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DISCLAIMER

Every effort has been made to ensure that the guidance given in this guide is correct. Nevertheless, that guidance is provided to members of SAICA and the IoDSA to assist them with particular problems relating to the subject matter of the guide. The Guide does not in any way or manner amount to formal advice, legal or otherwise, in relation to the subject matter. SAICA or the IoDSA will have no responsibility or liability to any person or organisation for any claim, loss or damages, whether direct, indirect or consequential, or of any nature whatsoever; that may arise out of or related to the contents or opinions provided for in this guide.
INTRODUCTION

In South Africa, Value Added Tax (VAT) is imposed on the consumption of goods or services in South Africa. This is achieved by imposing VAT on the local supply of goods or services by South African VAT vendors, and levying VAT on the importation of goods and certain services into South Africa.

Only goods or services supplied in the course of carrying on a VAT enterprise are subject to VAT.

Historically the position with regards to pay-as-you-earn (PAYE) and VAT relating to fees paid to executive directors (EDs) and non-executive directors (NEDs) was unclear and different practices have been applied depending on the interpretation followed at a particular point in time. In many instances, fees paid to EDs and NEDs were treated as not being subject to VAT on the basis that it was excluded by proviso (iii) (aa) of the definition of “enterprise” in section 1(1) of the VAT Act 89 of 1991 (the VAT Act) by constituting “remuneration” for the purposes of the Fourth Schedule to the Income Tax Act 58 of 1962 (Income Tax Act) and therefore subject to PAYE. In some instances, employers followed an interpretation that a NED was not subject to PAYE by virtue of the inherent requirement to be independent of the company he or she served, therefore such person carried on an independent trade and did not receive “remuneration”. However this interpretation created confusion in relation to proviso (iii)(bb) of the VAT Act that also relied on the independent trade test to again impose VAT on such director fees.

To clarify this uncertainty, the South African Institute of Chartered Accountants (SAICA) and the Institute of Directors in Southern Africa (IoDSA) approached the South African Revenue Service (SARS) and National Treasury in 2016 to seek a solution. SARS concluded that no legislative change would be implemented but that the SARS would issue a clarifying interpretation on this matter.

On 10 February 2017 SARS issued Binding General Ruling 40 (PAYE)(BGR40) and 41 (VAT)(BGR41) to respectively clarify SARS’ interpretation of the PAYE and VAT position of NEDs. On 4 May 2017 a second issue of BGR 41(issue 2)(Annexure A) was issued together with an updated media release and on 5 May 2017 SARS issued a media release to clarify the registration process applicable to NED’s (Annexure B).

BGR41 states that with effect from 1 June 2017, services supplied by non-executive directors will be regarded as services supplied by office holders carrying on a business independently from the employer. Accordingly, charges for such services will constitute “consideration” for taxable supplies and be subject to VAT if a VAT vendor supplies the services.
PURPOSE OF THIS GUIDE

This guide is issued to members to provide guidance with regards to the application of BGR 41, the general principles of VAT that may be applicable and the matters where uncertainty may still prevail where members should seek additional guidance.

This guide does not seek to provide an explanation or interpretation of the various legal interpretations prior to the issuance of BGR 40 and 41, notwithstanding that taxpayers can still follow those interpretations. Members are reminded that a BGR issued in terms of section 82 of the Tax Administration Act, 28 of 2011 (the TAA) is only binding on SARS and will constitute practice generally prevailing, as contemplated in section 5 of the TAA. Members are however encouraged to follow the principles in BGR41 to minimise the incidence of SARS disputes on this matter.

This guide therefore deals only with the application of the principles for VAT in respect of BGR41, as the PAYE implications of BGR40 are self-evident and clear. The guide also seeks to highlight areas of uncertainty. Once further areas of uncertainty have been clarified by SARS, the guide will be updated accordingly.

SCOPE OF THIS GUIDE

The scope of BGR41 is limited to only NEDs of incorporated companies and accordingly the scope of the guide is similarly limited. Therefore this guide does not address the services of EDs. Being limited to NEDs of incorporated companies as envisaged in the Companies Act 71 of 2008 (Companies Act), it also does not address office holders of other types of entities, including entities defined in section 1 of the Income Tax as “companies”, such as close corporations and associations of persons.

It is acknowledged that the principles applied by SARS in both BGR 40 and 41 are the same or similar to what could apply to many other office holders such as persons serving on medical schemes councils or boards, council members for universities, religious councils and board members of associations of persons (e.g. professional associations or sports clubs etc.). Should such entities or persons wish to clarify their PAYE or VAT implications, they should approach SARS for a binding private ruling in terms of section 78(1) of the TAA.
THE REGULATORY ENVIRONMENT

The Companies Act: Appointment of directors

Companies are governed by the requirements of the Companies Act.

The Companies Act requires companies to appoint a board of directors to act in a fiduciary capacity on behalf of the shareholders of the company. Shareholders are ultimately responsible for the composition of the board and it is in their interest to ensure that the board is properly constituted from the viewpoint of skill and representation. Directors of companies are appointed in terms of the constitution of the company and in terms of the Companies Act.

The Companies Act prohibits legal entities from acting as directors of companies. In practice, agreements are sometimes entered into whereby director fees are paid directly to a third person or company of which the director is an employee, notwithstanding the fact that the director is appointed in the position of a director as a natural person by the company paying the director fees. These nominee directors are still appointed in their personal capacity but in many instances agree to forfeit any remuneration that then from a tax perspective, accrues to the nominating employer (see SARS Practice Note 4/1985 that addresses the income tax challenges of this arrangement).

