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0001

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Dear Madam

## **SUBMISSION - ANNEXURE C 2018 BUDGET REVIEW**

1. We present herewith our written submissions on the request for Annexure C 2018 on behalf of the South African Institute of Chartered Accountants (SAICA) National Tax Committee (NTC), as set out in Annexure A.
2. Our submissions include a combination of representations, ranging from serious concerns about the impact or effect of certain provisions to simple clarification or suggestions for potentially ambiguous provisions, in relation to either existing sections or the latest amendments to various sections of the Income Tax Act, 1962 (the Act), the Value Added Tax Act (the VAT Act) and the Tax Administration Act 28 of 2011 (the TAA), as contained in the Taxation Laws Amendment Bill, 2017 (TLAB2017) and the Taxation Administration Laws Amendment Bill, 2017 (TALAB2017), respectively.
3. We also enclose a copy of our prior year Annexure C submissions for 2017, as Annexure B, for ease of reference. We note specifically that with the exception of a few items, National Treasury (NT) has largely not favourably considered our prior year submissions and we would seek to engage with NT on why it believes the relevant proposals would not be in the interests of the South African fiscal policy.
4. We indicate in each instance in Annexure B, the current status of the prior year's submissions, noting whether the proposals have been implemented by NT, and indicating where the proposals were partially accepted by NT.
5. We have deliberately tried to keep the discussion of our submissions as concise as possible, which does mean that you might require further clarification. In this respect, you are more than welcome to contact us in this regard.



6. As always, we thank NT for the on-going opportunity to participate in the development of the SA tax law.

Should you require any further clarification on any of the matters raised please do not hesitate to contact us.

Yours sincerely

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**CHAIRPERSON: NATIONAL TAX COMMITTEE**  
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## ANNEXURE A

### **CATEGORY - INCOME TAX: INDIVIDUALS, EMPLOYMENT AND SAVINGS**

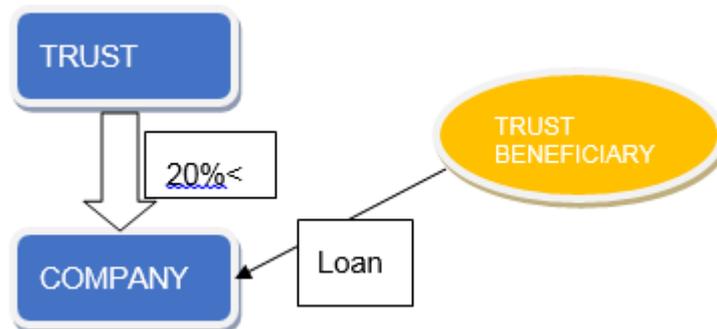
#### **Section 7C of the Act - Excessively broad ambit of section 7C in respect of loans provided to companies in which a beneficiary of a trust holds participation or voting rights exceeding 20% (TLAB 2017)**

##### Legal nature

7. Section 7C(1) of the Act will apply (post the TLAB2017) where, inter alia, a natural person or a company (at the instance of a natural person who is a connected person in relation to that company) directly or indirectly provides a loan, advance or credit to a company in which at least 20 per cent of the equity shares or voting rights can be exercised by a trust that is a connected person in relation to the natural person or company that provided the loan or by any beneficiary of that trust.

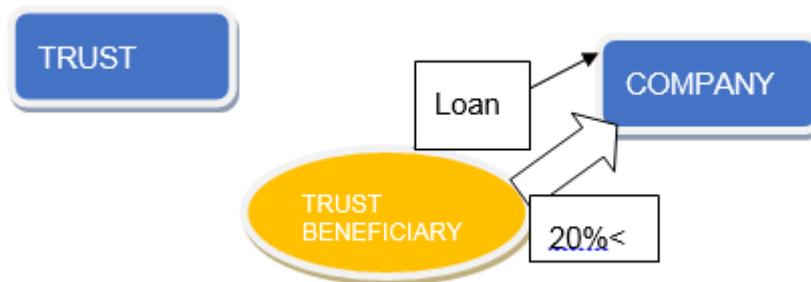
##### Detailed factual description

8. It is submitted that the ambit of section 7C is too wide and that the reference to the participation or voting rights of a beneficiary of a trust that is a connected person in relation to the natural person or company providing the loan, advance or credit will inevitably result in section 7C applying to normal business loans.
9. The effect of the proposal, as currently worded, is that any natural person who is a beneficiary of a trust and who holds at least 20 per cent of the equity shares or voting rights in an operating company to which he or she has advanced an interest free or low interest loan (even if there is no shareholding link between the company and the trust) will potentially be affected if no interest is charged on the loan, or if interest is charged at a rate less than the official rate.
10. This means that no causal link is required between the trust (where the targeted estate assets would be housed, either directly, or through its ownership in a company) and the company (as illustrated in paragraph 13 below). The section 7C provisions would now also apply to a natural person even though his or her estate assets are fully included in the estate, including the interest in the company.
11. This same point was raised in our TLAB2017 submission.
12. NT seemingly intended to address the following scenario:



s

13. However, it now also applies to this scenario:



### Proposal

14. The reference in section 7C(1)(b)(ii)(bb) to “...or by a beneficiary of that trust...” should be deleted.

### **Section 10(1)(k)(i) - Dividend tax exemption claim for employees**

#### Legal nature

15. Section 10(1)(k)(i) of the Act contains three provisos with respect to dividends paid in connection with employee share schemes, namely proviso (dd), (ii) and (jj), with effect from 1 March 2017.

16. These taxable dividends are included in the definition of "remuneration", for PAYE purposes, in paragraph 1 of the Fourth Schedule to the Act, with effect from 1 March 2017.

17. Consequently, such dividends will be exempt from dividends tax, in terms of section 64F(1)(l) of the Act, as they constitute income of the beneficial owner.



#### Detailed factual description

18. In terms of section 64G(2), the company paying the dividend must not withhold dividends tax if the beneficial owner of the dividend has, by the determined date, submitted to the company the necessary declaration (of exemption) and undertaking (to notify the company of any change in status).
19. Currently, in order to claim such exemption, the beneficial owner of the dividend (the employee in receipt of the dividend) must complete a declaration and undertaking in the format suggested in Appendix G of the SARS BRS: Administration of Dividends Tax (DTD(EX)).

#### Persons impacted

20. Whenever an employer processes a non-exempt dividend through payroll and subjects that amount to PAYE, it is essential that dividends tax is not also withheld from the same amount. It is impractical, however, for all affected employees to complete and submit a DTD(EX) form to the employer on a timely basis, as this is an administratively onerous requirement on the employee.
21. This is particularly the case where the company paying the dividend may be different to the employer, as is often the case in large corporate groups.

#### Proposal

22. It is proposed that section 64G(2) be amended to permit an employer to complete and submit the necessary declaration and undertaking on behalf of all affected employees, in cases where taxable dividends are subject to PAYE.
23. It is furthermore proposed that a specific version of DTD(EX) be developed by SARS (and included in an updated BRS) which permits the exemption to be claimed by means of a bulk declaration and undertaking to the paying company, wherein all relevant employees and their tax reference numbers are listed.
24. Please also see the proposals in relation to the company under **Domestic Business Taxes** below.

#### **Amendment to section 10(1)(nB) - Relocation allowances**

##### Legal nature

25. Section 10(1)(nB) of the Act grants an employee an exemption on costs incurred by the employer for an employee who relocates for work purposes. In the exemption, the qualifying costs (travel expenses, costs of selling previous place of residence and costs for temporary accommodation) were not subject to tax. Furthermore, the section provided for a discretion to be exercised by the Commissioner in allowing other relocation amounts payable to be deemed non-taxable.



26. In practice, an allowance amount equal to one month's gross salary of the employee was accepted as a reasonable allowance to allow the employee to cover certain other expenses.
27. In 2015, the discretion afforded to the Commissioner to deem certain relocation based payments to be non-taxable was removed from the section, thus resulting in the relocation allowance being fully taxable in the hands of the employee.
28. The amendment was effective 1 March 2016.

#### Factual description

29. The costs incurred by an employer on behalf of an employee relating to the relocation of employees previously assisted employees who were not in a financial position to relocate, to enable them to settle in to their new location quickly and to fund any expenses that may have arisen by the employer's request to relocate.
30. Given the current economic conditions, it may be challenging for employees to afford the relocation expenses and may result in a lack of appetite for relocations by employers and employees. From an employer perspective, this change may result in the employers having to bare the tax incurred by the employee as a result of the relocation.

#### Persons impacted

31. All employees who are required to relocate for work purposes are negatively impacted by the lack of a dispensation in this regard.

#### Proposal

32. A dispensation similar to what was previously available, whereby employees were able to relocate without bearing the costs of such relocation or any tax thereon if such costs were borne by their employer, needs to be reconsidered in the current economic climate. Therefore, we propose the inclusion of a threshold to allow for an allowance to be paid that will be regarded as non-taxable.
33. A possible suggestion might be to allow for 15% of annual remuneration as an allowable non-taxable allowance for relocation purposes, alternatively a value or percentage can be linked to the remuneration proxy definition already contained in the Act.
34. However, irrespective of how this dispensation is achieved, we request that a workshop be held to discuss and debate potential solutions in order for relief to be provided to employees in this regard.



### **Section 10(1)(o)(ii) - Foreign income exemption (TLAB2017)**

#### **Legal nature**

35. The Taxation Laws Amendment Bill No. 27 of 2017 amends section 10(1)(o)(ii) of the Act with the insertion of a R1 million threshold applicable to the exemption.

#### **Detailed factual description**

36. While the amendment is significantly more workable than the proposal in the draft legislation, there are still a number of concerns in this regard.

37. No amendments have been made to either employees' tax or provisional tax provisions under the Fourth Schedule, which provide clarity on the mechanism to be used in order to implement the threshold and the resultant (double) tax that will be suffered by the impacted individuals.

#### **Persons impacted**

38. South African residents working abroad and earning foreign remuneration.

#### **Proposal**

39. We submit that this amendment to section 10(1)(o)(ii) has been considered in isolation and that the proposed amendments should be reconsidered taking into account the practicalities of implementing this change, i.e. the other tax collecting mechanisms within SARS that are impacted.

40. We therefore propose that extensive consultation is required to workshop the practical hurdles which will need to be overcome in order to ensure that no double tax is suffered.

41. In addition, we propose that further legislative amendments to the Fourth Schedule, as well as changes to the way in which the foreign tax credit provisions contained in section 6quat of the Act are administered, may be required to facilitate an effective change in the tax policy in this regard.

### **Para 11B Fourth Schedule - "Non-standard employment" definition inadvertently deleted**

#### **Legal nature**

42. In Act No. 23 of 2015, paragraph 11B of the Fourth Schedule to the Act was repealed thereby removing the defunct Standard Income Tax on Employees (SITE) provisions with effect from 1 March 2016.

43. Part of the provision which was repealed included the definition of "standard employment", which had wider impact beyond the SITE regime.



#### Factual description

44. Following from the definition of “standard employment” followed the concept of “non-standard employment” for those employees who did not meet the criteria of “standard employment”. If an employee was deemed to be in non-standard employment, a standard fixed rate of 25% was applied to the remuneration earned.

45. The Employers’ Guide however retains the concepts of both standard and non-standard and refers to non-standard as follows:

*Any employment which cannot be classified under Standard or Deemed Standard employment.*

- Workers are employed on a daily basis and are paid daily, for example:
- Casual commissions paid, such as spotter’s fees;
- Casual payments to casual workers for irregular services rendered or occasional services;
- Fees paid to part-time lecturers;
- Honoraria paid to office bearers of organisations, clubs, etc

46. The Guide further provides that employees’ tax will be determined on non-standard employment as follows:

*Non-standard employment income*

Employees’ tax must be calculated and deducted at 25% on the balance of remuneration.

47. With the repeal of the definition of “standard employment” there appears to be no basis in law for the treatment of non-standard employment in such a manner and this creates legal uncertainty regarding the application of the fixed rate.

48. This is a concept which is widely used in business for ensuring that PAYE is being paid on remuneration where the employment relationship is a temporary one or is largely casual in nature.

#### Persons impacted

49. Temporary or casual employees, especially those who earn less than the threshold and who now become subject to PAYE but have no tax liability.



### Proposal

50. We propose the reintroduction of the definition of “standard employment” in paragraph 1 of the Fourth Schedule to the Act and the inclusion of the relevant rate in the tables to allow for legal certainty, particularly as regards the application of a fixed tax rate of 25% for those in “non-standard employment”.

### **Paragraph 13 Fourth Schedule – Furnishing of employees’ tax certificates**

#### Legal nature

51. Currently paragraph 13(5) of the Fourth Schedule to the Act places a duty on the employee who has not received an employees’ tax certificate (an IRP 5) to apply to the employer for such certificate, but requires no further action from the employee.

52. Paragraph 30(1)(f) creates an offence where an employer fails to comply with its obligations to furnish employees with an employees’ tax certificate where PAYE has been withheld.

53. Consequently, SARS has a legal obligation to compel the employer to comply by applying the offence provision.

#### Factual description

54. Where an employer has not furnished its employees with an IRP5, and in many instances not submitted its EMP501 reconciliation, but has withheld PAYE from its employees, the employees are left in a very difficult position, as they cannot submit their tax returns, and even if they do, SARS will not give them the PAYE credit but it will tax the income.

55. SARS has to date indicated that this is a matter between the employer and its employees, notwithstanding its legal obligation to apply and enforce the tax Acts and the IRP5 is not a document that flows from the labour law, unlike a payslip and employment contract.

56. Therefore, it is not created in terms of the employee/employer relationship but in terms of the obligation imposed by the tax law on the employer with SARS as the custodian of implementing the tax law.

#### Persons impacted

57. Employees who have not received their IRP5, including where the employer company is in liquidation, business rescue or where the employer has absconded.

### Proposal

58. It is submitted that paragraph 13 of the Fourth Schedule be amended to place a positive obligation on SARS to act once the employee has complied with paragraph 13(5).

59. Furthermore, paragraph 13 should be amended to provide relief by allowing employees to submit other evidence to SARS as proof of the withholding of PAYE from their



remuneration that will be considered a payment of normal tax in terms of section 5 of the Act.

### **Section 8(1)(b) – Business travel for call outs for standby employees**

#### **Legal nature**

60. Section 8(1)(b) of the Act allows an employee to claim the expense incurred for travelling on business against any allowance or advance received from his or her employer, whether as a fixed allowance or re-imbursive allowance. However, section 8(1)(b)(i) of the Act states that private travel cannot be claimed.
61. Private travel is qualified as including travelling between the employee's place of residence and his or her place of business.
62. Section 8(1)(b) therefore does not distinguish between an employee travelling during his or her normal hours of work from their residence to place of work, and an employee travelling abnormal/after hours, such as standby and callout.

#### **Factual description**

63. Many emergency service professions including nurses, radiographers, policeman, fireman, engineers, etc. are required to work normal working hours but also to be on standby for certain 'off duty' times when an emergency happens which requires the assistance of additional staff.
64. Given the nature of these professions, and the lack of such skilled professionals, these practices have become standard practice.
65. The employee will in most instances be at his or her place of residence or another place for private or domestic purposes when such a call out event occurs.
66. The current legislation will preclude the employee from claiming the expense incurred against the allowance or advance received for such travel, resulting in a tax charge for these employees, effectively reducing the amount recovered. This appears to be overly punitive.

#### **Proposal**

67. It is proposed that an exception be inserted into section 8(1)(b)(i) to exclude from private travel, travel between work and home where such travel is outside the employee's normal working hours, not for the purposes of his or her normal working hours and such employee is contractually required to be on standby or subject to be called out to a place of work outside of such employee's normal working hours.



68. Furthermore, to prevent abuse, we propose that the rate that such amounts may be reimbursed be limited to the rates and threshold issued by a Gazette in terms of section 8(1)(b)(iii) of the Act. In addition, although the same unfairness applies, the proposal could exclude employees who are subject to the marginal rate of tax to limit the relief to the more vulnerable employees on whom the burden is even more disproportionate.



## **CATEGORY – DOMESTIC BUSINESS TAXES**

### **Section 1 of the Act - Definition of “resident” in relation to persons other than natural persons**

#### Legal Nature

69. Tax residency in South Africa for persons other than natural persons can be triggered either by being incorporated, formed or established (hereinafter referred to as “incorporation”) in South Africa or by having the person’s place of effective management (POEM) in South Africa.

70. In most countries, tax residency is also triggered by incorporation in that specific country.

#### Detailed factual description

71. The interpretation of POEM adopted in Interpretation Note 6 (IN6), in short, defines POEM as the place where the key commercial and strategic decisions affecting a person is taken. This is in line with the interpretation adopted by the Organisation for Economic Cooperation and Development (OECD) and therefore IN6 aligned South Africa with the international community.

