

25 November 2014

Ms. Y. Mputa
The National Treasury
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Dear Ms. Mputa

RE: ANNEXURE C PROPOSALS 2015

Thank you for the opportunity to contribute proposals for the inclusion in Annexure C of the Budget Review 2015.

Set out below, is the consolidated commentary on **Value-Added Tax matters only**, developed from both an internal review of the provisions as well as from consultations with members, stakeholders and industry. The commentary reflects the collective view of members, stakeholders and industry role players consulted.

We have also included various submissions on policy matters which we would like the opportunity to further discuss with National Treasury.

All references to sections below are references to sections of the Value-Added Tax Act (No. 89 of 1991), unless stated otherwise.

1. Supplies between connected persons where full consideration is initially not determinable – section 9(4)

Problem statement

Section 9(4) calls for a special time-of-supply in circumstances where the whole of a consideration is not determinable at the time goods or services are supplied in terms of specific types of agreements.

This provision is currently subject to section 9(2)(a), which renders it not applicable to connected persons and thus prejudices these persons.

For example:

Company A renders services to Company B from 1 February. The consideration, based on hours worked, will only be determined once the work has been completed on 30 March. If the companies are not connected persons, section 9(4)(b) will apply, effectively deferring the time of supply to the

date when any payment is due or received or an invoice is issued, whichever is the earliest.
Assuming the date payment is due is 30 March, the time of supply will then be 30 March.

However, if the companies are connected persons, the supply will be deemed to take place when the services are actually performed as per section 9(2)(a)(iii), which is 1 February.

Whether vendors are connected persons or not, the circumstances which make the consideration initially indeterminable remain the same.

Proposed solution/recommendation

In light of the above, section 9(4) should also apply to connected persons that are fully taxable (i.e. vendors). This can be achieved by the not making section 9(4) subject to section 9(2)(a).

2. A comparable section 11(1)(q) provision for services

Problem statement

Section 11(1)(q) provides for the zero-rating of a so-called “loop” transaction where goods are supplied by a vendor to a non-resident non-vendor:

- where the vendor must deliver the goods to another resident vendor, as part of the non-resident’s supply to the second resident vendor;
- who will use the goods in the course or furtherance of his enterprise.

The *Explanatory Memorandum on the Revenue Amendment Laws Bill, 2005* provides the following example at clause 105:

A foreign company, Company A, is contracted to supply goods to the client. Company A in turn contracts with a local supplier to supply certain goods which goods will be delivered to the client in the Republic. The goods are therefore not imported by Company A into the Republic but are supplied and delivered by the local supplier directly to the client in the Republic.

The supply of goods by the local vendor to Company A will be zero-rated.

Suppose the same situation exists, except that services (and not goods) are supplied by the local vendor to Company A. Unfortunately there is currently no provision available in section 11(2) to provide for the zero-rating of such services.

The only provision in section 11(2) that bears a slight resemblance to section 11(1)(q) is section 11(2)(l)(ii)(bb), which only finds application if the services are supplied directly in connection with certain

movable property. In essence, if the services provided by the local vendor to the non-resident are not tied to movable property, the zero rating will not apply for a loop transaction.

Proposed solution / recommendation

A provision comparable to section 11(1)(q) should be inserted into section 11(2) for services but limited to recipients that are fully taxable.

3. Payments basis – section 15(2)(b)

Problem statement

The Taxation Laws Amendment Act, 1998 introduced the payments basis for natural persons (or an unincorporated body comprising only of natural persons) whose taxable supplies for a 12 month period did not exceed R2.5 million. This amount has not kept pace with inflation over the years.

Proposed solution / recommendation

The taxable supplies limit of R2.5 million applicable to such persons should be increased to keep pace with inflation.