The Companies Act: - Classification of directors

The Companies Act does not draw a distinction between EDs and NEDs, neither with regards to their status or function within a company. This is confirmed in the King IV Report on Corporate Governance for South Africa¹ (“King IV”) that all directors as a matter of law have a duty to act with independence of mind in the best interest of the organisation.

From a governance perspective, however, King IV requires that members of the governing body be classified as “executive” or “non-executive” with the latter also further classified into “independent” or “not independent”. EDs and NEDs were defined in the King III Report on Governance² as follows:

Executive directors (ED) (Annex 1.1 of King III)

“Involvement in the management of the company and/or being in the full-time salaried employment of the company and/or its subsidiary define the director as executive.”

Non-executive directors (NED) (Annex 1.2 of King III)

“Not being involved in the management of the company defines the director as non-executive.

Non-executive directors are independent of management on all issues including strategy, performance, sustainability, resources, transformation, diversity, employment equity, standards of conduct and evaluation of performance.”

It is not clear or expressly stated in BGR41 if the determination of whether a specific director is a NED must be done in accordance with the King III and IV Reports. However given that there remains no other relevant guidance to make this determination, it is our view that the determination can only be made by applying the principles of King III and IV.

Practical impact of distinction

In practice there is no distinction as far as the “board room responsibilities” are concerned. ED, independent NED and NED functions and responsibilities at board level are identical.

Where it comes to the operational management of the company there is a clear distinction; NEDs should never be involved in the day-to-day management of a business. Furthermore, independent NEDs are free of all perceived bias in decision-making or undue influence in regard to the organisation.

**SARS’ intended practice**

The distinction of NED and independent NED has not been clarified with SARS in relation to BGR 41 but as it is currently worded, it applies to all NEDs.
GENERAL VAT PRINCIPLES

A VAT enterprise

Section 7(1)(a) of the VAT Act, imposes VAT on the supply of goods or services made by a VAT vendor in the course or furtherance of a VAT enterprise carried on by the person.

The concept of a VAT enterprise requires that activities in the course of which taxable supplies are made must be carried on regularly or continuously, in or partly in, South Africa.

The VAT Act further requires that a person must register for all VAT enterprises that it carries on.

Proviso (iii) (aa) to the definition of “enterprise” in section 1(1) of the VAT Act excludes from VAT enterprise activities an employer-employee relationship, except where the employee carries on its enterprise independently from the employer.

SA resident NEDs supplying services in South Africa

It can generally be assumed that SA resident NEDs supplying their NED services in South Africa will be conducting an enterprise for VAT purposes in South Africa and will be required to register as VAT vendors in SA if the value of their taxable supplies exceed the compulsory registration threshold of R1 million.  

Non-resident NEDs supplying services from offshore

Where a non-resident NED supplies his or her services from offshore (for example by way of technology conferencing) and never or seldom enters South Africa, there is a strong argument that he or she will not be conducting an activity in South Africa that would require registration as a VAT vendor.

Where uncertainty exists SARS should be approached for a binding private ruling.

Non-resident NEDs supplying services in South Africa

Where a non-resident NED physically attends director meetings in South Africa on a regular or systematic basis based on the requirements of a contract with a South African company it may potentially be argued that the non-resident conducts an activity or enterprise “regularly or continuously” in South Africa even if the NEDs simply “fly in” for meetings and subsequently again “fly out”. This issue is an area of uncertainty and remain so until SARS clarifies their interpretation.

On the assumption that NEDs falling into this category will be conducting an enterprise for VAT purposes in South Africa, they will be required to register as VAT vendors if the annual level of their taxable supplies exceeds R1 million.

In the media release issued by SARS in May 2017 it confirmed certain actions that must be taken by non-resident NEDs when registering as a VAT vendor in South Africa. While the notice does not specifically deal with the circumstances under

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3 Section 23(1)(a) of the VAT Act
which a NED will be required to register as a VAT vendor in South Africa, the underlying assumption of the notice is an inclusion of non-resident NEDs in the South African VAT net.

As far as the VAT registration threshold is concerned, the R1 million threshold will only include South African activities if the NED keeps separate records of its South African activities. If separate records are not kept of the South African activities, the NED’s worldwide income will be taken into consideration to determine the R1 million registration threshold. This however does not mean that the worldwide income will be subject to VAT in South Africa. Activities conducted outside South Africa will constitute zero-rated supplies for VAT purposes.

Please note that the exclusion from the definition of “remuneration” in section 1 of the Income Tax Act with regards to amounts paid or payable in respect of services rendered or to be rendered by any person in the course of any trade carried on by him independently of the person by whom such amount is paid or payable, does not apply to non-resident NEDs. Payments to non-resident NEDs may therefore be subject to the deduction of PAYE as well as being subject to VAT. Under these circumstances PAYE is deducted from the VAT exclusive amount.
Registration of NEDs as VAT vendors

**General principles**

Any person that makes taxable supplies in excess of R1 million in any 12-month period in respect of all enterprises carried on by the person, becomes liable to register as a VAT vendor.\(^4\)

A NED falling into this category will accordingly be required to register as a VAT vendor.

BGR41 makes provision for various scenarios that may be encountered in practice.

i. If the NED is **already registered as a VAT vendor**, only the NED fees earned on or after 1 June 2017 will be subject to VAT. If no VAT was accounted for on the NED fees prior to 1 June 2017, **no retrospective adjustment** is required.

**Example 1**

A NED is registered as a VAT vendor based on consulting fees that he/she earns. With effect from 1 June 2017 the NED will be required to levy VAT on NED fees.

ii. If the NED is **not registered for VAT** but the combined annual value of the NED fees and other VAT-able income (i.e. taxable supplies) exceeds R1 million, the NED will be required to register as a VAT vendor. VAT must only be accounted for on NED fees earned **on or after 1 June 2017**.