72. Whilst this should be applauded, it is also important to understand the impact this has on multinational entities, which may be effectively managed in South Africa, resulting in possible dual residency.

73. The resolution of dual residency is extremely difficult in practice.

74. Where there is no double taxation agreement (DTA), as is still relatively common in Africa (only 23 DTAs out of 54 African countries), the company may be resident in two countries, with a resultant compliance burden in two countries, often with no increased taxes being due in South Africa, as the tax rates in African countries tend to be high.

75. Where there is a DTA, the tie breaker rule is either POEM or a requirement that the tax authorities need to mutually agree on the residency of the person.

76. In practice, the mutual agreement process takes in excess of 18 months to complete and may place a significant strain on SARS’ resources. In the intervening time, the company is placed in a very uncertain tax position, as it does not know where it is resident for tax purposes. In this regard, it is also important to note that the mutual agreement process may be the tie-breaker rule in all of South Africa’s DTA’s as South Africa has signed the Multilateral Instrument developed by the OECD and have indicated that they will follow Article 4 thereof (depending if the other country also agreed to follow Article 4). Paragraph 1 of Article 4 reads as follows:

*Where by reason of the provisions of a Covered Tax Agreement a person other than an individual is a resident of more than one Contracting Jurisdiction, the competent*



*authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.*

77. Where POEM is the tie-breaker, it is in practice very difficult to explain to the other tax authority that the company is now resident in South Africa, despite being incorporated in that other country and that this will have an impact on, for example, withholding taxes. Some source based countries even deny access to the DTA tie-breaker rule based on the wording of Article 4(1), which excludes from the definition of resident in the DTA, “any person who is liable to tax in that State in respect only of income from sources therein” despite the OECD making it clear that this is not the intention behind the exclusion in paragraph 8 of the Commentary on paragraph 4 of the Model Tax Treaty (<http://www.oecd.org/tax/transfer-pricing/36221030.pdf>):

*“Thus it has to be interpreted restrictively because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation, a result which is clearly not intended.*

78. Even once residency in South Africa has been determined, registering the company for tax purposes in South Africa first requires the company to register with the Companies and Intellectual Property Commission (CIPC).

79. It is further submitted that the Act is not written with these situations in mind, which in certain instances prejudices the foreign incorporated companies with South African tax residency status.

80. For example, it is submitted that the foreign incorporated companies will not qualify for the section 11(l) deduction in relation to contributions to South African retirement funds, as these retirement funds are unlikely to have been approved by SARS, and will therefore not fall within the scope of retirement funds as envisaged in section 11(l). It is then arguable whether the deduction can be claimed under section 11(a).

81. If the foreign incorporated companies pay insurance premiums on the lives of their key employees, these payments will not qualify for deduction, as the specific deduction in terms of section 11(w) will not apply, since the contributions are not subject to tax in the hands of the employees in terms of the Seventh Schedule to the Act. Section 23B will prohibit a deduction under section 11(a).

82. It is unlikely that the foreign incorporated companies will qualify for the section 12H allowances, as they are unlikely to have entered into learnership agreements registered



with a SETA as required in terms of section 12H, despite having entered into local training agreements in that country.

83. It is unlikely that the foreign incorporated companies will qualify for a deduction of donations paid under section 18A, as the companies are unlikely to have made donations to public benefit organisations (PBOs) sanctioned in terms of the Act, even though they may have made donations to PBOs approved under domestic legislation in that country.

84. The disposal of the foreign companies' capital assets will have CGT implications in South Africa. For CGT purposes, the valuation date of the foreign incorporated companies' pre-valuation date assets remains 1 October 2001. It would therefore have been important to have identified assets which may have CGT implications if disposed of (such as fixed property or shares investments) and to perform market valuations for these assets as at 1 October 2001 before 30 September 2004. This is unlikely to have happened. In the absence of a market valuation, the foreign incorporated companies will be restricted to apply the time apportioned base cost or 20% of proceeds method. Capital gains are often not taxed in Africa and as a result there may also not be a section 6quat rebate allowed.

#### Nature of business impacted

85. All multinational companies which are effectively managed in South Africa.

#### Proposal

86. Consideration should be given to the practical difficulties experienced by foreign companies, which are effectively managed in South Africa, when complying with the provisions of the Act.

#### **Section 7C interaction with section 31: Application of section 7C to cross-border loans subject to transfer pricing and exclusion in section 7C(5)(e)**

#### Legal nature

87. Section 7C of the Act was first introduced in 2016 to address tax avoidance structures using trusts and interest free loans and became effective on 1 March 2017.

88. However, as noted by NT at its workshops conducted during 2016, anomalies may arise which were not anticipated given the broad application of this anti avoidance provision. Therefore, NT invited stakeholders to engage should they identify such anomalies.

#### Proposal

89. Section 7C(5)(e) contains an exclusion from the scope of section 7C(2) and (3) if a "loan, advance or credit constitutes an affected transaction as defined in section 31 (1) that is subject to the provisions of that section"

90. An affected transaction is defined in section 31(1) as:



*“a transaction between certain persons listed in sub-paragraphs (i) to (iv) of paragraph (a) of the definition who are connected in relation to each other; and*

*any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm’s length (paragraph (b) of the definition).*

91. Section 31(2) requires a transfer pricing adjustment where a transaction is an affected transaction and any term or condition differs from what persons dealing at arm’s length would have agreed to.
92. From the final 2016 Explanatory Memorandum (dated 15 December 2016), the purpose of this exclusion in section 7C(5)(e) appears to be to avoid any overlap between the application of the transfer pricing rules in section 31 and the application of section 7C. The Explanatory Memorandum specifically states that the anti-avoidance measures under section 7C will not apply to a loan that is subject to the transfer pricing rules in section 31.
93. The Explanatory Memorandum explains the reason for the exclusion as being that the loan would already have been subject to an anti-avoidance rule, aimed at the mispricing of interest on loans to trusts, and should therefore not be subjected to section 7C, which is also aimed at the mispricing of such interest.

Detailed factual description

94. It is submitted that the current wording of section 7C(5)(e) excludes loans with terms or conditions that are not arm’s length (i.e. loans that meet both paragraphs (a) and (b) of the definition of an affected transaction in section 31(1)), and in respect of which a transfer pricing adjustment is required, from the scope of section 7C.
95. However, loans between a natural person (resident) and trust (not resident) with terms or conditions which are similar to those that would have existed between persons dealing at arm’s length are not “affected transactions”, as defined, as paragraph (b) of the definition of ‘affected transaction’ is not met.
96. This means that these loans, which are on arm’s length terms (including interest rate pricing), arguably remain within the scope of section 7C, even though the terms and conditions meet the arm’s length requirements of section 31, but have an interest rate which is less than the official interest rate in the Seventh Schedule.

Nature of business impacted

97. Taxpayers with cross border loans to offshore trusts.



### Proposal

98. We suggest that the reference in section 7C(5)(e) to an affected transaction, as defined in section 31(1), be amended to ensure that all loans to offshore trusts which are either on arm's length terms (including the rate of interest) or have been subjected to the penalty provisions in section 31(2), are excluded from the ambit of section 7C. The problematic words in section 7C(5)(e) are "subject to the provisions of that section", since this appears to apply only to loans which are not on arm's length terms and excludes loans which are on arm's length terms (including pricing).
99. Therefore, it is proposed that the words to be used in this section should rather be "compliant with the provisions of that section", which would then apply to loans where the pricing is correct and loans which have been subject to the penalty provisions of section 31(2) and (3).

### **Section 9 - Headquarter regime**

#### Legal nature

##### *Background to South Africa's Headquarter Company Regime*

100. Section 9I of the Act was promulgated to promote South Africa as a gateway for investments into Africa. While the initiative is welcomed, the regime is limited to new entrants looking to set up a holding company. Existing groups with an intermediate holding company are prejudiced due to the Controlled Foreign Company (CFC) rules in South Africa.

##### *Headquarter companies*

101. In terms of section 9I, a headquarter company is subject to tax in the same way as any other resident company. However, it is entitled to certain relief from income tax, capital gains tax and dividends tax which is not available to resident companies that are not headquarter companies.
102. As a consequence of the special relief granted to headquarter companies they are also subject to special anti-avoidance rules.
103. In addition to the headquarter companies themselves, a foreign person receiving interest or royalties from a headquarter company will, under specified circumstances, be exempt from withholding tax on interest and royalties respectively.

##### *CFC rules*

104. Section 9D(2) of the Act generally requires that a portion of a CFC's net income must be included in the income of any resident, other than a resident who is a headquarter company, who directly or indirectly holds any participation rights in a CFC. This is commonly referred to as "attribution".



105. The amount which must be attributed to a particular resident is a proportional amount determined by applying the percentage of the resident's participation rights over the total participation rights in the company on the last day of the year of assessment to the CFC's net income, as determined under section 9D.

106. Attribution is also not required to the extent the participation rights are indirectly held by a resident through any company which is a resident other than a company which is a headquarter company. The result is that headquarter companies are not subject to section 9D.

107. However, South African resident companies which indirectly (through the headquarter company) participate in a non-resident CFC are subject to section 9D.

#### Description of problem

108. Section 9I is aimed at incentivising South Africa as a destination to locate a headquarter company. The impact is favourable for non-resident groups looking to invest for the first time.

109. However, a number of corporate groups with an intermediate holding company (sitting between the non-resident parent company and the headquarter company) are not able to take advantage of the regime due to the CFC attribution shifting up a level to the intermediate holding company.

#### Nature of business impacted

110. The current wording in the legislation affects all businesses which are established in South Africa, which invest into Africa, with an intermediate holding company situated in South Africa, but ultimately held offshore.

111. As a result, using South Africa as a base for a regional headquarter company is not attractive and does not encourage foreign direct investment, contrary to the legislative intention.

#### Proposal

112. To overcome the above inequality, a carve out for CFC purposes should be extended to intermediate holding companies which hold a regional headquarter company – this carve out could be limited to the potential attribution arising from CFCs that are held by the regional headquarter company.

#### **Section 10(1)(k)(i) - Income tax deduction for re-characterized dividends**

#### Legal nature

113. With effect from 1 March 2017 certain amounts received by or accrued to a person by way of dividends contemplated in paragraphs (dd), (ii) and (jj) of the proviso to section



10(1)(k)(i) of the Act constitute income, and are regarded as “remuneration” for the purposes of the Fourth Schedule to the Act.

- 114. These dividends are subject to employees’ tax in the hands of the employee.
- 115. These dividends are exempt from dividends tax in terms of section 64F(1)(l) of the Act.
- 116. Despite the re-characterization of the dividends as remuneration in the hands of the recipient employees, the amount payable by the company is still regarded as a dividend, and as such, no income tax deduction is allowed thereon in the hands of the company.
- 117. The absence of a matching principle, in these circumstances, is considered to be unjust in relation to the company, especially since there is no tax avoidance motive by any of the parties.

Detailed factual description

- 118. Black empowerment employees typically are vested income beneficiaries under certain share incentive schemes and this is aimed at efficient empowerment and as a result to enhance the BEE credentials of a company.
- 119. Dividends would be distributed by the company to the employee share trust, which in turn will distribute same to the vested income beneficiaries.
- 120. Employees’ tax will be withheld from the payments to the vested income beneficiaries.
- 121. Despite the amount paid by the company representing remuneration in the hands of the employees, the amount so paid is not treated as remuneration subject to an income tax deduction in the hands of the company.
- 122. This is not considered to be equitable from the employer’s perspective.

Nature of business impacted

- 123. Various companies which have established employee share incentive schemes to incentivise their workforce.

Proposal

- 124. In order to achieve equity, an income tax deduction should be allowed in the hands of the employer company paying the dividend to an employee where such dividend is re-characterised as remuneration and PAYE withholding applies, in terms of the matching principle.
- 125. Please also see our comments on the proposed amendments under **Individuals** above.



### **Section 12B(1)(h) – Renewable energy technical correction**

#### **Legal nature**

126. Section 12B(1)(h) of the Act sets out the various items that qualify for deduction in terms of section 12B(2), for purposes of the production of renewable energy.
127. Items (i) to (iv) are listed and the formula appears to be incorrect insofar that an “and” is interposed between items (iii) and (iv) because it appears that all of the criteria from (i) to (iv) are required in order for relief to be granted. This is clearly not the case.

#### **Proposal**

128. It is proposed that the “and” between section 12B(1)(h)(iii) and section 12B(1)(h)(iv) is replaced with an “or” to reflect the correct position.

### **Section 12J - Venture Capital Companies**

#### **Legal nature**

129. One of the main challenges to the economic growth of small and medium-sized businesses and junior mining companies is access to equity finance.
130. To assist these sectors in terms of equity finance, the government has implemented a tax incentive for investors in such enterprises through a Venture Capital Company (VCC) regime. Investors will receive a tax benefit in the form of a tax deduction in respect of expenditure actually incurred to acquire shares in certain small and medium-sized businesses (approved VCCs).
131. The approved VCC will issue investor certificates to its investors which will provide SARS with proof when the investor claims the relevant tax deduction. The VCC regime is subject to a 12 year sunset clause, i.e. it will end on 30 June 2021.
132. The purpose of this clause is to allow a review of the effectiveness of the VCC regime and the decision will be made as to whether it should be continued.

#### **Detailed factual description**

133. One of the major obstacles investors are facing when assisting small and medium-sized businesses through the VCC regime is the limit on the book value of the assets of the approved VCC after the expiry of a period of 36 months. The current wording of the legislation limits the book value of the assets of the approved VCC to an amount not exceeding R50 million (where the qualifying company was a company other than a junior mining company), which limits various successful small and medium-sized businesses from accessing equity funding from investors and thereby growing their businesses further. There has been interest by investors to participate in the VCC regime but the limit, as noted above, presents an obstacle for investing in small and medium-sized businesses, which have the potential to exceed the R50 million limitation on assets.



### Nature of business impacted

134. Due to the limit which is set in section 12J(6A) of the Act, and as explained above, investors are not willing to participate in the VCC regime and benefit from the tax dispensation. In addition, the limit of R50 million disqualifies a number of companies from participating in the VCC regime.

135. This prevents small and medium-sized businesses from accessing much needed equity finance.

### Proposal

136. It is proposed that the policy intent behind the limitation of R50 million be re-visited in light of potential highly successful small and medium-sized businesses being denied access to much needed capital. If the economic reality of such potential small and medium-sized businesses warrants the need for this limitation to be reduced to a higher Rand amount, then NT is encouraged to increase this amount in order to incentivise more taxpayers to participate in the VCC regime and thereby support small and medium-sized businesses by granting them access to much needed equity finance.

### **Section 19(1) and paragraph 12A of the Eighth Schedule to the Act - The definition of 'concession or compromise' is too wide**

#### Legal nature

137. The definition of "concession or compromise" in section 19(1) and paragraph 12A(1) of the Eighth Schedule to the Act includes a change in any term or condition applying in respect of a debt, which then triggers a tax event for the debtor if such change results in a "debt benefit".

#### Detailed factual description

138. The introduction of this new concept of a "concession or compromise" replaces the existing rules relating to a "reduction amount", which creates a tax event or a debtor when a debt is reduced. The current regime taxes realized gains whereas the new regime creates a tax trigger in circumstances where there is only a potential unrealized gain, for example where a loan is subordinated. The subordination of a loan may be required for a number of commercial reasons, including when a company is in financial distress.

139. Given that the policy rationale behind this change in regime has not been explained in the draft TLAB2017 Explanatory Memorandum because the changes were only introduced into the TLAB2017, and were not in the draft legislation, we are uncertain as to why this new regime has been implemented at all. The reason for our uncertainty is due to the fact that the 2017 Budget Speech indicated that provisions relating to the alignment of the tax treatment of debt foregone for dormant companies and companies in business rescue would be implemented during the 2017 legislative cycle. Whilst it is clear that the TLAB2017 changes have addressed the tax treatment of debt foregone for dormant companies, these new provisions have not addressed debt foregone for companies in



business rescue. In fact, the regime appears to have further burdened such companies by creating an unrealized taxable gain in their hands.

#### Nature of businesses impacted

140. All debtors will be impacted by the provisions of section 19 and paragraph 12A of the Eighth Schedule to the Act, especially companies in business rescue.

#### Proposal

141. We recommend that the provisions of subparagraph (a)(i) of the definition of a “concession or compromise” in both section 19 and paragraph 12A of the Eighth Schedule to the Act should be repealed or at least deferred until such time as appropriate consultation has taken place in this regard to ensure that the policy intent, as stated in the 2017 National Budget Speech, is actually achieved and that the unintended consequences in relation to commercial transactions is fully understood.