4. Temporary letting of residential fixed property not subject to section 18B relief – section 18(1)

Problem statement

When a developer is forced (due to economic reasons) to rent out residential units developed for sale, section 18(1) specifies a taxable supply of the units at market value. What is uncertain is whether or not the residential units are “removed” from the VAT base on account of the application of section 18(1). It is not clear whether the subsequent sale of the units will be subject to output VAT.

Proposed solution/recommendation

Clarification is sought on whether the subsequent sale of the units will be subject to output VAT if there was already VAT imposed in terms of section 18(1) when the units were temporarily rented out.

5. Temporary letting of residential fixed property where section 18B applies

Problem statement

Section 18B offers temporary relief to property developers who, due to economic reasons, are forced to temporarily let out their properties because of difficulties experienced in selling those assets.

This is achieved by a deferring the time of supply. The provision currently contains a sunset clause, whereby the relief afforded to developers of residential properties will be terminated on 1 January 2015.

Treasury indicated in 2011 that it was considering taxing the change in use by the developer based on the monthly temporary rental income, but no policy direction has been forthcoming. The aftermath is that although the economic situation of developers has improved marginally (as compared with the 2008/9 downturn), developers would still face a potential cash flow impact borne from the application of section 18(1), if section 18B is terminated. In the light of the above, it would be harsh to allow the sunset clause of 1 January 2015 to remain as is.

Proposed solution/recommendation

Until the policy concerning the temporary letting of fixed property is fleshed out, it is suggested that the sunset clause be extended to a future date.

6. Car hire by short-term insurers - section 17(2)(c)

Problem statement

Short-term car insurers usually have an option for policyholders to be temporarily provided with a car while their vehicles are undergoing repairs as a result of an accident. For the provision of this service, their insurance is increased accordingly. The cars are typically hired by the insurer from car rental companies.

Proviso (i) to section 17(2)(c) allows an input VAT deduction “*where that motor car is acquired by the vendor exclusively for the purpose of making a taxable supply of that motor car in the ordinary course of an enterprise which continuously or regularly supplies motor cars, whether that supply is made by way of sale or under an instalment credit agreement or by way of rental agreement at an economic rental consideration*”

From this wording, it is arguable that short-term insurers can claim the input VAT deduction.

- A. A motor car is acquired by the vendor (the insurer) for the purpose of making a taxable supply.
- B. The taxable supply in this case would be the provision of insurance, the consideration being the insurance premiums received from policyholders, which is subject to output VAT.
- C. The frequency of car accidents on South African roads further means that this service will be supplied regularly. One can further surmise from this that the supply of the motor car is in the ordinary course of an enterprise that regularly supplies motor cars.
- D. By virtue of the fact that a portion of the insurance premiums is attributable to the provision for the possible car rental expense that may need to be incurred by the insurer in case the policyholder needs a car, one may argue that the supply of the car is by way of rental agreement at an economic rental consideration.

This puts the insurer in a position almost identical to a car rental company.

Since a car rental company would be able to claim the input VAT on vehicles acquired for the purpose of renting them out, it is submitted that short-term insurers also be allowed an input VAT deduction for car hire expenses as these input costs form part of the inevitable concomitant of the insurer's business. Both the insurer and the car rental company are providing the exact same service.

When a motorist is involved in an accident and his motor car is temporarily unavailable, that person can either hire a car or, if his car insurance provided for it, have a car provided for him by the insurer.

Proposed solution/recommendation

Another proviso to the section 17(2)(c) input VAT deduction prohibition should be added, excluding car hire acquired by a short-term insurer in the course of making taxable supplies of insurance to the insured.

7. Subscriptions/fees paid for membership to professional organisations – “input tax” definition

Problem statement

At point 8.5.2 of the latest version of the VAT404 Guide for Vendors, under the heading “Club subscriptions of a recreational nature”, SARS states that the VAT incurred on any fees or subscriptions to professional organisations may not be deducted as input tax.