The value of **taxable supplies** will include the value of any goods or services regularly or continuously supplied by the NED, for example consulting fees, book keeping fees, royalties received (e.g. from books sold), commercial rental income, etc. but will exclude other employment income (i.e. normal salary and bonus).

**Example 2**

A NED earns R 500k in NED fees and R600k in other consulting fees. The NED will be required to register as a VAT vendor as the value of taxable supplies of all enterprises carried on by the NED exceeds R1 million per annum (R500k + R600K = R1.1 million).

**Please note that the NED may not need to register as a VAT vendor on 1 June 2017. The requirement to register as a VAT vendor will only be triggered once the NED’s annual value of taxable supplies has actually exceeded R1 million.**

iii. If the NED is not registered for VAT and the combined annual value of the NED fees and other VAT-able income (see above example of potential taxable supplies) does not exceed R1 million, the NED will not be required to register as a vendor. The NED fees would under these circumstances not be subject to VAT.

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\(^4\) Section 23(1)(a) of the VAT Act
Example 3
A NED earns fees of R500 000 as a NED and other consulting fees of R300 000. There is no requirement that the NED must register as a VAT vendor in South Africa as its annual value of taxable supplies < R1 million. The NED may register voluntarily as his/her annual value of taxable supplies exceeds R50 000.
Timing of registration

A NED will be obliged to register as a VAT vendor at the end of any tax period in which the NED’s value of sales in the previous 12-month period has actually exceeded R1 million.

A NED will also be obliged to register as a VAT vendor if the NED at the commencement of any month has incurred a contractual obligation to make taxable supplies in the subsequent period of 12 month for a value of R1 million or more.

The following examples explain the potential circumstances that may present itself in practice.

Example 4
A NED earns R500 000 in NED fees and R600 000 in other consulting fees in a 12 month period. The NED will be required to register as a VAT vendor as the value of taxable supplies of all enterprises carried on by the NED exceeds R1 million per annum (R500 000 + R600 000 = R1.1 million).

Example 5
A NED earns R500 000 in NED fees and R600 000 in holiday accommodation rental income in a 12 month period. The NED will be required to register as a VAT vendor as the value of taxable supplies of all enterprises carried on by the NED exceeds R1 million per annum (R500 000 + R600 000 = R1.1 million). Rental activities would be such an enterprise activity.

Example 6
A NED earns R500 000 in NED fees and R1.6 million in salary as CEO in a 12 month period. The NED will not be required to register as a VAT vendor as the value of taxable supplies of all enterprises carried on by the NED does not exceed R1 million per annum as the salary earned is not from an enterprise (see proviso (iii)(aa) of the definition of Enterprise of the VAT Act).

Example 7
A NED enters into a contract for three years with a company to supply NED services to the company. The contract makes provision for a fee of R500 000 per annum for services rendered. The total fees over the period of the contract is accordingly R1.5 million.

The NED will not be required to register as a VAT vendor as the value of his or her taxable supplies in the next period of 12 months will not exceed R1 million.
Example 8

A NED enters into a contract for three years with a company to supply NED services to the company. The contract makes provision for a fee of R500 000 per annum for the first year and R1 million each for the subsequent two years.

The NED will not be required to register on commencement of the agreement as the NED’s value of taxable supplies will not exceed R1 million in the first year.

The NED will be required to register at the commencement of the second year, having an obligation to supply services with a value of at least R1 million in the subsequent 12 months.

Example 9

A NED enters into a contract for three years with a company to supply NED services to the company. The contract makes provision for a fixed three-year fee of R2 million.

The agreement does not create an obligation on the part of the NED to supply services within the next 12-month period with a value greater than R1 million. The best estimate of the annual value of taxable supplies to be made would be R666 000 per annum (R2 million/3).

Under these circumstances the NED will not be required to register as a VAT vendor.

The registration process

The detailed process to register as a VAT vendor is contained in the SARS Guide for Registration – VAT-Reg-02-G01. The latest guide can be obtained from the SARS website at www.sars.gov.za and you should also refer to the SARS Media release in Annexure B.

SARS intended practice

SARS indicated to SAICA that an individual NED must register as a VAT vendor notwithstanding the fact that fees are paid to a corporate entity. This means that a company of which the individual is a director may not issue a tax invoice on behalf of or in lieu of the individual director unless the company issues the tax invoice in the capacity of the NED’ agent. If this is done, the NED will still be required to account for the VAT under his or her own VAT registration number.

In summary there main steps are:

- The applicant must have a South African bank account
- The applicant must complete and submit a form VAT101
- The applicant must submit the supporting documentation set out in the VAT-Reg-02-G01.
The applicant must submit proof of turnover. SARS indicated that the following will be acceptable as proof of turnover:

- A copy of the NED’s letter of appointment;
- A copy of the minutes of the directors’ meeting;
- A copy of a service contract/agreement; or
- IRP5/IT3(a) certificate with source code 3620 (Directors Fees – RSA Resident NED) or 3621 (Directors Remuneration – Non-Resident NED).

Non-resident NEDs must appoint a representative vendor in South Africa. SARS reserves the right to verify the information supplied. This may entail SARS doing a site visit at the applicant’s place of business.

The VAT101 is not considered difficult to complete. An issue occasionally creating a challenge in practice is the Business Activity Code required on page 6 of the VAT101 form. In the case of NEDs registering for supplying NED services, the code required to be used is 2520 (Financial services).

**OUTPUT TAX RELATED TOPICS**

**Timing of accounting for output tax**

*General rules*

All VAT vendors must account for output tax on the invoice basis. This essentially means that the VAT vendor must account for output tax in the tax period that he or she issues an invoice for goods or services supplied, irrespective of whether the invoice has been settled when the VAT is due to SARS.