#### **Section 19(1) and paragraph 12A of the Eighth Schedule to the Act - The definition of ‘concession or compromise’ is too wide**

#### Legal nature

142. The definition of “concession or compromise” in section 19(1) and paragraph 12A(1) of the Eighth Schedule to the Act includes a change in *any* term or condition applying in respect of a debt.

#### Detailed factual description

143. It seems likely that in a number of situations the new debt reduction provisions will apply where there is a prospective change in the interest rate relating to a debt, notwithstanding that “an amount of interest” has been excluded from the definition of “debt” for purposes of the debt reduction provisions. Per definition, a “concession or compromise” includes any change in the terms or conditions relating to a debt (which will therefore include a change in the interest rate applying to that debt).

144. We understood that NT had accepted that a prospective amendment to the interest terms of a debt would be excluded from the application of the new debt reduction provisions. It is unclear whether this was sought to be achieved by excluding “an amount of interest” from the definition of debt, but if so, it is submitted that such exclusion does not achieve the desired outcome.

145. For example, assume the capital outstanding in respect of a debt is R100 and accrued but unpaid interest is R20, making a total face value of R120. If the parties to the debt agree that prospectively, zero interest should apply to the debt, and if the open market value of the debt decreases to R90 as a result, it would appear that there would be a “debt



benefit” as defined of the R10 decrease in the capital amount of the debt even though the ‘amount of interest’ of R20 is excluded from the definition of “debt benefit”.

Proposal

146. Specific exclusions should be introduced that provide that the provisions of section 19 and paragraph 12A of the Eighth Schedule will not apply to prospective changes to the interest terms of a debt.

**Section 19(1) and paragraph 12A of the Eighth Schedule to the Act - Error in the formula for determining the “debt benefit”**

Legal nature

147. In terms of section 19(1) and paragraph 12A(1) of the Eighth Schedule to the Act, a “debt benefit” is defined as any amount by which the face value of the claim held by the creditor in respect of a debt, prior to entering into any arrangement in respect of that debt, exceeds the following:

- In the event of a concession or compromise that encompasses a change in the term or condition applying to the debt or the substitution of the obligation, the market value of the claim in respect of that debt; or
- In the event that the debt is settled directly or indirectly through the conversion or exchange of shares into equity or through the application of proceeds from shares issued by the debtor company where the person who subscribed for or acquired the shares in that company in terms of such an arrangement did not hold shares in the debtor company prior to entering into that arrangement, the market value of the shares; or
- In the event that the debt is settled directly or indirectly through the conversion or exchange of shares into equity or through the application of proceeds from shares issued by the debtor company where the person who subscribed for or acquired the shares in that company in terms of such an arrangement held shares in the debtor company prior to entering into that arrangement, the amount by which the market value of the shares held by that person in that company after the implementation of that arrangement exceeds the market value of the shares held by that person in that company prior to the entering into of that arrangement.

Detailed factual description

148. Assume the following information: A company has assets with a market value of R140 000, equity of R60 000 and liabilities (constituting debt owing to its 100% shareholder) with a face value of R80 000 and a market value of the shares in the company of R60 000.

149. If the company and shareholder enter into an arrangement whereby the company issues shares with a market value of R30 000 to the shareholder in exchange for the settlement of R30 000 of the debt owing to the shareholder it will result in a theoretical increase of the market value of the shareholder’s shares in the company from R60 000 to



R90 000 (all other factors remaining equal). The debt benefit, in terms of its definition, will therefore be calculated as:

- The difference between:
  - The face value of the debt (i.e. R80 000); and
  - the market value of the shares.

150. This will result in a debt benefit of R50 000 (i.e. the difference between the R80 000 face value of the debt and the increase in value of the shares of R30 000). The debt benefit should however only be R30 000.

#### Proposal

151. The expression “face value of the claim held by that other person in respect of that debt, prior to the entering into of any arrangement in respect of that debt, exceeds” should be restricted to apply to arrangements contemplated in paragraph (a) of the definition of a “debt benefit”.

152. Consequently, the calculation of a “debt benefit” in respect of arrangements contemplated in paragraph (b) must be done solely with reference to the increase in the market value of the person’s shares in the company, limited to the face value of the debt.

#### **Section 19(1) and paragraph 12A of the Eighth Schedule to the Act - Clarifying the exact time at which the face value or market value must be determined**

#### Legal nature

153. The definition of “debt benefit” refers to various concepts such as the face value of the debt prior to entering into the arrangement, the market value of the claim and the market value of the shares held in the company.

#### Detailed factual description

154. Uncertainty arises in respect of the exact time at which the face value of the claim, the market value of the shares or the market value of the claim to a debt must be determined for purposes of determining the “debt benefit”.

#### Proposal

155. The word “immediately” should be inserted so as to clarify that what is envisaged is immediately prior to, or immediately after the arrangement, as the context dictates.



**Section 22B and paragraph 43A of the Eighth Schedule to the Act - Precedence over the corporate roll - over provisions**

**Legal nature**

156. Section 41(2) of the Act now stipulates that sections 41 to 47 must be applied notwithstanding any provision to the contrary contained in the Act other than, inter alia, section 22B and paragraph 43A of the Eighth Schedule of the Act.

**Detailed factual description**

157. In terms of the current wording of section 41(2) of the Act, the anti-avoidance provisions contained in section 22B and paragraph 43A of the Eighth Schedule override the corporate roll-over rules.

158. This may inadvertently trigger income or proceeds in the hands of a company under the provisions of section 22B or paragraph 43A of the Eighth Schedule upon entering into the corporate roll-over rules, which may counteract the relief intended by the corporate roll-over provisions. For example, a liquidation distribution in section 47 of the Act will in all likelihood trigger an “extraordinary dividend”, as defined. Therefore, if section 47 is subordinate to the new provisions in section 22B and paragraph 43A of the Eighth Schedule to the Act, then section 47 is, in fact, a ‘nullity’ going forward. Arguably, it could not have been the intention of NT to inadvertently ‘switch off’ the corporate rules in this regard.

**Proposal**

159. The reference to section 22B and paragraph 43A of the Eighth Schedule should be removed from section 41(2).

**Section 22B and paragraph 43A of the Eighth Schedule to the Act - Clarifying the meaning of preference share for purposes of the definition of ‘extraordinary dividend’ (TLAB2017)**

**Legal nature**

160. The definition of “extraordinary dividend” in section 22B(1) and paragraph 43A of the Eighth Schedule to the Act distinguishes between the concepts “preference share” and “any other share”. It further specifies that paragraph (a) to the definition of an “extraordinary dividend” encompasses preference shares in relation to which the dividends are determined with reference to a rate of interest.

**Detailed factual description**

161. The nature of a share that would be regarded as a “preference share” as contemplated in paragraph (a) of the definition of an “extraordinary dividend” is unclear. There is no definition in the Act for this term, other than in section 8EA(1) of the Act, and it is therefore unclear what requirements must be fulfilled in order to constitute a “preference share” for purposes of this new provision.



Proposal

162. A definition should be included in this new provision for the term “preference share”.

163. Alternatively, we propose that reference should be made to the definition of a “preference share” in section 8EA(1).

**Proviso to section 89quat(4) of the Act – Technical corrections due to erroneous referencing**

Legal nature

164. The proviso to section 89quat(4) of the Act provides that where any interest is payable to the taxpayer on any amount in respect of any period in terms of the provisions of section 88 of the Act, no interest shall be payable to the taxpayer in terms of the provisions of this subsection in respect of the said amount and period.

165. Section 88 of the Act has been repealed by section 271 read with paragraph 66 of Schedule 1 of the TAA.

166. Section 164(7) of the TAA contains similar wording to the repealed section 88 of the Act.

Proposal

167. In view of the repeal of section 88 of the Act, in terms of the provisions of the TAA, we submit that the reference to section 88 in section 89quat(4) of the Act must be replaced by a reference to section 164(7) of the TAA.



## **CATEGORY – VALUED ADDED TAX & CUSTOMS**

### **Section 2(2)(ii) of the VAT Act – Definition of currency**

#### Legal nature

168. The definition of “currency” in section 2(2)(ii) of the VAT Act currently only includes “bank notes or other currency of any country”.

169. This definition currently does not include cryptocurrencies (currencies not enjoying the status of formal legal tender). Cryptocurrencies are, however, in all respects similar to currencies defined as legal tender.

#### Detailed factual description

170. Uncertainty exists as to whether the supply of cryptocurrencies (most notably Bitcoin, although there are over a 1000 to date) is a taxable supply of services or an exempt supply of an exchange of currency.

#### Nature of business impacted

171. Any vendor acquiring, selling or paying with cryptocurrencies.

#### Proposal

172. We propose that consideration must be given as to whether the definition of “currency” in section 2(2)(ii) of the VAT Act should be extended to include cryptocurrencies.

### **Section 8(25) of the VAT Act - Relief in respect of group reorganisation**

#### Legal nature

173. Proviso (i) to section 8(25) of the VAT Act provides that the section will not find application in respect of supplies contemplated in sections 42 and 45 of the VAT Act, “*unless that supply is of an enterprise or part of an enterprise which is capable of separate operation, where the supplier and recipient have agreed in writing that such enterprise or part, as the case may be, is disposed of as a going concern*”.

#### Factual description

174. Having said that, one needs to determine the meaning of the term “going concern” as used in the context of the section. Unlike section 11(1)(e) of the VAT Act, no specific criteria needs to be met in order for the sale of the business to be considered as being one of a going concern.

175. Further, no definition of the term exists in the VAT Act. As a result one is reliant upon the ordinary English meaning of the term. In this regard the dictionaries do not seem to provide a definition of the term.



176. However, it seems that most commentators on the meaning of the term make reference to the meaning thereof from an accounting point of view.
177. The concept of preparing financial statements on the going concern principle is contained in IAS 1 Presentation of Financial Statements Reporting Framework though the concept is undefined and relies on a principle that an entity is a going concern unless evidence shows it won't be able to meet its obligations without substantial disposition of asset.
178. The below is an extract of a description of the meaning of the term by [www.accountingformanagement.org/going-concern-concept](http://www.accountingformanagement.org/going-concern-concept):

*“The going concern concept of accounting implies that the business entity will continue its operations in the future and will not liquidate or be forced to discontinue operations due to any reason. A company is a going concern if no evidence is available to believe that it will or will have to cease its operations in foreseeable future.*

*An example of the application of going concern concept of accounting is the computation of depreciation on the basis of expected economic life of fixed assets rather than their current market value. Companies assume that their business will continue for an indefinite period of time and the assets will be used in the business until fully depreciated. Another example of the going concern assumption is the prepayment and accrual of expenses. Companies prepay and accrue expenses because they believe that they will continue operations in future.*

*The going concern concept is applicable to the company's business as a whole. If, for example, a company closes a small business segment or discontinues one of its product and continues with others, it does not mean that the company is no longer a going concern because the going concern concept is applicable to the entity as a whole not to the particular segment of business or product.*

*The going concern concept of accounting is of great importance for accountants because if a company is a going concern, it must prepare its financial statements in accordance with applicable financial reporting framework such as generally accepted accounting principles applicable in United States of America (US-GAAP) and international financial reporting standards (IFRS).*

*The auditors conduct their own evaluation to see whether the going concern assumption is appropriate or not at the time of auditing financial statements even if the company claims to be a going concern.”*

179. From the said description and many other descriptions considered by different authors on the meaning of the term “going concern”, it appears that solvency/liquidity is the key criteria.



180. Based on this, it follows that no need exists for all of the criteria envisaged in section 11(1)(e) of the VAT Act to apply, for example, it is not necessary for the parties to agree that the enterprise or part thereof will be an income earning activity on date of transfer. Based on this interpretation it will be possible for the provisions of section 8(25) to apply in the event where a vendor carries on an enterprise consisting of, for example, prospecting or plantation farming, where no income is generated at the time of transfer of the business, provided the vendor is sufficiently capitalised to continue its operations.

181. However, in the absence of any definition of the term, in relation to section 8(25) and in the absence of any specific criteria for a “going concern” to be included in section 8(25), the application of the section remains ambiguous.

#### Nature of business impacted

182. Businesses involved in restructuring and group re-organisations.

#### Proposal

183. It is recommended that the VAT Act be amended by either including a definition of the term “going concern” applicable to section 8(25), or to provide the intended criteria in the body of section 8(25).

### **Section 8(28) – Merging or boundary changes for Municipalities (TLAB17)**

#### Legal nature

184. The recently introduced section 8(28) of the VAT Act appears to have two requirements that must be met, namely (a) and (b), before the relevant relief applies.

185. We submit that the current wording of the section is open to interpretation that requirements (a) and (b) must be read as separate and independent rules or tests notwithstanding the conjoining “and”.

186. In a situation where two municipalities are merged, but as a result of such merger, both municipalities cease to exist, the question arises whether the transferring municipality is deemed to make a supply.

187. If this is the case, this gives rise to uncertainty, given that (a) applies to mergers (i.e. where the outcome is one municipality) and (b) with separate municipalities so the requirements are distinct.

#### Detailed factual description

188. The effect of SARS Binding General Ruling 39, (the ruling) is that as at the effective date of the municipal boundary change:



- No supply of any goods or services is made by the existing municipality for the purposes of section 7(1)(a), and consequently, there will be no output tax payable by the existing municipality under section 16(4);
- No goods or services are acquired by the superseding municipality from the existing municipality, and consequently, no input tax deduction will be allowed under section 16(3) to the superseding municipality;
- No change of use adjustments under section 18 will be allowed to, or required by, either the existing municipality or the superseding municipality;
- An output tax or input tax adjustment may be required as contemplated in section 15(5) in a case where the existing and superseding municipalities do not account for VAT on the same accounting basis;
- The provisions of section 8(2) will not apply to the existing municipality upon its disestablishment and subsequent deregistration for VAT purposes unless any goods or rights capable of assignment, cession or surrender are not transferred to the superseding municipality as a result of the municipal boundary change, in which case, section 8(2) shall only apply to that extent;
- For the purposes of sections 16(2), 16(3), 17(1), 20 and 21, any valid tax invoice, debit or credit note or other prescribed document which has been issued in the name of the existing municipality, may be used as acceptable documentary proof for the purposes of deducting input tax or other allowable deduction in the name of the superseding municipality for a period of six months after the effective date of the municipal boundary change, provided such deduction has not previously been allowed to the existing municipality;
- For the purposes of calculating the superseding municipality's apportionment percentage as prescribed by section 17(1) and the related annual adjustment, symbols (a), (b) and (c) in the Formula in BGR 4 (Issue 3) shall be the aggregate of the values of those symbols for the existing and superseding municipalities for the financial year concerned;1 and
- As a superseding municipality becomes the successor in law of the existing municipality, the superseding municipality is liable to account to SARS for any VAT liability or outstanding VAT returns in relation to the activities of the existing municipality which arose before the effective date of the municipal boundary change.

*Nature of business impacted*

189. All municipalities are impacted.



### Proposal

190. In order to address the unintended VAT consequences as a result of the structural changes to certain municipalities, we propose that an amendment is made to the provisions of the VAT Act to provide for interim measures in these instances, in line with the provisions of the ruling and that the “and” is deleted and replaced with an “or” as it envisages two distinct alternatives.

### **Section 11(1)(u) of the VAT Act – Extension of ambit of application**

#### Legal nature

191. Section 11(1)(u) of the VAT Act defines as a zero-rated supply “*the supply of goods ... which have been imported and entered for storage in a licenced Customs and Excise warehouse but have not been entered for home consumption.*”

192. Section 12(k) of the VAT Act defines as an exempt supply “*the supply of goods in the Republic by any person that is not a resident of the Republic and that is not a vendor ... which have not been entered for home consumption.*”

193. Sections 11(1)(u) and 12(k) essentially serve the same purpose. Section 11(1)(u) ensures that supplies in bond do not attract VAT as the person that ultimately clears the goods will be liable for VAT on the importation of the goods. Section 12(k) ensures that any goods supplied by a non-resident that is not a VAT vendor in South Africa is exempt from VAT if the sale takes place before the goods are cleared for home use. This will include goods that are within the South African territorial waters (i.e. in the Republic as defined in section 1(1) of the VAT Act) that have not yet been cleared for importation (for example goods on a ship in a South African harbour).

194. Where a South African VAT vendor sells goods before the goods are cleared through a South African harbour but where the goods are within the South African territorial waters (for example goods on a ship in a South African harbour), the supply will be subject to VAT at the standard rate as well as further importation VAT when the goods are cleared for home use by the purchaser.