Furthermore, SARS withdrew a ruling issued to the South African Institute of Chartered Accountants (SAICA) that allows companies to claim the VAT on SAICA membership fees paid on behalf of their employees. This was based on the assertion that the VAT was incurred by the employees as principals and not by the employers, or in other words, that the services by the professional bodies were rendered to the employees, not the employer. It is again submitted that membership to professional organisations is, in many industries, necessary for the making of taxable supplies. Employers in many industries require their employees to be members of professional organisations in order them to make taxable supplies.

It is therefore submitted that the VAT on fees paid by an employer for an employee's membership to a professional organisation should be allowed as an input tax deduction to the employer. SAIT and SAICA is, however, in the process of compiling a combined submission on this matter that would be submitted to Treasury in due course.

Proposed solution/recommendation

A VAT ruling should be issued to allow employers to claim the input tax on the subscription fees paid to professional bodies of employees, provided that membership to the professional body is a prerequisite for the employee to perform his/her employment functions.

8. Branches of foreign entities in South Africa - section 8(9)

Problem statement

Where a branch or office of a foreign company conducts activities (e.g. marketing and support) for its main business outside SA then proviso (ii) of the definition of “enterprise” in section 1 of the VAT Act deems the main business and its SA operation to be separate persons provided-

- The SA operation is separately identifiable from its main business, and
- The SA operation maintains a separate system of accounting.

Furthermore, section 8(9) of the VAT Act has the effect that the activity of supplying goods or services to the main business by the branch would be deemed to be a supply of such goods and services in the course or furtherance of the branch’s enterprise.

We have noted that SARS have begun to refuse registration or attempted to deregister vendors who are branches and merely supply goods or services to the head office on the basis that such activities do not constitute an “enterprise”. The only reason we can deduce as to why SARS is approaching the matter in this manner, is by applying proviso (ii) to the definition of “enterprise” in such manner that the word “enterprise” as used in that proviso is referring to paragraph (a) of the definition of “enterprise” (i.e. self-referencing) and therefore applying to vendors and not the normal grammatical meaning namely any activity by any person.

Proposed solution/recommendation

It is requested that paragraph (a) of the definition of “enterprise” be amended to specifically include separately identified branches or main businesses as per proviso (ii) and specifically referencing section 8(9) to clarify the legal position. In principle there should be no distinction for VAT purposes whether a branch or subsidiary is used to supply goods or services to its main business outside SA. This is further supported by the fact that the zero rating provisions for both the branch and subsidiary (i.e. section 11(2)(o) and (l), respectively) contain the same requirements.

9. Contract prices section 67

Problem statement

It is our understanding that the amendment in the Taxation Laws Amendment Bill, 2014 seeks to clarify that a person entering into a contract (that will require this person to become registered for VAT), but who then fails to actually register for VAT as required, cannot then rely on section 67 to provide relief for the VAT due by it from the recipient of the contract. Section 64(1) will then deem the amount stipulated in the contract to be inclusive of VAT.

Our concern, however, is that at the stage that a contract is signed, and this contract results in a person being required to be registered for VAT, no VAT was allowed to be added to the contract price as the person could only apply for registration after the contract had been signed. Practically it is therefore difficult to comply with this section.

It is also not clear who this amendment is trying to protect as section 67(1) already includes a statement that the right of recovery of the VAT is not available if it is agreed to the contrary by both parties in any agreement in writing. The proposed prohibition therefore seems to merely constitute an additional penalty measure for non-compliance by a vendor.

Proposed solution/recommendation

Practically, the requirement to add VAT to the contract price and the ability to register and accordingly charge VAT is problematic. An interpretation note on how VAT should be treated when there is a liability to register and charge VAT but SARS does not allow a VAT registration before a legal contract has been concluded is required. Clear examples with solutions of what to do in such cases would be appreciated.

Furthermore, where penalties for non-compliance and protection for the recipient already exists, the relief mechanism should not be amended to further penalize vendors who failed to register and levy VAT.

Please do not hesitate to contact me should you have any further queries.

Yours sincerely

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