Natural persons with an annual VAT-able turnover of less or equal to R2.5 million may apply to SARS to account for VAT on the payments basis. On this basis the VAT vendor only needs to account for VAT to SARS once its debtors have paid their invoices.

A vendor wishing to account for output tax on the payments basis must on applying for registration indicate that the person wishes to be registered on the payments basis. This selection must be done by ticking the “Payment” block on page 6 of the VAT101 (under value of supplies section).

If a person has been registered on the invoice basis but qualifies to be registered on the payments basis, the person may apply to SARS to change its basis of registration.

The payments basis may only be used if the value of the person’s annual taxable supplies does not exceed R2.5 million. The onus is on the person accounting for VAT on the payments basis to advise SARS should the person’s value of taxable supplies exceed the R2.5 million annual threshold at any time.

While vendors registered on the payments basis must account for output tax only when and to the extent that the consideration charged for the supply is actually received, this rule does not apply to a supplies with a value exceeding R100 000. Where the consideration for a single supply exceeds R100 000, output tax must be accounted for on the invoice basis.
The following examples explain the practical application of being registered on the various bases.

**Example 10**

A NED registered for VAT on the invoice basis earns a fee for R500 000 from a company. The fee is due on 30 June 2017. The NED issues an invoice for the fee on 30 July 2017 and receives the actual payment on 1 August 2017.

Output tax on the supply must be accounted for in the tax period within which 30 July 2017 falls, being the earlier of invoicing or the receipt of any part of the consideration for a supply.

**Example 11**

A NED registered for VAT on the payments basis earns a fee for R50 000 from a company. The fee is due on 30 June 2017. The NED issues an invoice for the fee on 30 July 2017 and receives the actual payment on 1 August 2017.

Output tax on the supply must be accounted for in the tax period within which 1 August 2017 falls, being the tax period in which the consideration for the supply is actually received.

**Example 12**

A NED registered for VAT on the payments basis earns a fee for R120 000 from a company. The fee is due on 30 June 2017. The NED issues an invoice for the fee on 30 July 2017 and receives the actual payment on 1 August 2017.

Output tax on the supply must be accounted for in the tax period within which July 2017 falls, the consideration for the supply being in excess of R100 000.

**Special rules – Receipt of director fees in a form other than cash**

**General comments**

The VAT Act determines that the amount of the consideration for a supply is, to the extent that the consideration is not a consideration in money, the market value of the consideration in kind.

The Seventh Schedule to the Income Tax Act contains rules to determine the amount that accrues to an employee or office holder in respect of taxable benefits provided to the employee or office holder by an employer. The definition of “employee” in the Seventh Schedule to the Income Tax Act includes any director of a company.

Section 8C of the Income Tax Act contains the rules to value benefits accruing to beneficiaries of share incentive schemes.

The VAT Act\(^ 5\) determines that where a vendor supplies a taxable benefit (as envisaged in the Seventh Schedule to the Income Tax Act) to an office holder or employee of the vendor, and the benefit consists of the supply of goods or services that would normally be subject to VAT if supplied in the normal course of the

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\(^5\) Section 18(3) of the VAT Act
enterprise to a third person, the supply of the taxable benefit must be treated as a supply of goods or services by the vendor subject to VAT. The VAT Act deems the taxable supply to be made in the tax period that the benefit accrues to the employee or office holder in terms of the Seventh Schedule to the VAT Act. The value placed on the goods or services supplied as taxable benefits to employees or office holders is the value as determined in terms of the Seventh Schedule to the Income Tax Act with the exception of the supply of the use of motor cars, which is governed by a Regulation.

The above specific VAT rules only govern the potential VAT liability in the hands of the employer vendor on the supply of taxable benefits to employees or office holders. It does not serve to determine a “market value” on the goods or services received in the hands of the employees or office holders. This normally does not provide challenges from a VAT perspective, as employees will receive the taxable benefits as remuneration (i.e. not consideration for taxable supplies). In the case of NEDs, the amounts linked to taxable benefits do not constitute “remuneration” and must accordingly be valued for VAT purposes, being consideration received for services rendered or to be rendered. It does not necessarily follow that the value for VAT purposes under these circumstances will be the same value that would normally be placed on taxable benefits in terms of the Seventh Schedule to the Income Tax Act.

What follows is SAICA’s analysis of the likely rules that will apply. Until clarity has been obtained from SARS on this issue, we recommend that a binding private ruling be obtained from SARS in the case of uncertainty.

**Seventh Schedule benefits**

As a general principle all Seventh Schedule benefits will result in VAT consequences for NEDs. The fact that the benefits may constitute exempt supplies (for example the taxable benefit of low interest loans and employee provided housing) is irrelevant. For VAT purposes the benefits are not received as Seventh Schedule benefits, but as consideration in kind for the making of taxable supplies of NED services to a company.

The Seventh Schedule to the Income Tax Act is aimed at “levelling the playfield” to ensure that cash remuneration and remuneration in the form of goods or services result in the same income tax consequences. As such the value placed on taxable benefits would generally speaking constitute the market value of the goods or services.

NEDs should accordingly reflect the value of the benefit received by them on their invoices and levy VAT on such charges. As a general principle the values provided for in the Seventh Schedule to the VAT Act should provide a fair estimate of the market value of the consideration in kind. Where uncertainty exists though, SARS should be

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6 Section 9(7) of the VAT Act  
7 Section 10(13) of the VAT Act  
8 Government Notice No. 2835
approached to obtain a Binding Private Ruling to confirm the basis on which the value must be determined.

Example 13

A NED registered for VAT enjoys the use of a motor vehicle with a cost (including VAT) of R500 000. The NED submits VAT returns every two months.

