” encompasses both, the scenario where



subscription fees are paid in advance for a particular service using the web application, or where a person subscribes to a web application free of charge where fees are only due if and to the extent of the actual use of the services to which access is gained via a web application. In some instances subscriptions generally paid in respect of web applications are indeed not paid to have mere access to the application, but rather to those services to which the application provides access to.

134. As can be seen from the above examples, there are a number of complexities, e.g. the nature of the services in terms of the definition of electronic services and the consideration payable for the services.

135. Submission: We submit that “*consideration*” should be defined for purposes of electronic services to cater for the advanced market place where consideration takes all forms and substance.