#### Detailed factual description

195. The payment of VAT by a South African recipient of goods on the supply of goods still to be cleared by Customs as well as on the importation of the same goods, could not have been intended by the legislator.

196. In the case of a purchaser that is not entitled to an input tax credit, the limited application of section 11(1)(u) will effectively result in double taxation on the importation of such goods.

#### The nature of the businesses impacted

197. All South African VAT vendors that sell goods prior to clearing the goods for home use, where the goods have not been entered into a licenced Customs and Excise warehouse.



### Proposal

198. To overcome the above unintended consequences we propose that section 11(1)(u) be amended as follows:

*“the supply of goods in the Republic, by any vendor other than the supply of goods by an inbound duty tax free shop, which have not been [imported and entered for storage in a licensed Customs and Excise storage warehouse but have not been] entered for home use; or”*

### **Section 11(2)(g)(iv) read with section 11(1)(b) of the VAT Act (TLAB17)**

#### Legal nature

199. This matter was raised in 2016 and an amendment proposed in TLAB17 but that amendment has not achieved what was requested but instead created a worse problem.

200. Section 11(1)(b) of the VAT Act zero rates goods supplied by a vendor in the course of repairing, renovating, modifying treating, processing, cleaning, reconditioning or manufacture any goods to which, inter alia, section 11(2)(g)(iv) of the VAT Act refers and the goods supplied –

- Are wrought to, affixed to, attached to or otherwise form part of those other goods; or
- Being consumable goods, become unusable or worthless as a direct result of being used in that repair, renovation, modification or treatment process.

201. Section 11(2)(g)(iv) zero-rates services supplied by a vendor directly in respect of the repair, maintenance, cleaning or reconditioning of a foreign-going ship or foreign-going aircraft.

202. The activities listed in section 11(1)(b) do not mirror the activities listed in section 11(2)(g)(iv). This inconsistency gives rise to an anomaly that should be addressed by expanding the activities listed in section 11(2)(g)(iv) in line with those listed in section 11(1)(b). We are aware that SARS have issued Section 72 rulings in the past to deal with the anomaly. The VAT Act should however now be amended to formally address the anomaly i.e. the 8 activities in s11(1)(b) should be also the in section 11(2)(g)(iv) instead of the 4 listed.

203. For example, as the amended legislation reads, a foreign going ship entered into SA for modifying will qualify for the zero rate on the ship, but the actual service for which the ship was entered SA will not be zero rated under s11(2)(g)(iv) as that service is not listed, though clearly it should be as that is why 11(1)(b) zero rated the ship itself in the first instance.



204. Furthermore, section 11(1)(b) refers to "... repairing, renovating, .... any goods to which subsection 2(g)(iv) refers ..." (Our underlining))

205. While section 11(2)(g)(i) of the VAT Act deals with goods temporarily imported, section 11(2)(g)(iv) does not deal with any goods; it deals with a specific category of services. Technically, based on the current working of the section, no goods supplied with regards to section 11(2)(g)(vi) activities will qualify to be supplied at the zero-rate of VAT.

#### Detailed factual description

206. Technically any goods supplied relating to services supplied in terms of section 11(2)(g)(iv) will not qualify to be supplied at the zero-rate of VAT, the goods contemplated in section 11(1)(b) not being linked to goods contemplated in section 11(2)(g)(iv).

#### Nature of business impacted

207. All vendors that supply goods to foreign-going ships and aircrafts where such goods become part of such ships or aircraft.

#### Proposal

208. To remedy the anomaly stated above, it is proposed that section 11(1)(b) of the VAT Act must be amended to read:...the goods have been supplied in the course of repairing ...any goods to which subsection (2)(g)(ii) and any service to which subsection (iv) refers...

209. We further propose that the activities listed in section 11(2)(g)(iv) must be extended to mirror the activities listed in section 11(1)(b).

#### **Sections 11(2)(ℓ) and 11(1)(q) of the VAT Act – zero rate**

##### Legal nature

210. The interaction between sections 11(2)(ℓ) and 11(1)(q) of the VAT Act gives rise to unintended consequences under certain circumstances.

211. Section 11(1)(q) provides for the zero-rating of a 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; and
- Who will use them in the course or furtherance of his enterprise.

212. This is aimed at avoiding cascading effect of VAT for the VAT registered purchaser.

##### Detailed factual description

213. The application of section 11(1)(q) is limited to the supply of goods to a non-resident. If the local vendor supplies services to a local recipient, who is the client of a non-resident,



there is currently no provision available in section 11(2) to provide for the zero-rating of such services.

214. 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 applies if the services are supplied directly in connection with certain movable property. If the services provided by the local vendor to the non-resident are not supplied directly in connection with movable property, the zero rating will not apply.

#### Nature of business impacted

215. Supplies of services by local VAT registered suppliers, to non-resident non-vendors, where the supply is made to a SA recipient who is a registered vendor.

#### Proposal

216. We propose that 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.

#### **Section 12(b) of the VAT Act & section 9(1)(c) of the Transfer Duty Act - Donations used more than 80% to supply goods/services**

#### Legal nature

217. Section 12(b) of the VAT Act exempts the supply by an association not for gain of donated goods or services or goods made or manufactured by such association if at least 80 per cent of the value of the materials used in making or manufacturing such other goods consists of donated goods.

#### Detailed factual description

218. Section 12(b) generally exempts the supply of any donated goods or services, if made by any association not for gain. It follows that:

- Where a donor donates goods (for example a farm) to an association not for gain, and the association in turn sells the goods (i.e. the farm), the sale is exempt from VAT; and
- Where a donor donates his or her services (or otherwise acquired services which the donor then donates to the association not for gain), and the donor's services are on-supplied by the association in a fund raising endeavour (for example a natural person who donates his or her time and effort in a car wash for fundraising event), the supply of these services by the association will be exempt from VAT.

219. Section 12(b) furthermore exempts an association not for gain's supply of any other goods where the goods are manufactured from donated goods such that the value of the goods donated constituted at least 80% or more of the total value of goods and materials used in the manufacturing process. It follows that, by way of an example, a few broken TV sets could be donated to an association not for gain, from which one TV set could be



manufactured from the parts obtained from the broken TV sets. The sale of the working (manufactured) TV set is exempt from VAT.

220. Apart from the above rule with regards to goods manufactured from donated goods, this section does not cater for a scenario where the association not for gain generates income from donated goods or services otherwise than by onwards supply.

221. For example, where goods were donated to an association not for gain, and the goods were supplied temporarily by way of a lease to another party (i.e. asset use to generate rental income rather than sale income). Had the goods been sold outright, the supply would have been exempt from VAT. However, since the association supplied the goods over the short term by way of a lease, the association will incur these unintended consequences:

- Although the goods received by way of a donation was fully used in the course of making a supply by way of lease, the lease was not exempt; and
- The exemption from transfer duty in terms of section 9(1)(c) of the Transfer Duty Act did not find application. In terms of this section, the acquisition of property by certain associations not for gain is exempt from transfer duty provided that the property is acquired by the association wholly or substantially for the purposes of using it in one or more approved public benefit organisation activities carried on by the association. Because the wording in the Act does not provide any clarity in this regard, it is arguable whether the nexus was sufficiently close between the lease (i.e. the fundraising endeavour) and its approved benefit activities for it to qualify for the exemption.

#### *Nature of the business impacted*

222. Associations not for gain are affected.

#### *Proposal*

223. Section 12(b) of the VAT Act should be amended to exempt the supply by an association not for gain of donated goods or services if at least 80 per cent of the value of goods or services utilised, consumed or supplied in the course of making the supply consists of donated goods or services.

224. Section 9(1)(c) of the Transfer Duty Act should be amended to provide clarity as to what constitutes property which is wholly or substantially acquired for the purposes of using it in one or more approved public benefit organisation activity carried on by the association.

#### ***Section 17(2)(c) of the VAT Act – Denial of input tax credit on rental of cars***

#### *Legal nature*

225. Section 17(2)(c) of the VAT Act denies an input tax deduction in respect of any motor car supplied to or imported by a vendor.



226. The term “supply” is wide enough to include motor cars supplied by way of rental agreements.

227. Other than specific rules, the VAT Act currently does not generally recognize the purpose for which a motor car is acquired and applied. As such input tax on the supply of motor cars is often denied where it is incurred wholly for business purposes.

Detailed factual description

228. The intention of denying input tax on the supply of motor cars is to effectively tax the potential private use of the vehicle.

229. In the case of entertainment, the legislator acknowledges that where a person is away overnight from their normal place of work and residence on official business, VAT on the supply of goods and services associated with the person’s personal subsistence cannot be regarded as entertainment and as such should be allowed as input tax. This is on the basis that under these circumstances the consumption of the goods and services by the employee concerned, cannot be regarded as private consumption; it is a cost necessary to maintain the resource while away on business.

230. The above application has not been extended to the rental of motor cars where employees are away overnight on business.

Nature of business impacted

231. Any enterprise renting motor cars for employees when away overnight.

Proposal

232. We propose that the “away on business overnight” rule applicable to entertainment, be extended to the rental of motor cars used by employees when away overnight on business.

**Section 18B – Removal of time restriction**

Legal nature

233. Section 18B of the VAT Act provides relief to property developers in respect of residential properties that cannot be sold immediately and is accordingly temporarily rented out pending the sale of such properties. The section will cease to apply on 1 January 2018.

Detailed factual description

234. The nature of the property development industry is that not all properties would be able to be sold immediately after completion of the construction of such properties. The fact that properties are temporarily rented out pending finding a buyer for the properties is no indication of an intention to deal with the properties as rental properties as long as there is a clear evidence that the properties are still actively marked for sale.



Nature of business impacted

235. All residential property developers.

Proposal

236. We propose that section 18B be made a permanent section in the VAT Act as it mirrors the commercial reality of property development. We therefore propose that the current applicable limited time frames be removed.

**Section 20(5A) and section 21(8) of the VAT Act - Tax invoices, credit and debit notes issued within a period of six months from sale of enterprise**

Legal nature

237. Section 20(5A) of the VAT Act provides that where a vendor acquires an enterprise from another vendor and as a result of that acquisition, the supplier immediately ceases to be a vendor, and the recipient, within a period of six months from the date of the acquisition, issues or receives a tax invoice in respect of the acquired enterprise, that tax invoice may reflect the name, address and VAT registration number of the supplier.

238. Similarly, section 21(8) of the VAT Act provides that where a vendor acquires an enterprise from another vendor and as a result of that acquisition, the supplying vendor immediately ceases to be a vendor, and the purchasing vendor, within a period of six months from the date of acquisition, issues or receives a credit note or debit note, as the case may be, in respect of the acquired enterprise, that credit note or debit note may reflect the name, address and VAT registration number of the supplying vendor.

Detailed factual description

239. It follows from the above that the period of six months to issue tax invoices or credit or debit notes reflecting the name, address and VAT registration number of the supplying vendor is only applicable to a situation where the vendor acquires an enterprise from another vendor.

240. Based on experience we have found that where a vendor changes its legal name or when there is a part sale of a business (i.e. divisions being sold as a going-concern), it is required to obtain and issue invoices and debit/credit notes in its new legal name from the date it was so changed and registered through CIPC. The part sale of business would result in contracts with suppliers and customers being changed to the new legal entities name and an agent principal agreement cannot be relied upon.

241. However, practical difficulty arises to obtain and issue tax invoices and credit/debit notes with these particulars immediately from the date its legal name has changed. The difficulties include that a certain time period is needed to enable the vendor to notify its customers and suppliers of the name change which must be accompanied by the CIPC notification.



242. Currently there are no provisions in the VAT Act which grants the vendor a specified time period to enable it to notify its suppliers and customers of the name change and to provide that tax invoices, credit and debit notes are permitted in its old name until such time period has lapsed.

Nature of business impacted

243. Any vendor which changes its legal name at the CIPC.

Proposal

244. We therefore propose that the VAT Act be amended to adequately provide for the difficulties discussed above.

**Section 21(1) of the VAT Act - Credit and debit notes**

Legal nature

245. Vendors that make 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.

Detailed factual description

246. Where a vendor has issued a tax invoice with the incorrect name of the recipient, 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.

Nature of business impacted

247. All vendors that issue tax invoices.

Proposal

248. We propose that the scenarios in section 21(1) of the VAT act be expanded to include any scenario where a tax invoice had been issued in error. In practice, we experience that SARS allows for credit notes to be issued in these scenarios but it is not supported by the current legislation.

**Section 21(3)(a) of the VAT Act - Credit notes for supplies after sale of an enterprise as a going concern**

Legal nature

249. Company A sells its enterprise to Company B. Subsequent to the acquisition of the enterprise a customer of Company A returns goods acquired from Company A, but the return is made to Company B.



250. Section 21(3)(a) provides that where the amount shown as tax charged in a tax period exceeds the actual tax charged in respect of a supply, the supplier shall provide the recipient with a credit note.

251. In the instance where the enterprise has been sold and the goods are returned to the purchaser, this creates an issue since the purchaser cannot issue a credit note from a VAT perspective and will accordingly not have the requisite documentary evidence to claim the input tax deduction.

Detailed factual description

252. The provisions are similar to the provisions for bad debts written off where the debt has been acquired on a non-recourse basis.

Nature of business impacted

253. All vendors where goods may be returned subsequent to a sale of the business.

Proposal

254. We propose that an amendment is made to the effect that it will allow the purchaser of an enterprise to issue a credit note in respect of goods supplied by the supplier of the enterprise but returned to the purchaser of the enterprise.

**Section 21(3)(a) and section 21(3)(b) of the VAT Act - Credit and debit notes**

Legal nature

255. Section 21(3)(a)(i) and section 21(3)(b)(i) of the VAT Act provide that when a credit note or debit note is issued, the credit note/debit note must contain the words “credit note” or “debit note”.

Detailed factual description

256. Certain international IT systems require customization to include the prescribed wording and this has unnecessary cost implications.

Nature of business impacted

257. All vendors who issues and/or receives credit and/or debit notes.

Proposal

258. We propose that section 21(3) is amended to provide for the use of the alternative wording for a “credit note” or debit note” such as “credit memo” or debit memo” in circumstances where an international IT system is used to ensure that this description may be used in the alternative and therefore not impact on the tax compliance of the taxpayer.



## **Section 21 of the VAT Act – Interpretation of section 21(1)(e)**

### **Legal nature**

259. Section 21(1)(e) of the VAT Act defines as an adjustment incidence “an error has occurred in stipulating the amount of consideration agreed upon for a supply.”
260. Section 21 of the VAT Act deals with two categories of adjustments: adjustments resulting from incorrect VAT documentation (section 21(1)(i) of the VAT Act) and adjustments resulting from the incorrect completion of a VAT return (section 21(1)(ii) of the VAT Act).
261. Section 21(3) of the VAT Act determines that debit or credit notes must be issued in respect of adjustments resulting from incorrect VAT documentation issued (section 21(1)(i) incidences). There is no requirement that debit or credit notes must be issued in respect of section 21(1)(ii) incidences. This construction of the VAT Act makes sense, as errors made in submitted returns would not require any change to original VAT documentation issued.
262. In practice uncertainty exists as to whether section 21(1)(e) applies to such circumstances (i.e. instances where errors occurred in the submission of VAT returns, especially with regards to the amount of the consideration for supplied disclosed on such returns). The Explanatory Memorandum dealing with the amendment in 2013 only deals with incorrect values used on tax invoices. There therefore appears to be a delink between the circumstances set out in section 21(1) of the VAT Act and the category of adjustments envisaged in section 21(1)(ii) of the VAT Act (errors on VAT returns).

### **Detailed factual description**

263. In practice vendors sometimes make capturing errors resulting in an excess amount of output tax payable (for example disclosing zero-rated supplies as standard rate supplies). The VAT Act contains a simple mechanism to correct such errors in section 21 of the VAT Act, but in practice the view is sometimes held that the section 21(1)(e) read with section 21(1)(ii) of the VAT Act does not apply to such cases.
264. Vendors are then required to follow the remedies of applying for reduced assessments as envisaged in section 93(1)(d)(ii) of the TAA. This could be a prolonged exercise with unnecessary strain on taxpayer and SARS resources.

### **The nature of business impacted**

265. All vendors submitting VAT returns.

### **Proposal**

266. We propose that a clear link be created to section 21(1) incidences and section 21(1)(ii) adjustments. If the legislator did not intend the link, the legislation should be amended to clearly link the section 21 adjustments to tax documentation only.