How should the NED declare the value of the use of the motor vehicle in his/her VAT return?

Value of taxable benefit per the Seventh Schedule = R500 000 × taxable benefit per the Seventh Schedule\(^9\). For two months the value of the taxable benefit is accordingly R35 000. As this is the amount of the consideration received for the supply of NED services, the amount will include VAT.

The NED will accordingly be required to issue an invoice/tax invoice to the company for R35 000 (including VAT) for the tax period. In practice, generally speaking, this should also approximate the market value of the use of the vehicle.

The formula to determine the output tax liability in the hands of the employer \((14/114 \times 500 000 \times 0.3\%)\) will not be appropriate as it will not approximate the true value of the use of the motor vehicle.

Example 14

A VAT registered NED enjoys the use of rented accommodation as a benefit of being a NED. The NED submits VAT returns every two months. The company rents the residential property for a monthly rental of R50 000. No VAT is paid on the rental, being a supply of residential accommodation.

How should the NED declare the value of the use of the accommodation in his/her VAT return?

Value of the benefit = value of rental = R50 000 per month\(^11\) = R100 000 per tax period. As this is the amount of the consideration received for the supply of NED services, the amount will include VAT.

The NED will accordingly be required to issue an invoice/tax invoice to the company for R100 000 (including VAT) for the tax period. In practice this value would represent the market value of the use of the use of the property.

The fact that the supply of the accommodation is an exempt supply for VAT purposes does not change the situation. The NED is being paid for his/her taxable supplies of NED services by being granted the use of residential property. The fact that if the use of the property had been supplied directly to the NED, it would have been exempt from VAT, is irrelevant.

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\(^9\) Paragraph 7 of the Seventh Schedule to the VAT Act

\(^10\) Government Notice No. 2835

\(^11\) Paragraph 9 of the Seventh Schedule to the VAT Act
Example 15

A VAT registered NED is granted trading stock by the company with a cost of R500 000 (excluding VAT) as a benefit of being a NED. The NED submits VAT returns every two months.

How should the NED declare the value of the trading stock granted to the NED in his/her VAT return?

Value of the benefit = cost of trading stock12 = R500 000. As this is the amount of the consideration received for the supply of NED services, the amount will include VAT.

The NED will accordingly be required to issues an invoice/tax invoice to the company for R500 000 (including VAT) for the tax period. In practice this value should represent the market value of the trading stock.

Share incentive benefits

Where a NED receives shares in a company as compensation for NED services rendered or to be rendered, the market value of the shares will be the value of the consideration for the NED services supplied by the NED. The NED will be required to issue a tax invoice for the market value of the shares in the tax period when the shares are awarded to the NED. The market value of the shares used to determine the consideration of the NED services supplied to the company for VAT purposes will include VAT.

Where a limitation is imposed on the share, that results in no vesting for the purposes of section 8C, for example on the period within which the NED is entitled to dispose of the shares, the impact of the limitation must be considered on the market value of the shares. This however does not defer the VAT liability on such consideration for VAT purposes even though the income tax consequences may be deferred according to section 8C. See example below.

Example 16

A NED registered for VAT receives listed shares in the company with a market value of R500 000 on the day that the shares are allotted to the NED. The NED is however prohibited from disposing of the shares within a period of five years from the date that the shares are first allotted to the NED and will therefore on vest for the purposes of section 8C after 5 years. For the purposes of determine the VAT value, the market value of the shares is impeded by R100 000 on the date that it is allotted to the NED due to the disposal limitation.

How should the NED declare the value of the shares in his/her VAT return?

The value of the consideration is the market value of the shares on the date that it is allotted to the NED13 which is also date of supply. The market value of the shares

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12 Paragraph 5 of the Seventh Schedule to the VAT Act
13 Section 10(3)(b) of the VAT Act
used to determine the value of the consideration for the NED services supplied to the company includes VAT.

The NED will accordingly be required to issues an invoice/tax invoice to the company for R400 000 (including VAT) in the tax period that the shares are allotted to the NED. The possible PAYE and income tax liability must be determined in accordance with section 8C Income Tax Act where vesting and accrual may possibly only occur at the end of the 5 year period.

**Special rules – Cessation, assignment or transfer of rights to receive NED fees (antecedent cession)**

Generally speaking, where a right to be paid money is ceded, assigned or transferred to a third party, the transaction is a VAT exempt financial service.

Where the cession, assignment or transfer results in output tax not being attributable to any tax period, the cession, assignment or transfer of such right is regarded as a taxable supply.

**Example 17**

A NED is a vendor who is registered for VAT purposes on the payments basis. The NED becomes entitled to NED fees of R50 000 on 1 July 2017. The NED issues an invoice to the company for which he acts as NED, but cedes the right to the payment to a company before the actual payment is made. The payment is ultimately made directly to the company.

As the NED never received payment for the services rendered and is registered on the payments basis for VAT purposes, output tax on the NED fees will never be attributable to a tax period (i.e. output tax would never be payable on the services supplied by the NED).

Under these circumstances the cession, assignment or transfer of the rights to receive money will be treated as a taxable supply in the hands of the NED.

The NED will be required to account for output tax on any consideration received for the cession, assignment or transfer of the rights. If the rights are ceded, assigned or transferred for no consideration, no output tax will be payable, unless the NED and the person/company to whom the right are ceded, assigned or transferred are connected persons, in which case the supply will be deemed to be made at the market value thereof if the acquiring company would not have been entitled to a full input tax credit had a consideration equal to the market value been charged (see further example below).

