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RE: ANNEXURE C FOR 2017 BUDGET: COMMENTS PERTAINING TO VAT ISSUES

We have attached the comments from the SAIT VAT Work Group on the Annexure C tax proposals for the 2017 Budget pertaining to key VAT issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

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

Yours sincerely

Victor Terblanche

Chair of the VAT Work Group

VALUE-ADDED TAX

1. SECTION 21(1) OF THE VAT ACT – CREDIT AND DEBIT NOTES

Problem statement

Vendors making taxable supplies must issue tax invoices to recipients within 21 days of the date of the supply. Vendors may issue credit and debit notes for supplies under specific scenarios. These scenarios cover cancelled supplies, fundamental changes to a supply, adjustment to agreed consideration, the return of supplies and the correction of mispriced tax invoices. All vendors that issue tax invoices and all recipients entitled to claim input tax deductions could be impacted.

Where a vendor issued a tax invoice with the incorrect recipient details (name, address, VAT registration number or VAT registration number omitted), or where an invoice was just issued in error, the vendor is prohibited from issuing a credit note to correct the mistake because it falls outside the list of permissible scenarios. As a result, the recipient is not entitled to deduct an input tax deduction.

Proposed solution

We recommend that section 20 and/or 21 and/or 16(2)(g) and/or its BPR be amended to ensure that recipient vendor may deduct input tax deductions in specific situations i.e. section 20 amended to ensure that a vendor is not required to re-issue invoices to the recipient as a result of the recipient having obtained a back dated VAT registration (invoices accepted under section 20 even though the recipient's VAT number is not reflected on the invoice). Section 21(1) of the VAT Act can also be expanded to include any scenario where a tax invoice was issued in error if this does not impact on the accounting timing of the transaction. In practise we experience that SARS allows for credit notes to be issued in these scenarios but it is not supported by the current legislation.

2. ADJUSTMENTS TO IMPORTED SERVICES

Problem statement

Section 7(1)(c) of the VAT Act imposes VAT on the supply of imported services by any person. In this regard section 1 of the VAT Act defines the term “imported services” to mean a supply of services made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that the services are utilized or consumed in the Republic for the purpose of making non-taxable supplies.

Section 14(2) and section 14(3) of the VAT Act dictates the time and value on which a person should account for VAT. Currently the VAT Act does not make any provision to adjust the previously declared value, if the nature or value of the offshore expense changed.

Currently neither the VAT Act, nor any rulings issued by SARS prescribes a methodology to determine the “extent” to which an expense was acquired other than making taxable supplies. It has become a common practice to merely apply the inverse of the apportion methodology as envisaged in section 17(1) of the VAT Act.

All purchasers (VAT vendors and any other person) that procures services offshore could be affected, for example:

Scenario 1

Vendors making exempt supplies account for VAT on imported services in relation to shared costs within the global group. Typically the shared costs are regulated by the group’s Transfer Pricing (“TP”) Policy. Depending on the TP Policy, a TP adjustment will be passed quarterly or on a yearly basis. In most instances the result of the TP adjustment is that income needs to flow inbound. To give effect to the arrangement the local vendor will receive a credit note from its parent. The effect of the adjustment is that the local vendor over-declared VAT on imported

services. Currently there are no provisions allowing a vendor to make the necessary adjustment.

Scenario 2

Most rulings issued by SARS as well as Binding General Ruling 16 states that a vendor is obliged to make an adjustment within 6 months after the year-end for any shortfall or overestimation in the percentage used for the calculation based on the audited financial statements for the current financial year.

In practice most vendors making an adjustment to input tax, at the same time, makes the adjustment to imported services of any shortfall or overestimation in the percentage used for input tax purposes. I.e. it makes use of the inverse of the apportionment ratio.

Proposed solution

Currently there are no provisions allowing a vendor to make the necessary adjustments. We recommend that a specific section to be inserted to allow for such adjustments.

3. DOCUMENTARY REQUIREMENTS FOR BAD DEBTS (SECTION 16(2))

Problem statement

If a VAT vendor supplies goods or services on credit and the debt becomes irrecoverable, section 22(1) of the VAT Act provides for an input VAT deduction in respect of the irrecoverable debt. Similarly, if a VAT vendor supplies goods or services in terms of taxable supplies on credit and then transfers the debtors book to another vendor on a non-recourse basis and the debts become irrecoverable the transferee of the debtors book qualify for a VAT input deduction in respect of the irrecoverable debt.