**Section 22(3)A and 22(6) of the VAT Act - Supplying vendor ceases to be a vendor and the shares in this vendor are subsequently disposed of to a third party who is not part of the group of companies**

Legal nature

267. Section 22(3) of the VAT Act provides that where a vendor accounts for VAT on the invoice basis and has made an input tax deduction on a taxable supply made to him and the vendor has not, after expiry of a period of twelve months from the tax period in which the input tax was claimed, paid the full consideration, the vendor is liable to account for VAT equal to the tax fraction of the outstanding consideration.
268. However, where the supplier and the recipient are part of the same “group of companies”, section 22(3A) provides that, subject to subsection 6, the provisions of subsection (3) will not apply for as long as both parties are part of the same group of companies (our emphasis).
269. Subsection (6) provides that where a vendor, who is part of a group of companies, makes a taxable supply to another vendor, who is part of the same group of companies, the supplying vendor may not make a deduction of input tax, as envisaged in subsection 1 read with subsection 3, in respect of any amount of tax that has become irrecoverable.
270. Insufficient clarity is, however, given to distinguish between a taxable supply of goods as opposed to a taxable supply of services in circumstances where the supplying vendor ceases to be a vendor and the shares in this vendor are subsequently disposed of to a third party who is not part of the group of companies.

Detailed factual description

*Taxable supply is a supply of services or goods (e.g. management fees or consumables).*

271. Where the taxable supply in question is in respect of a supply of services and certain goods (not included in the assets detailed below), the supplying vendor will not have a section 8(2) liability upon deregistration, since this section deems the service in question to be one of a service, and the supply of a debtor, is an exempt supply being a debt security.
272. Equally, the supplying vendor will not have an input tax claim on the bad debt, since the recipient vendor is still part of the group of companies. Should the shares in the supplying company (now non-vendor) subsequently be disposed of to a third party, say after a year, the recipient vendor will in terms of section 22(1) be liable to account for output tax in terms of section 22(3A) read with section 22(3), since it has been deregistered. In this scenario, it is considered that SARS will be prejudiced.

*Taxable supply is a supply of goods*

273. Where the taxable supply is one of goods which form part of the assets of his enterprise when ceasing to be a vendor, the supplying vendor will equally not have a section 8(2)



liability and will equally not be able to claim any input tax on the recipient debt being written off, since they are still part of the same group of companies.

274. Should the supplying vendor subsequently no longer be part of the group of companies, the recipient vendor will, in terms of section 22(3A) read with section 22(3) have an output tax liability. In this situation, it is considered that SARS will be enriched.

275. If the taxable supply in question was one of goods which form part of the assets of his enterprise when ceasing to be a vendor, the said anomaly will not in our view exist since the recipient vendor will have had a section 8(2) liability upon de-registration.

#### Nature of business impacted

276. Any group of companies making taxable supplies to each other where payment is not made or becomes irrecoverable.

#### Proposal

277. It is proposed that the provisions of sections 22(3A) and 22(6) be clarified to ensure that they remain applicable for as long as the parties are part of the same group of companies and for as long as both parties are vendors.

#### **Section 25(dA) of the VAT Act - no longer applicable**

##### Legal nature

278. Section 25(dA) of the VAT Act provides that a vendor must notify the Commissioner in writing within 21 days of any change whereby the provisions of section 27(4B)(a) cease to apply to that vendor.

279. Section 27(4B) has been deleted by section 28(1)(f) of Act 44 of 2014 with effect from 1 July 2015 and applicable in respect of tax periods commencing on or after that date.

#### Proposal

280. We propose that section 25(dA) is deleted as section 27(4B) has been deleted and the provision is therefore no longer required.

#### **Section 41 of the VAT Act-Error in referencing**

##### Legal nature

281. Section 41 of the VAT Act refers to section 41A of the VAT Act, which has been repealed.

#### Proposal

282. The reference to the repealed section 41A must be removed.



**Section 44 of the VAT Act and Section 190 of the Tax Administration Act (the TAA) - Refunds of output tax overpaid**

**Legal nature**

283. Section 44(4) of the VAT Act only deals with refunds of VAT where the input tax claimed on the VAT return exceeds the output tax declared. Section 44(3)(c) of the VAT Act provides that the Commissioner shall not make a refund under Chapter 13 of the TAA unless the Commissioner is satisfied that any amount of output tax claimed to be refundable to a vendor will, if such amount has been borne by any other person, in turn be refunded by the vendor to such person.

284. Section 190(1)(b) of the TAA provides that SARS must pay a refund if a person is entitled to a refund of an amount erroneously paid in respect of an assessment in excess of the amount payable in terms of the assessment.

285. Prior to its deletion from the VAT Act in 2011, section 44(2) of the VAT Act specifically provided that where any amount of tax, additional tax, penalty or interest paid by a person in terms of this Act was in excess of the amount that should properly have been charged under this Act, the Commissioner shall, on application by the person concerned, refund the amount of tax, additional tax, penalty or interest paid in excess or the amount by which the amount refunded was less than the amount properly refundable, as the case may be.

286. In this regard, the court ruled in *Weare v Commissioner for South African Revenue Service [2004] 4 ALL SA 520 (SCA)* that any output tax excessively paid cannot be claimed by virtue of deducting such amounts as “input tax”, since section 16(3) of the VAT Act does not permit same. As a consequence, it was held that such refunds are to be claimed in terms of section 44(2).

**Detailed factual description**

287. From the current provisions in the VAT Act and the TAA it is clear that no specific provision is made as to the manner in which a vendor has to claim a refund of the amount overpaid, as envisaged in section 190(1)(b) of the TAA, read with section 44(3)(c) of the VAT Act.

288. In terms of the said case law though, such amounts cannot be claimed as “input tax”. It is further evident from the provisions of section 44(3)(c) that the Commissioner has to satisfy himself that the VAT claimed to be refundable will be refunded by the vendor to the person who borne the tax. It is thus clear that an application for such refund be made to the Commissioner, presumably in writing, albeit that no specific provision, such as the former section 44(2) exists.

**Nature of business impacted**

289. All vendors who are in a refund position, or who will claim a refund from SARS in future in the above circumstances.



### Proposal

290. It is proposed that section 44 of the VAT Act be amended to reflect the correct position.

291. In the alternative, we propose that the provisions of the TAA be amended, so as to re-introduce a section similar to the former section 44(2) of the VAT Act in order to provide clarity as to the manner in which such application or request for a refund for VAT has to be made.

### **Section 50(2) of the VAT Act - Requirements for separate VAT registrations of enterprises, branches or divisions**

#### Legal nature

292. Section 50 (1) of the VAT Act read with section 50(2) of the VAT Act provides that:

Where separate enterprises are carried on by any vendor or an enterprise is carried on by any vendor in branches or divisions, the vendor may apply to the Commissioner for separate VAT registrations of such enterprise, division or branch, where:

- it maintains an independent system of accounting; and
- is separately identifiable by the nature of its activities carried on or the location of the separate enterprise, branch or division.

#### Detailed factual description

293. Based on experience, the words “independent system of accounting” is often interpreted by vendors to mean that the said enterprise, branch or division will need to implement a separate accounting or ERP system to collect, store and process accounting data.

294. It is our view that the intention of the legislation was not to impose an additional cost on the vendor by procuring multiple accounting systems for the enterprises, branches or divisions requiring separate VAT registration.

295. Instead, a vendor, should be required to keep separate accounting records for the said enterprise, branch or division requiring separate VAT registration (i.e. the activities of the said enterprise, branch or division must be clearly distinguished or ring-fenced from the remaining vendor’s activities, within the same accounting/ ERP system).

#### Nature of business impacted

296. All vendors who register separate enterprises, branches or divisions.

### Proposal

297. It is proposed that the phrase “maintains an independent system of accounting” is amended to read “maintains an independent set of accounting records” instead.



### **Section 51 of the VAT Act - Unincorporated bodies of persons (jointly owned fixed property)**

#### **Legal Nature**

298. Where two or more persons jointly own undivided interests in fixed property (e.g. a shopping centre) which is let for the collective benefit of the co-owners, such activity constitutes the carrying on of an “enterprise” by an unincorporated body of persons.

299. This is evident from the following provisions in the VAT Act:

- Section 1 defines the term “person” as including anybody of persons, (incorporated or unincorporated); and
- Section 51 deals with bodies of persons corporate or unincorporated and provides, inter alia, that where anybody of persons, whether corporate or unincorporated (excluding companies) carries on any enterprise:
- Such body shall be deemed to carry on such enterprise as a person separate from the members of such body;
- Registration of that body shall be affected separately from any registration of any of its members;
- Liability for tax in respect of supplies by the body shall be determined and calculated in respect of the enterprise carried on by the body as an enterprise carried on independently of any enterprise carried on by any of the members of such body; and
- The duties and obligations imposed by this Act on the body shall be performed separately from the duties and obligations of the members of such body.

#### **Detailed factual description**

##### ***VAT on cost of acquisition and development***

300. The first question to be asked is who is entitled to claim the VAT incurred on the original acquisition of the property and the development costs, especially since the individual co-owners are often registered vendors in their own right.

301. This question is of particular importance since the Deeds Office requires that the property be registered in the names of the co-owners. In order for the co-owners to individually claim the VAT incurred on the said costs as input tax, the property need to be acquired/developed for purposes of use or supply in the course of making taxable supplies.

302. Although the property will be acquired/developed for the said purpose, the rental activity will be conducted in the unincorporated joint venture (the UJV), which has no legal standing in our law, but rather is a “VAT persona” created by the VAT Act. From an



accounting point of view, the fixed property, together with the development costs, will be capitalised in the balance sheets of the individual co-owners, net of VAT.

303. In this regard we may experience different scenarios for example, the VAT is claimed as input tax by the co-owners individually, but the VAT on the rentals charged to tenants is accounted for by the UJV vendor. Alternatively, the total amount of VAT incurred is claimed as input tax by the UJV vendor, and the UJV accounts for the VAT on rentals charged to tenants.
304. The first scenario is where the input tax is claimed by the individual co-owners. In this scenario, the question is whether they are entitled to do so, since the individual co-owners will not make any taxable supplies with their individual undivided interests in the fixed property. Instead, they will receive their individual profit shares from the UJV, which profits are not subject to VAT.
305. In this instance, we have seen rulings issued by SARS which consider this treatment to be correct on the basis that the co-owners essentially make taxable supplies of their rights of use available to the UJV for no consideration, as envisaged in section 10(23) of the VAT Act. This interpretation may be questioned against the findings in the KCM case read with SARS' IN70.
306. The second scenario is where the individual co-owners enter into an agreement with the other co-owners (UJV), in terms of which the individual co-owners make the right of use of their respective undivided interests in the fixed property available to the UJV, in exchange for a consideration equal to the amounts of profit distributed to them.
307. This implies that the individual co-owners are entitled to claim input tax on the acquisition/development, and are liable to account for output tax on their profit share (i.e. rental for VAT purposes), which VAT will be claimable by the UJV vendor as input tax, since the rights of use are acquired to make taxable supplies to tenants.
308. The third scenario is where the total amount of VAT on expenses incurred is claimed by the UJV vendor. In this scenario, although the costs may be borne by the co-owners, they do so in their capacity as agent for the purpose of their principal being the UJV, and as a result, any VAT incurred would be attributable as "input tax" to the UJV and not the co-owners.
309. The fourth scenario is where the VAT on costs incurred are, based on the VAT registration status of the parties, proportionally claimed by certain co-owners in their respective returns with the remaining VAT being claimed in the UJV, especially in cases where some of the co-owners are not VAT vendors in their own right.

*VAT on running costs, maintenance and upgrades/renovations*

310. The second question is who is entitled to claim input tax on the running costs, maintenance and upgrades/renovations, considering yet again that legally these costs are



incurred by the individual co-owners. It should also be borne in mind that the supplier tax invoices may either be issued to the individual co-owners, albeit not very common, or to the co-owners collectively, or to and in the name of the UJV (i.e. the name of the shopping centre in our example). As is the case with the acquisition and development costs, various scenarios occur in practice. These may include that the VAT on running costs and maintenance is claimed as input tax in the UJV, whilst the VAT on upgrades and renovations is claimed by the individual co-owners, or all of the VAT is claimed in the UJV or all of the VAT is claimed by the individual co-owners. Here too, the question is whether the co-owners are entitled to claim any of the input tax, where they will not account for VAT on the making available of their right of use to the UJV, as envisaged in the first scenario above.

#### *VAT treatment of sale of undivided share to another person*

311. A further ambiguity exists where one of the co-owners disposes of its undivided share in the fixed property to another person. In law, this transaction constitutes the sale of fixed property. Despite the legal nature of the transaction, different terminology is used to describe the transaction with potentially different VAT consequences namely, the sale of the partner's interest in the UJV to a new member of the UJV, the sale of the undivided interest in the fixed property to another person, or the sale by the existing UJV of its business as a going concern to the new UJV (i.e. the UJV after the original co-owner sold its undivided share to a new co-owner who is now part of the UJV). As is the case with the sale of any other fixed property, the co-owner (seller) is required to make a declaration to SARS as to whether it is a VAT vendor and if so whether VAT is payable and at what rate, or whether the sale is subject to Transfer Duty, payable by the purchaser. This declaration needs to be approved by SARS, and if Transfer Duty is payable, same has to be paid, before the Deeds Office will effect registration of the property.
312. Considering, as stated above, that the co-owner in question may or may not be VAT registered and may or may not have claimed the VAT incurred on the property as input tax, and the fact that the declaration is to be made by the co-owner and not the UJV, this declaration becomes difficult and confusing and the correct VAT treatment equally is challenging and ambiguous, dependent upon the terminology used to describe the transaction. We discuss the bases of the different interpretations and consequential ambiguities below.
313. Section 7(1)(a) of the VAT Act imposes VAT on the supply of goods by a vendor in the course of his enterprise. The term "vendor" is defined as meaning any person who is, or who is liable to be registered.
314. Section 11(1)(e) of the VAT Act provides, inter alia, that where, but for this section, a supply of goods would be charged with tax terms of section 7(1), such supply of the business as a going concern will be charged with tax at the rate of zero per cent, in circumstances where the supply is made to a registered vendor of an enterprise or part of an enterprise which is capable of separate operation, where the supplier and the recipient



have agreed in writing that such enterprise or part, as the case may be, is disposed of as a going concern, provided that:

- The parties have, at the time of conclusion of the agreement agreed in writing that the enterprise or part, as the case may be, will be an income earning activity on the date of transfer thereof; and
- The assets which are necessary for the carrying on such enterprise or part, as the case may be, are disposed of to the recipient; and
- The parties have, at the time of conclusion of the agreement for the disposal of such enterprise or part, as the case may be, agreed in writing that the purchase consideration agreed upon for that supply is inclusive of tax at the rate of zero per cent.

315. Section 51(2) of the VAT Act provides where a body of persons who is a partnership or other unincorporated body, dissolved in consequence of the retirement or withdrawal of one or more (but not all) of its members or the admission of a new member and a new partnership or unincorporated body comes into being consisting of the remaining members of the dissolved partnership or body or remaining members and one or more new members and such new partnership or body continues to carry on the enterprise of the dissolved partnership or body as a going concern, the dissolved partnership or body and the new partnership or body, shall unless the Commissioner, having regard to the circumstance of the case, otherwise directs for the purpose of the VAT Act be deemed to be one and the same partnership or body as the case may be. (our emphasis)

#### Potential different interpretations and effects

316. Where the co-owner is not a vendor, or is a vendor but the VAT on the fixed property has been claimed as input tax by the UJV and not the co-owner, the result could be that the transaction is subject to Transfer Duty, since the co-owner never used the fixed property in any enterprise carried on by it, as envisaged in section 7(1)(a) of the VAT Act. In this instance the question is whether the co-owner buying the fixed property, or the UJV in which the rental activities are carried on, can claim a notional input tax on second-hand goods acquired, and if neither can claim it, the Transfer Duty will remain a cost.

317. Where the co-owner has claimed the input tax on the fixed property on the basis that it accounted for output tax on the “rental” equal to its profit share charged to the UJV, or has claimed the input tax rightly or wrongly, on the basis that it made its right of use available for no consideration as envisaged in section 10(23) of the VAT Act, the co-owner would be liable for output tax, with no Transfer Duty payable. The question is whether this VAT will be claimable as input tax by either the new co-owner buying the fixed property or the UJV in which the VAT on the rentals charged to tenants will be accounted for.

318. This brings us back to the earlier question of who is entitled to claim the VAT incurred on the acquisition of the property, given the different permutations/interpretations, e.g. no



input tax can be claimed by the co-owner if he will only receive profit share which is not taxable.