**Special rules – Successive supplies**

This special rule determines that where services are supplied under any agreement or law that provides for periodic payments, a supply is deemed to take place when a payment becomes due or is received, whichever event takes place first.
This rule may have an impact on the transitional period, i.e. contracts dealing with supplies made before and after 1 June 2017. The example below demonstrates the practical implications of this.

**Example 18**

A person enters into an agreement with a company to act as an NED. The NED is registered as a VAT vendor. The agreement is for a period of 3 years and determines that payment for services rendered will be a fixed amount payable every six months. Payments are made on the last day of June and December of each calendar year. A payment of R50 000 becomes due on 30 June 2017.

As the time of the supply is the earlier of the date that a payment becomes due or is received, the time of supply is 30 June 2017. The full amount of R50 000 will accordingly be subject to VAT.

If the vendor accounts for output tax on the invoice basis, output tax must be declared in the tax period that 30 June 2017 falls.

If the vendor accounts for output tax on the payments basis, output tax must be declared in the tax period that the actual payment for the service is received.

**NB:** Under no circumstances may the NED make an apportionment of services physically supplied before and after 1 June 2017.
**IMPORTED SERVICES**

Where a non-resident supplies services to a South African recipient and such services are not for use or consumption in South Africa for the purpose of making taxable supplies, the South African recipient of the supply becomes liable for VAT on imported services.

**Example 19**

A South African holding company is not registered as a VAT vendor as the only income it earns is dividends. The company instructs a non-resident attorney to prepare a legal opinion for the company on a legal issue in South Africa. The charge for the services is R10 000.

The South African holding company will be required to account for VAT of R1 400 (R10 000 × 14%) on the imported service, as the service will not be used or consumed in a South African VAT enterprise.

**Example 20**

An NED provides NED services to a South African company. The services are provided from offshore and the NED never physically enters South Africa. The South African company makes taxable supplies to the extent of 25%. The NED charges a fee of R50 000 to the South African company.

The South African company is liable for VAT on imported services of R5 250 (R50 000 × 75% × 14%).
**FEES CHARGED THROUGH COMPANIES**

In practice, arrangements are sometimes entered into in terms of which NED fees are paid directly to a corporate entity. In this regard it is important to note that the Companies Act only makes provision for natural persons to be directors of companies. A company cannot therefore contract with another company to act as a director of the company.

SARS indicated that they will require the individual NEDs to register as VAT vendors notwithstanding the fact that the actual fees are payable to a corporate entity. The NED therefore remains liable for VAT irrespective thereof that the invoicing may be directed via a company.

This means that the NED (or by the company acting as the agent of the NED) must issue the tax documentation (tax invoices, debit notes, credit notes, etc.). Whether the NED or the company (as the agent of the NED) issues the documentation, the actual declaration of output tax must be made in the VAT return submitted by the NED.
**INPUT TAX AND RELATED ISSUES**

Input tax deduction on NED fees in the hands of the payee

There are no special rules governing input tax recoveries on NED fees. The normal test that goods or services must be acquired for the purpose of consumption, use or supply in the course of making taxable supplies must be applied.

With regard to NED fees, there are two schools of thought. This analysis would however have to be done in respect to what the board of directors do and how those services are used in the furtherance of conducting an enterprise in making taxable supplies.

The first school of thought is that the functions of NEDs cannot be differentiated from executive directors when operating at board level. It is only at the level of lower level detailed management that the distinction is made. It could therefore be argued that the costs associated with the operation of a board of directors represents a normal overhead cost of the business.

The second school of thought takes the view that NED services are closely linked to the governance and policy functions of corporate entities and therefore too far removed from operations to warrant a contention that the services are incurred in the course of making taxable supplies. Such this school of thought therefore holds the view that VAT charged by NEDs does not qualify as recoverable input tax.

This will remain an area of uncertainty until such time that SARS clarifies its views in this regard or the issue is tested in a court of law.

We recommend that in the case of uncertainty SARS be approached to obtain a Binding Private Ruling.

Input tax deductions in the hands of NEDs

NEDs who are registered as VAT vendors will be entitled to claim input tax incurred on goods or services acquired for their VAT enterprise. They will also be entitled to a retrospective adjustment in respect of goods and services acquired before they registered as a VAT vendor where the goods or services are brought into the enterprise.

**Retrospective adjustment**

A NED that registers for VAT for the first time will be entitled to a deduction in respect of goods or services acquired prior to registering as a VAT vendor to the extent that VAT was paid on such goods or services and the goods or services were used in the VAT enterprise after the date of registration as a VAT vendor\(^\text{14}\).

The amount of the deduction is computed by applying the following formula:

\[
A \times B \times C \times D,
\]

Where

\(\text{A}^\text{14}\) Section 18(4) of the VAT Act
Example 21
A NED registers for the first time in July 2017 as a VAT vendor. At the time of registration the NED holds office furniture (cost (including VAT) of R150 000 and market value of R50 000), a computer (cost (including VAT) of R35 000 and market value of R10 000) and a motor car (cost (including VAT) of R450 000 and market value of R220 000).

Compute the adjustment that the NED may claim in its first VAT return with regards to the goods brought into the newly registered VAT enterprise.

Suggested solution
An adjustment may be claimed on the office furniture and the computer brought into the VAT enterprise. No deduction may be claimed on the motor car, a deduction of input tax generally being denied.\(^\text{15}\)

\[
\text{Deduction} = A \times B \times C \times D = \left(\frac{14}{114}\right) \times (50 000 + 10 000) \times 100\% \times 100\% = R7 368.42
\]

Normal input tax deductions
A NED will be entitled to claim as input tax deductions any VAT incurred on goods or services acquired for the purpose of the VAT enterprise conducted by the NED. This includes costs incurred directly for the VAT enterprise as well as general overhead expenses.