Section 16(3)(a)(v) of the VAT Act provides for the deduction, but section 16(3) is made subject to compliance with section 16(2), in terms of which a vendor needs to submit a document or documents listed in section 16(2) in order to qualify for any deduction under section 16(3)

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of the VAT Act. Interpretation Note No 49 (issue 2), which was issued by SARS in March 2013, determined the documents required by SARS for an input deduction in terms of section 16(3)(a)(v) as follows:

- "a) *Accounting records reflecting the balance of the outstanding debt and amount of VAT written off.*
- b) *Proof that the VAT was charged and declared in a VAT return."*

This interpretation note has now been archived and no longer applies which results in uncertainty as none of the documents referred to in section 16(2) would be relevant to the writing off debtors in the circumstances covered by section 22 or section 22(1A) of the VAT Act. Although a new Interpretation Note No 92 was issued in October 2016, prescribing the documentary requirements for purposes of deductions claimed under section 16(3)(c) – (n), it does not contain any guidance or requirements for a VAT input deduction claimed in terms of section 16(3)(a) (including, thus, section 16(3)(a)(v)).

All vendors making taxable supplies on credit, or vendors purchasing debtors books consisting of debts derived from taxable supplies made by the seller of the debtors book could be impacted.

Proposed solution

We propose that the documents prescribed should be listed under section 16(2) of the VAT Act. Alternatively, the legislation should be amended to allow for SARS to prescribe the documents required for a section 16(3)(a)(v) deduction.

4. SECTIONS 190 AND 187 OF THE TAA READ WITH SECTION 45 OF THE VAT ACT – INTEREST ON DELAYED REFUNDS

Problem statement

Interest payable by SARS on delayed VAT refunds is currently legislated in section 45 of the VAT Act. Section 45 of the VAT Act is consistently incorrectly applied and interpreted by SARS and results in substantial losses to taxpayers. All vendors who are in a refund position, or who will claim a refund from SARS in future could be affected.

We submit that the payment of interest on delayed VAT refunds must be repealed from the VAT Act and included in section 187 of the TAA to ensure consistency between the various forms of taxes.

SARS has 21 business days after the date on which the VAT return for a specific tax period was received to refund any amount refundable. If SARS does not refund the taxpayer within the said period, interest will accrue on the refund amount at the prescribed rate commencing on the 22nd business day.

Based on the feedback received from members of the tax profession, we understand that it is SARS' standard practise not to pay interest where refunds are delayed beyond the 21-business day period. In addition, we understand that SARS will only consider paying the interest if the aggrieved taxpayer submits a written application. Section 45 of the VAT Act does not require a taxpayer to make a written application for interest but obliges SARS to calculate and pay it where the refund is delayed.

Further, we understand that SARS often requests verification of banking details before a refund is lifted and then applies section 45(1)(iiA) of the VAT Act which results in interest being denied on delayed refunds. Section 45(1)(iiA) of the VAT Act only applies where the vendor has not furnished the Commissioner with the particulars of the banking account. Seeing that all taxpayers provide detailed banking details together with proof to substantiate those accounts when an application for VAT registration is made, we do not see how this section can be invoked unless the taxpayer changed its banking details without having notified SARS.

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Proviso (i) to section 45(1) refers to returns which are incomplete or defective. We understand that this provision was drafted when returns were submitted manually and should not be relevant anymore due to the electronic filing of returns. We agree that the 21-business days must only commence on the date of resubmission of an incorrect return (verification letter resulting in a resubmission of a return).

Section 45(1)(iA) of the VAT Act provides for interest not to be paid where the vendor is in default, under any Act administered by the Commissioner, to furnish a return. This is not consistent with section 187 of the TAA and does not apply similarly from an Income Tax perspective. Interest should be calculated and paid on delayed VAT refunds even though other tax returns may be outstanding. There are specific sections in the TAA which has its own penalties and procedures for the late filing of tax returns. As a result, writing off the interest for delayed VAT refunds may result in a duplication of penalties.

Section 45(1)(ii) of the VAT Act is also incorrectly applied in many instances to the disadvantage of the taxpayer. Interest can only be withheld in terms of this section where the Commissioner is prevented from satisfying himself as to the amount refundable as a result of him not being able to gain access to the books and records of the vendor. The Commissioner must within a reasonable time within the period of the 21-business days request the information in writing. We understand that it often occurs that a taxpayer submits the verification information within the 21-days and then receives a second letter for additional information just before the 21-days lapses or even after the 21-days lapsed. Interest is then only calculated from the date on which the additional information is submitted. There is also not a similar provision in the TAA which applies to the other taxes administered by the Commissioner.

In numerous instances, the information requested and re-requested by SARS rarely achieves any results other than a delay in paying the refund to the taxpayer.

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The current legislation and practise results in an unfair cash flow disadvantage to the taxpayer, being a delay in the refund amount as well as a loss of interest. We are further of the view that the current legislation is not in line with section 33 of The Promotion of Administrative Justice Act, 2000 (PAJA)

which gives effect to the constitutional principles i.e. everyone has the right to administrative action that is lawful, reasonable and procedurally fair and everyone whose rights have been adversely affected by administrative action has the right to be given written reasons.

Proposed solution

We therefore suggest that interest on delayed refunds must be aligned with section 187 of the TAA and accrue from the day following the 21 business days regardless of whether SARS requests information from the taxpayer. If, after the evaluation of the said information, SARS concludes that only a portion of the initial refund amount requested is refundable, interest should be calculated and paid on the said portion from the 22nd business day after the date on which the vendor's return in respect of a tax period is received by an office of SARS.