319. Where the co-owner did account for output tax on its “rental” (i.e. making available its right of use) charged to the UJV, it may dispose of its business as a going concern to the new co-owner and may apply the zero rate of VAT, if the conditions of section 11(1)(e) are met.
320. Alternatively, the existing UJV could sell its business as a going concern to the new UJV, since the old and the new UJV are deemed by section 51(2) to be two separate persons, which sale can be subject to zero rate VAT, provided the conditions of section 11(1)(e) are met.
321. A further alternative interpretation is that, unless the Commissioner otherwise directs, the sale of the undivided interest by one member of a UJV to another person who is, or becomes a member of the UJV, is in terms of section 51(2) disregarded since the old UJV and the new UJV are deemed to be one and the same person.

#### *VAT registration of the UJV*

322. Once any one co-owner has disposed of its undivided interest in the fixed property to another co-owner, the question is whether the existing UJV is required to de-register and the new UJV is required to register as a vendor, or whether the new UJV may continue to account for VAT under the VAT registration number of the old UJV. Since section 51(2) does not require any application or disclosure to be made to SARS and since sections 25 of the VAT Act and 23 of the TAA do not require that the vendor informs SARS of the change in composition of the UJV, it is unclear on what basis the Commissioner will become aware of the change, in order for him to exercise his discretion.

#### *Transfer Duty declaration TDC01*

323. From a VAT point of view, the TDC01 requires the seller to declare his/her/its VAT registration number, in the absence of which Transfer Duty will be payable. In this regard the Guide for Transfer Duty via e-Filing (TD-AE-02-G02 Revision 11) states the following on page 27:
324. “The VAT registration number of the seller (if the seller is a registered VAT vendor) must be completed. Where the standard or zero rate is applicable, the VAT reference number of the seller (i.e. the registered owner) must be captured, otherwise the transaction will be regarded as being subject to Transfer Duty”.(our emphasis).
325. The said guide further confirms that one of the exemptions from Transfer Duty is where the seller is a vendor and the transaction is subject to VAT.
326. Thus, since all fixed property jointly owned are registered in the collective names of the co-owners, and not in the name of the UJV, it follows that where a co-owner who is not a



vendor, sells its undivided share in the fixed property to another person, such supply will be subject to Transfer Duty, regardless of whether the UJV is VAT registered and has claimed the VAT on acquisition, development, repairs/maintenance etc. This is due to the fact that the TDC01 requires the seller's VAT registration number.

327. Equally, where the existing UJV sells the entire business as a going concern to a new UJV, as a result of one or more co-owners selling their undivided share to new co-owners, the exemption from Transfer Duty will strictly speaking not apply, since the UJV's VAT number cannot be disclosed on the TDC01 as it is not the owner of the property. As a result that transaction is automatically subject to Transfer Duty, and not zero rate VAT. The same applies where the transaction is to be disregarded in terms of section 51(2).

328. However, in practice it appears as if the VAT registration numbers declared on the TDC01 are not verified to confirm it belongs to the seller. This observation is made since many non-vendor owners sell their undivided interests in fixed property, leased through a VAT registered UJV, at the zero rate, which suggests that the UJV VAT registration number was declared on the TDC01 form.

#### Nature of business impacted

329. Any co-owners of fixed property as part of a UJV.

#### Proposal

330. It is proposed that the wording of the entire section 51 of the VAT Act be reconsidered in order to address the abovementioned anomalies. It should also be noted that some of the said anomalies (e.g. is VAT payable on the "capital" contributions made by the participants to the UJV, considering that the profit share is not necessarily subject to VAT and if so can the UJV claim the VAT as input tax) also apply to other UJV's such as mining joint ventures, with the result that these difficulties should also be considered. It is further recommended that the TDC01 be amended to specifically cater for fixed property which is owned jointly by more than one person, and where such fixed property is traded with through a UJV envisaged in section 51 of the VAT Act.

#### **Schedule 1 to the VAT Act – Definition of brown bread**

##### Legal nature

331. Clause 87 of the draft TLAB2017 defines brown bread (qualifying to be supplied at the zero-rate of VAT) as "Brown Bread as defined in Regulation 1 of the Regulations in terms of Government Notice 405 published in Government Gazette No. 40828 of 5 May 2017".

332. "Brown Bread" is defined in the regulation as "wheat obtained by baking fermented or otherwise leavened dough made from brown bread wheat flour which complies with the requirements prescribed in regulation 8(1)(b)."



333. “Brown bread wheat flour” is defined as “wheat flour which complies with the requirements prescribed in regulation 4(12).”

334. Regulation 4(12) determines that brown bread wheat flour must comply with certain specific requirements.

335. The characteristics of high bran wheat flour and whole-wheat brown flour are separately contained in regulations 4(13) and 4(14) respectively.

Detailed factual description

336. The impact of the reference to brown bread as defined in the regulation will exclude zero-rating high-fibre and whole-wheat brown bread. This exclusion goes against the policy of zero-rating basic foodstuffs and should be reconsidered.

Nature of business impacted

337. All business selling and all consumers consuming brown bread.

**Section 22(1A) of the VAT Act - definition**

Legal nature

338. Section 22(1A) of the VAT Act should include the definition of ‘face value’ which is contained in clause 36 of the Explanatory Memorandum to the Taxation Laws Amendment Bill, 1997, i.e. the net value of the account receivable at the time of transfer, thus after adjustments have been made for debit and credit notes, and bad debts already written off by the transferor.



## **CATEGORY - TAX ADMINISTRATION**

### **Assessments issued in response to discrepancies contained in an IT14SD**

#### Legal nature

339. Assessments made on the basis of discrepancies found in an IT14SD reconciliation is of concern and gives rise to significant practical issues.
340. The TAA does not currently make provision for the IT14SD process, as it is arguably not a return (i.e. not something a self-assessment or liability for tax is based on) nor a record or relevant information (i.e. it is not something held by the taxpayer but created under instruction from SARS) and the manner in which it is applied by SARS officials is inconsistent and to the prejudice of taxpayers, leading to significant disputes that are costly and ineffective.
341. Where a discrepancy appears in the reconciliation in terms of the IT14SD, this does not mean that there is prejudice to the fiscus and the cause of the discrepancies requires a detailed analysis of the underlying reasons.

#### Detailed factual description

342. We submit that it would appear that SARS officials consider discrepancies in the IT14SD reconciliation as a basis for issuing an assessment. In one example, the taxpayer submitted an IT14SD which showed a VAT reconciling item of say R14 000. The SARS official issued a letter of audit findings to the taxpayer indicating that an assessment will be issued for the 'grossed up' income tax amount of R114 000, unless proof of the discrepancy is provided. On the basis that there is no statutory prescribed process governing the IT14SD process, the taxpayer was not given sufficient time to respond and the assessment was issued.
343. The only manner in which the matter could be dealt with was to initiate a dispute process in terms of lodging an objection and subsequently noting an appeal, which was a costly and time consuming process, in circumstances where there was clearly no proper legal basis for the assessment.

#### Nature of business impacted

344. Any taxpayer required to submit an IT14SD.

#### Proposal

345. It is proposed that the TAA is amended to specifically include a legislative provision that will govern the IT14SD process, setting out specific time lines, as well as the duties and obligations of the SARS' officials responsible for this process.



## **Sections 227 - Outstanding returns**

### **Legal Nature**

346. Section 227 of the TAA details the requirements for a valid voluntary disclosure in terms of the Voluntary Disclosure Programme (VDP) and lists only six matters which include that it must be voluntary and involve a default.
347. A “default”, by definition, includes the submission of inaccurate information or non-submission of information, which would include relevant information.
348. A “return”, by definition, in section 1 of the TAA includes any document or information submitted to SARS that incorporates relevant information.

### **Factual Description**

349. When Part B of Chapter 16 was implemented, SARS accepted VDP applications in respect of taxpayers who had failed to submit the relevant returns.
350. However, since that time, SARS has taken a different view and rejected such submissions on the basis that it was either not voluntary (i.e. SARS knew it to be outstanding) or that it was not a default (i.e. was a failure to submit a return and not information).
351. Though it is understandable that SARS does not want to encourage non-compliance, these views do not seem valid in respect of taxpayers who have never registered for tax, such as a foreign branch or a natural person becoming tax resident in South Africa.
352. This may create a position where, for example, taxpayers argue that if they lie on the outstanding return and submit R1, they then qualify for VDP, as opposed to just applying for VDP directly just for it to be rejected and an additional assessment issued with no relief.
353. We acknowledge that the inclusion or exclusion of outstanding returns in the VDP dispensation is a policy matter, but the legal application and the legal uncertainty it creates, especially with the current wording, is a legal and an operational anomaly.

### **Proposal**

354. It is submitted that NT should take a policy position with regard to the eligibility of taxpayers for VDP relief on outstanding returns for both tax registered and unregistered taxpayers and then clarify the law with its intent.

## **Sections 225-233 - Chapter 16 of the TAA - Voluntary Disclosure**

### **Legal Nature**

355. It is often experienced in making voluntary disclosure submissions to SARS that uncertainty exists as to whether or not a person has a particular VAT or other tax liability.



356. In these instances, taxpayers often seek clarity by requesting a ruling from SARS with the view that, if it transpires that a tax liability does exist, that they would make voluntary disclosure of the relevant VAT or other tax exposure to obtain the relief afforded by the VDP in accordance with the VDP provisions contained in Chapter 16 of the TAA.
357. Similarly, where a taxpayer becomes aware of an historic VAT registration liability and wishes to make a voluntary disclosure, he or she cannot do so unless and until being duly registered as a vendor. Although it seems, on the face of it, to be a straight forward process to obtain a ruling in the circumstances or to register as a VAT vendor, whilst remaining eligible for VDP relief, these processes have proved to be tedious and ineffective since neither the VAT Act nor the TAA makes specific provision for such circumstances.
358. Furthermore, Part B of Chapter 16 of the TAA does not make provision for circumstances where the vendor is unable to accurately determine the quantum of the tax liability. Although section 95(3) of the TAA provides that where a taxpayer is unable to submit an accurate return, a senior SARS official may agree in writing with the taxpayer as to the amount of tax chargeable and issue an assessment accordingly, which assessment may not be objected to, this section of the TAA does not seem to find application in the case of a voluntary disclosure made by the vendor.

#### Factual Description

359. In essence, one seems to be dealing with a 'chicken and egg' situation, as it remains unclear whether a taxpayer should first request a ruling or first apply for VDP or do both simultaneously. Either way, there are inherent risks in not obtaining the required relief and therefore not making a voluntary disclosure, which risks further include the following:
- 359.1 If the ruling request is lodged first, and SARS commences an audit or notifies the taxpayer of an audit, pending the outcome of the ruling request, the taxpayer may, in terms of section 226(2) of the TAA, be disqualified from applying for VDP relief;
- 359.2 If SARS rules that a tax liability does exist, SARS may either issue an assessment, or commence an audit or argue that since the taxpayer made full disclosure of the facts in the ruling application, the taxpayer is disqualified from VDP relief since one of the requirements of section 227(a) of the TAA (i.e. the disclosure must be voluntary) can no longer be met; and
- 359.3 Where voluntary disclosure is made first, it can only be done on the assumption that the tax liability actually exists. However, it will be necessary to make disclosure with the proviso that should the SARS ruling (to be requested) proves that no tax liability exists, the VDP application should be considered null and void. In this instance various risks exist, including:
- 359.3.1 SARS may decline the application on the basis that until it has been determined that tax is in fact due, no "understatement" as defined exists;



359.3.2 The ruling request may take extensive time to finalise, with the result that the VDP unit advises that unless the revised VAT returns are filed before a certain date, the VDP application will be turned down;

359.3.3 If the revised returns are filed and the tax is paid, and the SARS ruling is subsequently finalised on the basis that no tax liability existed, an onerous refund process is required, not to mention the negative cash flow suffered by the taxpayer;

359.3.4 In the case of retrospective registration as a vendor, SARS may issue returns for completion before the VDP application has been submitted. Alternatively, SARS may argue that since full disclosure of the tax liability has been made upon application for registration, any subsequent disclosure can no longer be said to be “voluntary”, with the result that the taxpayer is disqualified from the VDP relief.

#### Proposal

360. It is proposed that a new section be introduced in Part B of Chapter 16 of the TAA which makes provision for a VDP application to be lodged, subject to SARS finalising a ruling requested by the vendor or taxpayer within a specified period from the date that the VDP application is lodged.

361. Insofar that retrospective VAT registrations are concerned, it is proposed that the VAT 101 form be amended to provide for the selection of VDP relief in respect of retrospective registrations, to be lodged within a specified period from the date that the VAT registration number has been allocated and communicated to SARS.

362. A provision should be included in the VDP provisions to ensure that the agreement between SARS and the taxpayer in instances where an amount must be agreed to for purposes of finalising the VDP agreement is properly governed.

#### **Sections 240(4) - Suspension pending criminal prosecution**

##### Legal Nature

363. Section 240(4) of the TAA allows a Senior SARS official against whom criminal proceedings have been instituted to not register or suspend registration as a tax practitioner.

364. There is no requirement to notify the relevant Registered Controlling Body (RCB) of such action, which is inherent and critical to an RCB's part of the regulatory framework.

##### Factual Description

365. Where such action happens, the relevant RCB will not be able to respond to enquiries from the member and neither be able to suspend him or her from its list of tax practitioners or from the RCB's tax activities.



### Proposal

366. Section 240(4) of the TAA should be amended to specifically require SARS to notify the relevant RCB wherewith whom the tax practitioner in question is registered of the suspension immediately before it is implemented and immediately after it has been restored.

### **Sections 240(1) and (3) - Registration and deregistration of tax practitioners**

#### Legal Nature

367. Section 240(1) of the TAA empowers SARS to register a tax practitioner but provides no mechanism for them to inform the relevant RCB that the person is registered and what his practitioner is. An RCB requires a member's tax practitioner number in order to submit RCB related member information on members to SARS via SARS' eFiling.

368. Furthermore, there is no prescribed deregistration process or grounds other than listed in section 240(3) of the TAA (i.e. no process for voluntary or non-compliance with RCB requirements as grounds for deregistration) or an obligation on SARS to notify the RCB of the deregistration.

#### Factual Description

369. Section 240(1) of the TAA requires a tax practitioner to be both registered as a member of an RCB and as a tax practitioner with SARS.

370. There is also an obligation on RCBs to communicate such registration as a member for the purposes of tax practitioner reporting to SARS on eFiling and annually to report the compliance of members with chapter 18 (section 240A(3) of the TAA).

371. Furthermore, once a member is non-compliant with the RCB requirements and this is reported to SARS, such person can be deregistered or on application voluntarily so but there is no statutory mechanism for this.

### Proposal

372. Section 240 of the TAA should be amended to prescribe a process for deregistration of RCB members as tax practitioners for all instances where this is required, including voluntary deregistration, and compel SARS to notify the RCB immediately after such deregistration has been effected.

373. A mechanism to report member registrations with SARS as tax practitioners to the RCB immediately thereafter should also be added.



## **Sections 240 & 70(2)(e) - Tax compliance status and process enhancement**

### **Legal Nature**

374. The section 70(2)(e) of the TAA empowers a senior SARS official to disclose such information as may be required by an RCB for the purposes of verifying compliance with section 240A(2) and 240A(3) of the TAA.

375. This would include adherence to the code of ethics and disciplinary code, as well as to enable reporting on the information required by SARS for the relevant RCB report.

376. However, unlike section 70(1), section 70(2) does not specifically refer to both SARS' information and taxpayer information but rather the purpose of the information.

### **Factual Description**

377. Where SARS requests in the report in terms of section 240A(3) of the TAA that the tax practitioner's tax compliance must be indicated, SARS has taken a conservative view on whether section 70(2)(e) of the TAA applies to tax compliance information or SARS' information.

378. This restriction is overly broad, although we acknowledge the challenges SARS would face without a broad interpretation.

379. It also makes it difficult for an RCB to assist SARS in implementing systems or obtaining data on SARS service, etc. to assist SARS in improving services to tax practitioners or performing joint research on such data.

### **Proposal**

380. It is proposed that section 70(2)(e) of the TAA specifically refer to both SARS information and taxpayer information to enable an RCB to efficiently comply.

381. Furthermore, it is proposed that the Commissioner be granted the discretion to determine what SARS or taxpayer information an RCB may obtain that will be used to enhance the effectiveness of Chapter 18, but not required for the purposes of section 240A(2) and (3) of the TAA.