The NED must be in possession of a valid tax invoice to claim input tax deductions.

No input tax deductions may be claimed in respect of the following categories of input tax:

- Input tax on entertainment
- Input tax on club subscriptions
- Input tax on motor cars

Input tax on entertainment
“Entertainment” includes foods, beverages, accommodation, etc.

An important exception to the above rule is VAT on food, beverages and accommodation that may be claimed where a NED incurs the costs while being away from his/her normal place of work and residence for VAT enterprise purposes.

Input tax on club subscriptions

\(^{15}\) Section 17(2)(c) of the VAT Act
The disallowance is limited to clubs or associations of a social or recreational basis (e.g. membership fees of a golf club).

NEDs will be entitled to claim input tax in respect of professional associations of which they may be members (e.g. SAICA fees).

**Input tax on supplies of motor cars**

The prohibition includes cars acquired in terms of outright sales, rentals or leases.

The prohibition does not apply to operating costs of motor cars, for example service fees.

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BINDING GENERAL RULING (VAT) 41 (ISSUE 2)

DATE: 4 May 2017

ACT: VALUE-ADDED TAX ACT 89 OF 1991
SECTION: PROVISO (III) TO THE DEFINITION OF “ENTERPRISE” IN SECTION 1(1) AND SECTION 23(4)(b)
SUBJECT: VAT TREATMENT OF NON-EXECUTIVE DIRECTORS

Preamble

For the purposes of this ruling –

- “BGR” means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- “NED” means a non-executive director;
- “non-resident” means a person that is not a “resident of the Republic” as defined in section 1(1) of the VAT Act;
- “remuneration” means remuneration as defined in paragraph 1 of the Fourth Schedule to the Act;
- “section” means a section of the VAT Act;
- “the Act” means the Income Tax Act 58 of 1962;
- “VAT Act” means the Value-Added Tax Act 89 of 1991 and any other word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This BGR deals with the VAT treatment of the activities conducted by NEDs and clarifies whether those activities fall within the ambit of proviso (iii)(aa) or proviso (iii)(bb) to the definition of “enterprise” in section 1(1).

This BGR must be read in conjunction with BGR 40, which provides clarity on whether director’s fees for services rendered by NEDs fall within the definition of “remuneration” in the Fourth Schedule to the Act.

2. Background

It is stated in BGR 40, that as a result of certain amendments in 2007 to the exclusions contained in the definition of “remuneration” in the Fourth Schedule to the Act, some uncertainty developed as to whether the amounts payable to an NED are subject to the deduction of employees’ tax. This uncertainty also extends, by implication, to the application of proviso (ii) to the definition of “enterprise” in section 1(1) which excludes the activities of an employee, but includes the activities of a so-called “independent contractor”.

The question therefore arises as to whether NEDs should be regarded as—

- employees or deemed employees under the Fourth Schedule to the Act so that their income is subject to employees’ tax; or
- independent contractors that may be liable to register for VAT if their fees for services rendered exceed the VAT registration threshold of R1 million in any consecutive period of 12 months; or
- being subject to both employees’ tax and VAT.

3. Application of the law – employee or independent contractor?

The courts have highlighted a number of factors to be taken into account to distinguish between an employment contract (employee) and a contract for services (independent contractor). However, there is no absolute test which can be applied to distinguish between the two types of contract; for the purposes of this BGR and proviso (iii) to the definition of “enterprise” –

- an employee is a person who commits his or her productive capacity to another person (the employer) in terms of an employment contract; and
- an independent contractor is a person who commits his or her labour to the recipient (employer) to produce a given result in terms of a contract for services.

The VAT treatment of employees and independent contractors is dealt with in proviso (iii) to the definition of “enterprise” in section 1(1).

Proviso (iii)(aa) to the definition of “enterprise” refers to the services rendered by a person (employee) to an employer under an employment contract. This is a reference to the services of a so-called “common law employee”. The effect is that such services can never qualify as an enterprise activity. As such, the employee cannot register for VAT and will not charge VAT on any salary, wages, commission or similar amount which is paid or payable by the employer in that regard.

Proviso (iii)(bb) to the definition of “enterprise” refers to the services rendered by an independent contractor to the employer (recipient) under a contract for services in circumstances where such enterprise is carried on independently of the recipient. In other words, the activities of the service provider show the hallmarks of an independent business (enterprise) activity carried on by that person as opposed to the services rendered by an employee under an employment contract. In addition, even if a person is an employee as contemplated in proviso (iii)(aa), that person is not necessarily prevented from conducting enterprise activities outside of the employment contract as contemplated in proviso (iii)(bb). In such a case, that person may be liable to register and charge VAT in respect of such enterprise activities carried on independently.

The fact that certain independent contractors such as labour brokers or personal service providers are deemed to earn “remuneration” under the Fourth Schedule to the Act does not affect the independent nature of that person’s activities for VAT purposes. It is therefore incorrect to conclude that an independent contractor must be regarded as an employee for VAT purposes merely because that person’s income is deemed to be “remuneration” which is subject to employees’ tax under the Fourth Schedule to the Act. The income earned by NEDs does not, in any event, fall within
the ambit of those deeming provisions. However, an NED may voluntarily request that employees’ tax be deducted from any directors’ fees which are paid to him/her.

Similarly, the fact that a non-resident NED earns “remuneration” under the Fourth Schedule to the Act does not affect the independent nature of that non-resident NED’s activities under proviso (ii)(bb) to the definition of “enterprise” and any potential liability for that person to register for VAT in the Republic. However, the focus of attention in such cases will be on how the NED’s services are rendered. For example, a non-resident NED will be carrying on an enterprise if the services are physically performed in the Republic on a continuous or regular basis, or if the services are conducted on a continuous or regular basis through a fixed or permanent place in the Republic.