5. PROPOSALS STEMMING FROM PRIOR SUBMISSIONS

5.1 Cash-basis (Section 15 of the VAT) – Small Business Companies (policy)

Problem Statement

Section 15(2)(b) allows only natural persons (and unincorporated bodies of persons) to register on the cash payments basis. It is submitted that section 15(2)(b) should be extended to incorporated persons (e.g. companies), especially small businesses.

Numerous small businesses are struggling to maintain positive cash flows. Accounting for output tax on the invoice basis only worsens the situation because VAT is often payable long before the underlying cash yield is received. Accounting for VAT on the invoice basis is especially problematic for vendors who render goods or services to government and to large businesses that insist on

extended credit terms. Government can take as long as two years to pay for tenders. Even large private firms often take as long as 90-to-120 days to make payment (e.g. it is not unheard of for some larger companies to use their leverage with smaller contractors to delay payment). It is further submitted that the invoice basis places a substantial compliance burden on small businesses who often rely on cash-flows (as opposed to invoice accounting) in order to run their daily businesses.

Proposed solution

It is proposed that the relief of section 15(2)(b) be extended to incorporated entities. Many small business entrepreneurs form companies to reduce risk or as a viable form of operation to obtain tenders. The proposed expansion would be of great assistance to many small businesses.

To curb avoidance, transfers between connected persons should remain on an invoice basis if one of the persons that are party to the supply operates an invoice basis. In addition, it is proposed that companies registered on the payments basis must still account for output tax on the invoice basis (despite the payment basis registration) should the value of a single item exceed R100 000. This limit would match the R100 000 limit for natural persons and unincorporated bodies (section 15(2A)). It is further submitted that section 22(3) would adequately address any avoidance that may occur by forcing recipients registered on the invoice basis to account for output tax if those recipients have not been paid to the supplier registered on the payments basis within 12 months.

5.2 Transfers of partnership interests (section 51) – Deemed Dual Levels (anomaly)

Problem statement

Upon close examination, two issues exist when transferring partnership interests (e.g. ownership of unincorporated enterprises). Firstly, while section 51 recognises the business of a partnership as a separate enterprise, the relationship of the partners to the partnership is unclear. Secondly, partnership enterprises that are transformed into an independent branch do so without relief.

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Section 51 seeks to make the transfer of a partnership (e.g. unincorporated persons) equivalent to the sale of a company but does so only at one level. Under section 51(2), the transfer of a partnership interest has no impact on the taxable enterprise of the partnership as long as two or more partners remain and the partnership enterprise actively continues. This continuation mirrors the impact of the transfer of shares in a company. The question is what rights are being transferred – underlying partnership assets or the partnership interests.

Company Share Transfer Example: Shareholders X, Y and Z each own 100 ordinary shares in a company, and the company is engaged in a manufacturing enterprise. Shareholder X sells all 100 ordinary shares to Shareholder T. Under basic VAT principles, the manufacturing enterprise carries on as before. Shareholder X is viewed as selling a financial service (section 2(1)(d) of the VAT Act), which constitutes an exempt supply (section 12(1)(a) of the VAT Act).

Partnership Transfer: Partners A, B and C each own interests in a partnership amounting to 1/3rd each. The partnership is engaged in a retail enterprise. Partner A sells all of its 1/3rd interest in the partnership to Partner T. Under section 51(2) of the VAT Act, the manufacturing enterprise carries on as before. However, for purposes of the VAT Act, what is Partner A selling – the partnership interest or 1/3rd of the partnership assets?

Proposed solution

In order for the supply of a partnership interest to be truly equivalent to the supply of a company interest (i.e. shares), the supply should be viewed as financial service (i.e. an exempt supply) – not the supply of a proportion of underlying partnership assets. Given that section 51 views the partnership enterprise as something separate from the partners, the partners should be viewed as holding and transferring partnership interests (much like the holder and transferor of shares in a company).

5.3 Transfers of partnership interests (section 51) – Terminations (anomaly)

Problem statement

Many partnership transfers have no bearing on the continuance of the partnership enterprise because the partnership maintains two or more partners. However, certain transfers can reduce partnership interests to a single owner, thereby converting the partnership into a branch. This conversion to a single owner triggers VAT even if the underlying business remains operating as before.

Partnership Transfers: Holding Company owns all the shares of Subsidiary M and Subsidiary N. Subsidiary M and N each own 50 per cent of the interest of Partnership, the latter of which engages in a manufacturing enterprise. Subsidiary M transfers all of its 50 per cent interest in Partnership to Subsidiary N. Partnership automatically dissolves once all partnership interests are held by Subsidiary N, thereby converting the partnership enterprise into a branch. Section 51(2) does not apply to the overall transaction because only one partner remains.

Proposed solution

The conversion of a partnership to a branch should be viewed as a continuation under section 51(2). No VAT should apply.