## Annexure B

### 2016 ANNEXURE C SUBMISSION

1. We note that, with a few exceptions, as noted below, most of the proposals made in terms of the SAICA Annexure C submission made on 29 November 2016 were not accepted or implemented by NT.
2. The exceptions, which have been implemented or partially implemented by NT, are the following:
  - 2.1 We requested that the same exclusion rules provided for in paragraph 12A(6)(d) and (e) be inserted and included in the section 19(8) provisions (i.e. companies forming part of the same group and debt reduced in the course of or in anticipation of liquidation, winding-up, deregistration or final termination or existence of that company) so that the tax treatment is identical under both sections. The final legislation that was passed did not adhere to our request, since the group exemption in relation to the waiver of a loan in paragraph 12A of the Eighth Schedule was entirely revoked rather than being extend to section 19.
  - 2.2 The monetary amounts specified in terms of section 10(1)(q) have been amended.
3. We specifically note, in each instance, the current status of the prior year proposals, as set out below, namely “implemented”, “not implemented” or “partially implemented”.

<b>CATEGORY - INCOME TAX: INDIVIDUALS, EMPLOYMENT AND SAVINGS</b>
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**NOT IMPLEMENTED - Section 7B of the Act: Exclusion of thirteenth cheque bonus**

Legal nature

4. The provisions of section 7B of the Act causes the add back of bonus provisions which are in fact accrued but not paid thirteenth cheque provisions of employees who either structure their remuneration packages to include a thirteenth cheque or who are only entitled to a thirteenth cheque but not entitled to any discretionary bonus.
5. The employees are entitled to the amount provided should they leave the employment of the employer before the thirteenth cheque is paid. The reason for this exclusion is not clear.

Detailed factual description

6. Employees, in particular those in the lower employee ranks, are given the opportunity to structure their remuneration packages to include a thirteenth cheque which is usually paid in December of each calendar year.
7. The employees are entitled to the portion of the thirteenth cheque provided for in the event that the employees leave the employment of the employer, however accrual is only on the happening of an event (i.e. termination or reaching the relevant time).



8. The employees most often also elect that the PAYE related to the thirteenth cheque be withheld and paid over to SARS from the other 12 salary/wage payments (i.e. voluntary over deduction).
9. SARS therefore has the benefit of having received the PAYE payments for the amounts to be accrued in future, yet the employer is denied the deduction should its year end not coincide with the month during which the thirteenth cheque is paid to the relevant employees.

#### Nature of business impacted

10. Various employers where the year-end does not coincide with the month during which the thirteenth cheque is paid.

#### Proposal

11. The prohibition on the deduction of payments recorded as bonus payments or thirteenth cheque payments in these circumstances should be removed from section 7B.

#### **NOT IMPLEMENTED - Section 10(1)(q) of the Act: Bursaries awarded to employees and relatives of employees**

#### Legal nature

12. Section 10(1)(q) of the Act provides that no taxable benefit arises when an employer provides a bursary or study loan to assist employees or relatives of employees to study and become skilled.
13. The nil value benefit will only apply should the bursary be provided for the purpose of studying at a recognised educational/research institution, and in the event that assistance is provided to employees, an agreement has to be concluded whereby the employee agrees to refund the employer for the bursary in the event of failing to continue with the studies (for any reason other than death, ill-health or disability).

#### Detailed factual description

14. In terms of section 10(1)(q) the payment of fees directly to an institution does not trigger tax, however, payment to the employee to reimburse for expenses paid to the same institution does create a taxable event.
15. Many employers do not have the resources to manage full bursary schemes or to fund payments upfront to institutions or to manage approval processes in time for registration dates to be met.
16. For many employers, the award of bursaries is an *ad hoc* function and the reimbursement mechanism gives the employer some flexibility in payment options.



17. It is noted that NT has indicated before that they do not favour a reimbursive structure for education. However, given the dire need for education in South Africa, the policy rationale behind this stance is unclear.
18. It is unclear what NT's concerns are as we perceive little in the way of abuse as the payment would be directly associated to a study outcome and this approach merely addresses employer risk.
19. A reimbursement substantially reduces the employers risk in having to manage debt for non-completion which the Department of Higher Education has in its 2016 report on fees indicated can be as high as 60% of first year graduate students.

#### Proposal

20. If the true nature of the payment, in whatever form, is for the purpose of enabling an employee or relative of an employee to study further then the section 10(1)(q) exemption should apply. Section 8 of the Act should therefore be amended to specifically allow for the reimbursement of study fees to be a non-taxable reimbursement. Further the Interpretation Note should therefore be amended to include the other forms of funding.
21. In our view NT should be encouraging employers to fund these studies as it eases the burden on the state in terms of education as well as for future social grants as more individuals will be qualified to earn a liveable wage.

#### **IMPLEMENTED - Section 10(1)(q) of the Act: Increase of monetary amount exemption of bursaries to employees and relatives of employees where person is disabled**

#### Legal nature

22. Section 10(1)(q) further provides that when a bursary or scholarship is provided to the relative of an employee that such benefit will only be exempt from tax in the hands of the employee if the remuneration derived by the employee during the year of assessment does not exceed R400 000, and if the amount awarded does not exceed the R15 000 and R40 000 limits (2017 year of assessment).

#### Detailed factual description

23. The majority of public schools in South Africa do not have the facilities to accommodate children with disabilities, and many of the public schools that do have such facilities can only deal with disabilities that are not severe in nature.
24. When selecting a school, the parents of a severely disabled child are faced with limited options, and will in most cases end up having to enrol their child in a private school. The average annual cost of private schools in South Africa that has the ability to deal with severe disabilities are an estimated R71,049.00 which does not include the costs relating to special transport, dietary requirements or even daily medical support, to name but a few.



25. It is evident that the current limit of R15 000 and R40 000, respectively will never be enough to assist these parents with the high financial burden, and as a result the parents will face additional and unnecessary tax implications on the additional amounts provided by an employer.
26. According to STATSSA 2011 census information persons with disabilities make up 7.5% of the population but it was noted that at primary, secondary and tertiary education levels there was very low attendance.
27. Further, this contributes to what the report concludes is a very low market absorption rate for employment.

#### Nature of business impacted

28. Employees, particularly lower income earners who may benefit from bursaries.

#### Proposal

29. It is suggested that the current limit of R15,000 and R40,000 be reviewed and adjusted to a more favourable amount in special circumstances as detailed above, taking into account all the related expenses to provide education to disabled children in South Africa.
30. This proposal is in line with the current policy on learnership in section 12H which also creates a more favourable rate for disabled learners and it is suggested that this approach be adopted for bursaries to the disabled as well.

#### **NOT IMPLEMENTED-Paragraph 1 of the Fourth Schedule to the Act: Provisional taxpayer includes local employees**

#### Legal nature

31. Paragraph 1 of the Fourth Schedule to the Act defines a “provisional taxpayer” to include any person (other than a company) who derives income by way remuneration from an employer that is not registered in terms of paragraph 15.
32. The definition of “provisional taxpayer” furthermore excludes a natural person who does not derive any income from the carrying on of any business, provided that the taxable income of that natural person derived from interest, dividends, foreign dividends, rental from the letting of fixed property and any remuneration from an employer that is not registered in terms of paragraph 15 does not exceed R30 000 for the relevant year of assessment.

#### Detailed factual description

33. Paragraph 1 of the Fourth Schedule was amended in an attempt to force local employees of foreign based employers that are not registered for pay as you earn (PAYE) in South Africa to register as provisional taxpayers and pay provisional tax on their remuneration.



34. However, it appears that this amendment inadvertently also force local employees to register as provisional taxpayers where their South African based employers are not registered for PAYE. The local employees will therefore need to register and submit provisional returns even if their South African based employers are at fault.
35. This is because the *de minimus* exclusion of R30 000 per annum (definition of “provisional taxpayer” paragraph (dd)(B)(BB)) will not be enough to cater for the annual earnings received from South African based employers whom are at default (i.e. employers not registered for PAYE).
36. This invariably includes, for example, any employee earning over R2 500 per month such as domestic workers whose employers are not registered as there is no need to deduct PAYE.

#### Proposal

37. It is proposed that instead of lumping this category (i.e. remuneration from an employer that is not registered in terms of paragraph 15) together with other categories (i.e. interest, dividends, foreign dividends and rental), it should be in its own category with the focus on foreign based employers that are not registered for PAYE or at least aligned to the PAYE registration requirements in the Fourth Schedule for local employers.

#### **NOT IMPLEMENTED-Paragraph 5(4) of the Seventh Schedule to the Act: Long service awards**

##### Legal nature

38. Paragraph 5(2)(b) of the Seventh Schedule allows for employers to provide long service awards to employees that are non-taxable under certain limited circumstances including the nature of the award, the value of the award and the defined terms for which such an award can be given.
39. The definition of “long service” under paragraph 5(4) states that “long service” means “*an initial unbroken period of service not less than 15 years or any subsequent unbroken period of service of not less than 10 years.*” These periods were based on the old Government employees’ long service awards policy.

##### Detailed factual description

40. There is increasing mobility of employees in the working environment currently and it is rare for employees to remain employed for periods exceeding 15 years; as a result many employers have long service policies that do not align with the preferential tax treatment. Long service awards are also used as an incentive for an employee to stay with the company.
41. The average long service policy of employers provides for long service benefits in intervals of 5 years. This type of structure within a policy means that these employees technically



do not get the benefit of the tax free long service awards. Due to the tax free intervals employers have to gross-up a long service award to cover the tax on behalf of the employee that creates an additional fringe benefit and becomes very costly.

Nature of business impacted

42. Employers and employees that pay and receive long service awards.

Proposal

43. We would therefore suggest that paragraph 5(4) of the Seventh Schedule be amended to allow for long service awards to remain tax free however that the initial period be reduced to 5 years with and thereafter with 5 year intervals.

44. Furthermore, similar to business practice, the value should be incremental which rewards longer periods of service more generously.

45. Lastly, given that the base amount has remained unchanged for quite some time, it is proposed that it also be adjusted.

**NOT IMPLEMENTED-Paragraph 7(4)(a)(ii) in the Seventh Schedule to the Act:**

Legal nature

46. Paragraph 7(4)(a)(ii) of the Seventh Schedule provides for the determination of a taxable fringe benefit to be based on the cost to an employer and the cost of fuel in respect of the right to use an employer provided motor vehicle where the vehicle was obtained by the employer under an operating lease as defined in Section 23A(1) of the Act.

47. The requirement further provides that the transaction of obtaining the motor vehicle in question must have been entered into by unconnected parties transacting at arms' length.

Detailed factual description

48. The requirement that the employer must be transacting with an unconnected person does not remove the prerequisite for a transaction to be at arms' length. There is no definition for an arms' length transaction in the Act, however, the general requirements for a transaction to be viewed as arms' length is as stated below:

*“the concept of an **arm's length transaction** is to ensure that both parties in the deal are acting in their own self-interest and are not subject to any pressure or **duress** from the other party”*

49. While businesses within a Group of Companies are seen as connected persons, many of these businesses act independently of each other.



50. With specific reference to an operating lease transaction in relation to a company owned motor vehicle within a Group of Companies; one business owns the vehicle, while the other contractually leases the vehicle for the provision of the vehicle to latter's employees.
51. This may be a transaction between connected persons as defined, however, the transaction can be seen as an arms' length transaction where done on the same or similar conditions as to other clients. The cost of this lease transaction is aligned with that between same company and other unconnected clients.
52. Similarly to an arms' length transaction, where two parties enter into an agreement, one party provides a service/product while the other compensates for the service/product obtained. In this regard, both parties fulfil self-interest in their own right.

#### Nature of business impacted

53. All businesses under a leasing agreement that may be viewed as an operating lease agreement that are connected persons.

#### Proposal

54. We propose that the requirement for the parties entering into an operating lease agreement in relation to a vehicle to be connected persons be removed from paragraph 7(4)(a)(ii) of the Seventh Schedule as Operating leases in their nature do not require connected persons. New proposal
55. Furthermore, the arm's length transaction requirement is sufficient given that a comparative can easily be done by SARS for commercial operating leases as seen in section 31. We further propose that the arm's length provision be in accordance to section 31 to ensure that the risk of non-compliance be mitigated.

#### **NOT IMPLEMENTED-Paragraph 10(2)(b) of the Seventh Schedule to the Act: Transport of employees**

##### Legal nature

56. Paragraph 10(2)(b) of the Seventh Schedule to the Act provides for a nil value benefit where an employer provides transport for his employees from "home" to their place of employment or vice versa.

##### Detailed factual description

57. We have been made aware of a number of queries being raised by SARS on the interpretation of "home" and claiming that should the employees not be delivered "home" then the NIL value will not apply.
58. In circumstances where an employer delivers/collects his employees from a designated point, such as a Gautrain, Metro train or bus station or a main taxi rank or even from a



designated point at a fuel station for example, this provision should apply to retain the value of the benefit in these cases as NIL.

59. In our view there is no policy rationale to distinguish between transport to physical home or to a destination that is on the path home.
60. In our view the distinction that SARS is trying to make discourages employers implementing such services to employees which in turn impacts negatively on their use of public transport.
61. In our view this does not undermine NTs policy with the current provision but rather limits uncertainty of practical implementation where a “front door” drop off service is not viable due to all the staff being accommodated.

#### Proposal

62. We propose that paragraph 10(2)(b) be amended to refer to a “including a designated point between” as opposed to just “home” to encourage the use of public transport options with the employer thereby merely providing support to the existing infrastructure.

#### **NOT IMPLEMENTED-Restriction of remuneration for purposes of UIF and SDL**

#### Legal nature

63. The definitions of remuneration for purposes of unemployment insurance contributions and skills development levies are linked to the definition in the Fourth Schedule to the Act. Furthermore, the definition of remuneration in the Unemployment Insurance Contribution Act and Skills Development Levies Act excludes certain amounts, such as a lump sum from retirement funds and amounts paid by the employer upon termination of employment by the employee for purpose of determining the liability for skills development levy and unemployment insurance contributions.

#### Detailed factual description

64. Certain lump sum payments such as share gains (including BEE share gains) paid to employees during the year of assessment which creates an inflated liability for the employer.
65. These amounts do not occur every year, such as lump sum from retirement funds and amounts paid by the employer upon termination of the employment by the employee.

#### Nature of business impacted

66. Employers and employees that pay and receive lump sums.

#### Proposal

67. We propose that any lump sum amount, such as share gains payments, must be excluded in calculation of the monthly liability for the employer as they inflate the monthly liability of



the employer. This amendment will be aligned with the current treatment which does not include other lump sum payments.

## **CATEGORY – DOMESTIC BUSINESS TAXES**

### **NOT IMPLEMENTED-Section 23L(3)(a) of the Act: Short term policies with investment components**

#### **Legal nature**

68. Section 23L(3) does not cater for taxpayers who were conservative in their treatment of premiums on short-term policies with an investment component prior to the introduction of section 23L.

#### **Factual nature**

69. If a taxpayer receives a policy benefit after 1 April 2014 in circumstances in which the taxpayer did not claim a deduction of such premiums in terms of the general deduction formula prior to 1 April 2014, then on a strict reading of section 23L(3)(a), the taxpayer may not subtract such premiums in determining the amount to be included in gross income in terms of the policy benefit.

70. This is because, since section 23L(2) only came into effect on 1 April 2014, premiums incurred prior to this date that were not deducted, were not non-deductible 'in terms of subsection (2)'.

#### **Nature of business impacted**

71. This issue affects taxpayers in any industry with a short-term policy where the policy premiums (or part of such premiums) were or are not deductible.

#### **Proposal**

72. Subsection (3)(a) should be amended to simply read 'the aggregate amount of premiums incurred in terms of that policy that were not deductible'.

### **NOT IMPLEMENTED-Sections 23(c) and 23L: The interaction between the two**

#### **Legal nature**

73. Section 23(c) disallows a loss or expense to the extent that it is recoverable under any contract of insurance, guarantee, security or indemnity. It is important to note that section 23L and in particular 23L(3), relates to all short-term policies, not merely those with an 'investment' element.

#### **Factual nature**

74. The interaction between these two sections is unclear as can be seen from the following example:



*X Co pays short-term premiums of R5m which are all deductible in terms of IFRS.*

*X Co incurs a loss of R9m which is recoverable to the extent of R8m in terms of the policy and receives a payment of R8m from the insurer to cover this loss.*

*Section 23L(3) contains what is in essence a claw-back provision relating to premiums which were previously deductible. In terms of the above facts, there would be an inclusion in gross income of R8 million as a result of the application of section 23L(3). However, section 23(c) has the effect that the loss of R9m is not deductible to the extent recoverable under the policy (and here once again the R8 million is taken into account). In other words, only R1m would be deductible in terms of section 23(c). The overall result is an inclusion of R8m in gross income and a deduction of R1m, which does not make commercial sense.*

75. Prior to the enactment of section 23L, the treatment of payouts in terms of risk-only short term policies (i.e. those without an investment component) in terms of section 23(c) combined with the general deduction formula and core gross income principles made commercial sense.