Section 23(4)(b) provides that if a person has not applied for registration in terms of Chapter 3 of the Tax Administration Act 28 of 2011, that person is regarded as a vendor with effect from the date on which that person first became liable to be registered. However, when considering the circumstances of a particular case, the Commissioner may exercise a discretion to determine a later date from which the person concerned should be a vendor, as may be considered equitable in the circumstances.

4. Ruling
This ruling constitutes a Ruling issued under section 96 of the Tax Administration Act 28 of 2011.

4.1 VAT treatment of non-executive directors
It is concluded in paragraph 3.2 of BGR 40 that an NED is not considered to be a common law employee. This is based on the view that the services must be supplied independently and personally by the NED. Any director’s fees paid or payable to an NED for services rendered in that capacity is therefore not regarded as “remuneration”. It follows that for VAT purposes on NED is treated as an independent contractor as contemplated in proviso (ii)(bb) to the definition of “enterprise” in section 1(1) in respect of those NED activities.

4.2 Liability of non-executive directors to register and account for VAT
An NED that carries on an enterprise in the Republic is required to register and charge VAT in respect of any director’s fees earned for services rendered as an NED if the value of such fees exceed the compulsory VAT registration threshold of R1 million in any consecutive 12-month period as provided in section 23(1). This rule applies whether the NED is an ordinary resident of the Republic or not.

An NED may also choose to register for VAT voluntarily under section 23(3) if the value of such fees does not exceed the compulsory VAT registration threshold prescribed in section 23(1).

NEDs that are already registered as vendors, but have neither levied VAT nor accounted for output tax in respect of any fees earned as an NED, must start charging and accounting for VAT on such fees by no later than 1 June 2017.
4.3 Equitable date of registration

Any NED that carries on an enterprise in the Republic and has exceeded the R1 million compulsory VAT registration threshold as contemplated in 4.2 that has not registered for VAT as at the date of this BGR must apply for registration by no later than 1 June 2017. The effective date of such registration (liability date) as determined by the Commissioner under section 23(4)(b) in such cases must be no later than 1 June 2017.

5. Period for which this ruling is valid

This ruling applies from 1 June 2017 until it is withdrawn, amended or the relevant legislation is amended. Any ruling or decision issued by the Commissioner which is contrary to this BGR is hereby withdrawn with effect from 1 June 2017. To the extent that this BGR does not provide for a specific scenario relating to an NED, a vendor may apply for a VAT ruling or VAT class ruling in writing by sending an e-mail to VATRulings@sars.gov.za or fax/mile to 086 540 9390. The application should consist of a completed VAT301 form and must comply with the provisions of section 76 of the Tax Administration Act, excluding section 79(4)(h) and (A) and (B).

Executive: Legal Advisory
Legal Counsel
SOUTH AFRICAN REVENUE SERVICE
Dear Tax Practitioner

NON-EXECUTIVE DIRECTORS: VAT REGISTRATION

On 10 February 2017, SARS issued binding general ruling (BGR) 41 which confirms that a Non-executive director (NED) who carries on an enterprise in/partly in SA is required to register and charge VAT in respect of any director’s fees earned for services rendered as an NED if the value of such fees exceeds R1 million in any consecutive 12-month period.

A NED is required to register and charge VAT on fees with effect from 1 June 2017. In addition, a NED may also choose to register for VAT on a voluntary basis where the fees earned are a minimum of R30 000 in a 12-month period.

SARS has been receiving several operational queries regarding the VAT registration process and in particular, practical considerations for non-resident NEDs. In addressing these, please note the steps in the VAT registration process:

VAT Registration process
The normal VAT registration requirements must be followed.

The following options are available for purposes of making the application:

- via eFiling
  - If the applicant is an existing eFiler, he/she can register for VAT via the RAV01 form. The applicant will be informed via eFiling if an interview is required in which case the VAT application (VAT101 form) must be completed.
  - If the applicant is not an eFiler, he/she must first register as an ‘eFiler user’ and can then register for VAT via the RAV01 form
- At a SARS branch: the applicant can complete the VAT101 form and submit it in person at the nearest SARS Branch
- Important information to be completed:
  - The nature of person must be “sole proprietor”
  - The liability date must be 1 June 2017 unless the NED chooses an earlier date of liability
  - The main industry classification code is 2572

A NED applying for payments basis of accounting for VAT must do so by selecting the relevant option on the VAT registration application form. Please note that the payments basis option only applies where the total value of taxable supplies made by a NED does not exceed R2.5 million in a 12-month period.
Financial Information
The following documents will be accepted as proof of turnover/financial information:

- Copy of letter of appointment as NED;
- Copy of the minutes of the director’s meeting;
- Copy of a service contract/ agreement; or
- IRP5/IT3(a) certificate with source code 3620 (Directors Fees – RSA Resident NED) or 3621 (Directors Remuneration – Non-Resident NED)
  - Note: IRP5/IT3(a) certificates with these source codes will not be available prior to the issuing of the 2018 certificates by employers being April - May 2018
  - IRP5 certificates with source code 3620 will only be available where voluntary PAYE was withheld

Practical considerations apply to non-resident NEDs

- The VAT registration process and supporting documents as highlighted above, will apply
- The non-resident NED will have to appoint a representative vendor in SA, who controls the NED’s affairs in SA or manages any enterprise of the NED in SA
- Details of a SA bank account must be provided.

For more information visit the SARS website on www.sars.gov.za. Any additional queries may be sent to NEDEnquiries@sars.gov.za or call the SARS Practitioner Contact Centre on 0860 12 12 19.

Sincerely

THE SOUTH AFRICAN REVENUE SERVICE
June 2017