76. A full deduction of the premiums was obtained and you could claim 'excess' losses i.e. to the extent that these were not recoverable. The inclusion of risk-only policies in the scope of section 23L leads to anomalies such as highlighted above.

#### Nature of business impacted

77. This issue affects taxpayers incurring premiums in respect of risk-only short-term policies in any industry.

#### Proposal

78. Clarification of the interaction between section 23L and 23(c).

### **NOT IMPLEMENTED- Section 23M of the Act: Controlling relationship**

#### Legal nature

79. **Section 23M** contains a threshold of "at least 50% of equity shares or voting rights" for purposes of determining whether or not a controlling relationship exists between a debtor and creditor in assessing the application of section 23M. This remains a serious concern for institutional investors (including retirement funds and long-term insurers) who provide capital for development impact and infrastructure projects through 50:50 joint ventures with project managers or government; namely where there is no majority control. It has always been understood that section 23M seeks to capture a scenario where the creditor and debtor form a single economic unit; namely where a majority shareholder exists. The establishment of the threshold of at least 50% is a deviation from the majority shareholding intention underlying section 23M.



#### Factual nature

80. There is a limitation of interest deductions where the borrower has obtained funding from untaxed lenders who are in a “controlling relationship” with the borrower. It is proposed that the threshold should be more than 50% as opposed to at least 50% as this would denote control.

#### Nature of business impacted

81. This section is applicable to situations where funding is provided by untaxed entities to:

- infrastructure funds and project SPVs (set up in partnership with governments to meet infrastructure development needs),
- development impact funds that invest to address shortages in affordable housing and the provision of quality schooling in support of government’s strategy.

#### Proposal

82. The definition of controlling relationship should refer to a beneficial holding of more than 50% of the equity shares.

83. In addition it should be clarified that the term “holds” refers to beneficial and not legal ownership.

#### **NOT IMPLEMENTED- Sections 23N and 24O of the Act**

#### Legal nature

84. Uncertainty as to whether section 23N of the Act applies where shares in an entity which receives/accrues rental income from its operations.

#### Detailed factual description

85. For all interest incurred on or after 1 January 2015, the Act provides for a limitation on the amount of interest which can be deducted on debt finance sourced for the purpose of, amongst others, an “acquisition transaction”, as defined.

86. A listed commercial property company, which is listed as a REIT, (the REIT) acquires shares in an unlisted commercial property group of companies (the unlisted group) which receives/accrues rental income from the unlisted group’s operations. The key consideration here is whether the acquisition by the REIT of the shares in the unlisted group will amount to an “acquisition transaction”.

87. The interest limitation provision references the definition of an acquisition transaction as per section 24O of the Act. In essence the definition of an acquisition transaction relates to the acquisition of equity shares in an “operating company”, or a “controlling group company” (both defined) in respect of an operating company. The Act goes on to define an operating company as a company which derives at least 80% of its income (receipts and



accruals) from a business carried on continuously and in the course or furtherance of providing goods or services (our emphasis).

88. With reference to the property investment industry, there is no definition in the Act or guidance, for income tax purposes, as to whether renting of commercial property amounts to providing service, (it is clear that no good is provided - only the use of the commercial property space, not the property itself, is provided).
89. There is a definition of services in the VAT Act which specifically includes the “granting of ... or making available any facility...” . The fact that the Legislature had to specifically include the rental of any facility in this definition, indicates that it does not believe the rental of property to fall within the general definition of a service.
90. Although proposed to be removed from the Act, the current legislation regarding service fee withholdings tax does provide a definition of service fees, however, it only refers to fees in respect of technical, managerial and consulting services, i.e. it is evident that the rental of property would not be included.
91. Based on the above, there is some uncertainty as to whether the acquisition, by the REIT, of the equity shares in the unlisted group will fall within section 24O of the Act, as it is not clear if these entities would qualify as operating companies, as defined, which is required for an “acquisition transaction” per section 24O of the Act.
92. If it does not meet the criteria of an “acquisition transaction”, the interest limitation provision of section 23N of the Act should not apply.
93. The history of the property investment industry is to distribute all rental income through the group, which was confirmed (for the listed entities at least) with the introduction of the REIT tax legislation from 1 April 2013.
94. It is not evident as to why a property investment company/group would seek to obtain a significant interest deduction in respect of the acquisition of another property investment company/group, as all cash profits are distributed through the group and the end investor is taxed on the profits in their hands.

#### Nature of business impacted

95. Property investment companies/groups, specifically REITs.

#### Proposal

96. It is recommended that in clarifying the above property investment companies, specifically listed REITs, are excluded from the anti-avoidance provisions of section 23N of the Act.



**NOT IMPLEMENTED- Amendment to Section 8F in the Draft Taxation Laws Amendment Bill, 2016**



### Legal nature

97. The amendment to section 8F as reflected in the Taxation Laws Amendment Bill, 17 of 2016 (“TLAB”) released on 26 October 2016 has gone beyond what was discussed at the NT feedback session on the Draft TLAB released earlier in 2016.
98. It in fact appears to effectively eliminate from section 8F any debt instrument, the repayment of which (and/or interest thereon) is conditional upon the solvency of the issuer.

### Detailed factual description

99. Section 8F was introduced as a measure to curb the deduction of interest on an instrument that was perceived to have equity like characteristics (as explained in the Explanatory Memorandum to the 2013 Taxation Laws Amendment Bill, 2013). The result was that the return on such instruments should rather constitute a dividend in line with the characteristics of the instrument.
100. The following is an extract from the 2013 Explanatory Memorandum –

#### **II. Reasons for change**

*When determining the debt versus equity character of an instrument, it is widely believed that most of the tax law follows form. This focus on form seemingly provides taxpayers with the freedom to choose a label for an instrument with consequential tax benefits without regard to (economic) substance. This freedom poses a risk to the fiscus because certain taxpayers consistently choose a combination of features that bring about unintended tax benefits. The key driver for this form of tax planning is the issuer’s desire to obtain an interest deduction for payment to financiers (as opposed to non-deductible payments of dividends).*

*When making payments to exempt persons, taxpayers have even a greater tendency to classify share-type instruments as debt in order to obtain an interest deduction, knowing that the recipient is exempt. In this instance, the debt label is commercially neutral for the taxpayer, but the result is negative for the fiscus because there is no matching of deductions with income inclusions.*

*While anti-avoidance rules exist as outlined above for debt conversions, artificial classifications go beyond the use of mere conversion features. For instance, an instrument lacking a maturity date for repayment is a strongly questionable form of debt. Moreover, even the conversion focus presently existing within the hybrid debt rules is too narrow – being limited to a three-year period.*

#### **III. Proposal**



*In order to reduce the scope for the creation of equity that is artificially disguised as debt, a two-fold regime is proposed for domestic company issuers. One set of rules focuses on features relating to the nature of the instrument itself (i.e. the corpus); the second set of rules focuses on the nature of the yield. In making these rules, it is understood that the features distinguishing debt from equity are varied and are often contextual. Nonetheless, the proposal takes aim at companies that issue stated debt instruments so as to artificially generate interest deductions if clear-cut equity features exist when viewed in isolation.*

*In terms of the anti-avoidance rules relating to the instrument (i.e. the corpus), the proposal focuses on debt-labelled instruments that (i) have features that enable a conversion into shares whose market value is less than the amount of the outstanding debt; (ii) have a yield based on the solvency of the issuer or (iii) have features indicating that redemption is unlikely within a reasonable period where a debt instrument exists between connected persons. These features will be tested on a continuous basis (i.e. not once off at the date of issue but at any time thereafter).*

101. As part of the submissions to NT made for the purposes of current year amendments to the legislation and in particular, section 8F, it was noted that section 8F prejudiced a “group of companies” in circumstances where a holding company subordinated its loan(s) to its subsidiary.
102. The basis for this contention was that in circumstances where the subsidiary was unable to pay interest on the loan as a result of the market value of its assets being less than the market value of its liabilities with the result that the loan fell within the ambit of section 8F, it resulted in the company potentially being liable to income tax as a result of it no longer having an income tax deduction.
103. This was accepted by NT and an exclusion from the provisions of section 8F was introduced in the 2016 DTLAB for this situation.
104. At the NT feedback session on the 2016 DTLAB, it was noted that this exclusion was too limited and that it should be extended to connected parties.
105. This was accepted by NT at this meeting. A further point was made that it was not practical for an issuer to make this determination at each payment date and that provided that the auditor certified that the payment was subordinated this should suffice to fall within the ambit of section 8F. This too was accepted by NT.
106. The 2016 TLAB recently released now goes beyond what was agreed at the aforementioned NT feedback session.
107. Whereas previously (as per the 2016 DTLAB), if the features of the debt instrument were that its repayment was subject to the market value of the assets of



the issuer exceeding the market value of the liabilities (“solvency”) of the issuer, it fell within the ambit of the definition of “hybrid debt instrument” in section 8F.

108. It then may or may not have fallen within the ambit of the proviso introduced in the 2016 DTLAB and thus may have been excluded from the definition if the instrument were between a group of companies as contemplated in the proviso.

109. Paragraph (b) of the definition of “hybrid debt instrument” now provides that it meets the definition of “hybrid debt instrument” only when the payment of any amount under that instrument has been (past tense) deferred by reason of insolvency. In other words, notwithstanding that the payment of any amount under the instrument is conditional upon the solvency of the issuer, it will only constitute a “hybrid debt instrument” when the payment of any such amount is actually deferred, even though these terms are embedded in the instrument and therefore exists at the outset.

110. Payment of such amount must also be deferred as opposed to lost or written off. Consequently, if an amount is written off, as opposed to merely deferred, it then does not constitute a “hybrid equity instrument”.

111. Should this situation indeed arise, the instrument is then in any event excluded from the definition of “hybrid debt instrument” if an auditor certifies that the amount has been so deferred as a result of the solvency requirement. This exclusion is applicable regardless of whether the instrument is issued between a group of companies, as in the 2016 DTLAB, or connected persons as agreed and accepted by NT at the 2016 DTLAB feedback session – in other words, any instrument whereby the payment of interest is deferred in terms of a solvency requirement is then excluded from the ambit of section 8F of the Act.

112. Since the certification by an auditor of a situation whereby payment of an amount by an issuer has been deferred as a result of it being technically insolvent is inevitable, it would seem that paragraph (b) of the definition of “hybrid debt instrument” is now entirely superfluous.

113. It results in a specific inclusion with a subsequent exclusion of the exact and only inclusion.

114. Consequently, it would seem that no instrument that contains a feature whereby its repayment is subject to the solvency of the issuer will ever (on the assumption that an auditor certifies appropriately) constitute a “hybrid equity instrument”.

#### Nature of business impacted

115. Company issuers and holders of debt with hybrid characteristics.



### Proposal

116. We would have anticipated that in order to be consistent with the NT feedback referred to above that:
117. The inclusion should apply to an instrument in terms of which the payment of all amounts of interest and/or capital are subject to the solvency of the issuer, regardless of whether the issuer is required to defer or is prohibited from paying any amount owing in respect thereof. In this regard, we would have anticipated that it is the terms of the instrument that constitute avoidance as opposed to whether these terms are in fact imposed;
118. The exclusion should surely apply to connected persons only as opposed to all instruments regardless of whether they are connected.
119. We are therefore unsure of what NT intended with the final amendment to the 2016 TLAB.

### **NOT IMPLEMENTED Section 9C in relation to foreign shares and funds**

#### Legal nature

120. The safe harbour provided by section 9C of the Act only applies in respect of equity shares held in South African resident and dual-listed companies and portfolios in local collective investment schemes in securities or hedge fund collective investment schemes.
121. Thus, while South African tax residents are taxed on their world-wide income, which includes proceeds from foreign shares and foreign fund investments, these shares and investments do not enjoy section 9C protection.
122. We submit that, given that South African tax residents are taxed on their world-wide income, section 9C protection should cover both their local and foreign shares and fund investments.

#### Nature of business impacted

123. South African taxpayers holding foreign funds are impacted, in that they do not enjoy the section 9C safe harbour that South African taxpayers invested in local shares enjoy.

### Proposal

124. We submit that the definition of “equity share” in section 9C(1) of the Act should be extended to include shares in non-resident companies and portfolios in foreign funds that are akin to collective investment schemes.



### **NOT IMPLEMENTED-Section 12N of the Act**

#### **Legal nature**

125. Generally, taxpayers are only entitled to claim capital allowances in respect of assets owned by the taxpayer. However, Section 12N of the Act deems qualifying taxpayers to be the owner of the relevant improvements for the purposes of sections 11D, 12B, 12C, 12D, 12F, 12I, 12S, 13, 13*bis*, 13*ter*, 13*quat*, 13*quin*, 13*sex* and the Eighth Schedule to the Act.

126. In order to qualify for the relief provided under section 12N, a taxpayer must meet all four of the following requirements:

- a) hold a right of use or occupation of land or a building; and
- b) effect an improvement on the land or to the building in terms of:
  - a Public Private Partnership (PPP);
  - an agreement in terms of which the right of use or occupation is granted, if the land or buildings is owned by-
    - the government of South Africa in the national, provincial or local sphere; or
    - certain tax exempt entities; or
  - the Independent Power Producer Procurement Programme administered by the Department of Energy; and
- c) incur expenditure to effect the improvement contemplated above; and
- d) use or occupy the land or building for the production of income or derives income from the land or building.

127. However, by virtue of the application of section 12N(3) the relief provided in terms of section 12N is **not** available to taxpayers, which:

- a) carry on any banking, financial services or insurance business; or
- b) enters into agreements whereby the right of use or occupation of the land or building is granted to another person, unless:
  - that other person is a member of the same group of companies as the taxpayer;



- the cost of maintaining the land or building and of carrying out repairs thereto required in consequence of normal wear and tear is borne by the taxpayer; and
- subject to any claim that the taxpayer may have against that other person by reason of the other person's failure to take proper care of the land or building, the risk of destruction or loss or other disadvantage to the land or building is not assumed by that other person.

128. The limitation imposed by section 12N(3)(b)(i) is unnecessarily restrictive and not in accordance with the stated objective for the introduction of section 12N into the Act, being the removal of the effective prohibition of depreciation allowances in respect of improvements undertaken by lessees of government-owned property.<sup>1</sup>

129. This is demonstrated in the example below.

*Detailed factual description of the relevant transaction / nature of the business impacted by the problem*

130. A taxpayer enters into a PPP, in terms of which it is obliged to operate and improve an airport or port facility. In terms of the PPP, only a relatively small portion of the facility will be used by the taxpayer for terminal operator activities, whilst the remainder of the facility is to be improved in order to be let to third party vendors (including to large retailers).

131. Notwithstanding the fact that the general requirements of section 12N will be met, i.e. the taxpayer will:

- hold a right of use of the facility (i.e. of land and buildings);
- effect improvements to the facility in terms of a PPP;
- bear the cost of the expenditure so incurred; and
- use the facility for the production of income (e.g. rental from sub-leases and tariffs in respect of the terminal services provided by the taxpayer),

the taxpayer will be precluded from benefitting from the relief provided in section 12N, because it will sub-let a portion of the facility to third party vendors.

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<sup>1</sup> Clause 4.7 of the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010



132. In addition, because the taxpayer is not the owner of the relevant building, it will also not qualify for the capital allowances provided for in sections 12F and 13quin of the Act.

#### Proposal

133. As stated above, the limitation imposed by section 12N(3)(b)(i) of the Act is unnecessarily restrictive and not in accordance with the stated objective for the introduction of section 12N into the Act, being the removal of the effective prohibition of depreciation allowances in respect of improvements undertaken by lessees of government-owned property.

134. Consequently, it is proposed that this limitation be removed.

#### **PARTIALLY IMPLEMENTED BUT NOT IN LINE WITH OUR PROPOSAL-Alignment of debt reduction provisions for a group of companies**

#### Legal nature

135. Section 19 and para 12A of the Eighth Schedule to the Act deal with debt reduction provisions. The exclusion provisions in section 19(8) and paragraph 12A(6) differ despite the fact that section 19 and paragraph 12A both address the tax provisions on a loan waiver – the differentiating factor being that section 19 addresses income tax and paragraph 12A capital gains tax consequences.

136. Paragraph 12A(6) includes two additional exclusions in sub-paragraph (d) and (e) that are absent from section 19(8), which determine that the debt reduction provisions in paragraph 12A should not apply to debt owed by a person—

*(d) to another person where that person and that other person are companies that form part of the same group of companies as defined in section 41, unless, as part of any transaction, operation or scheme entered into to avoid any tax imposed by this Act (i) that debt (or any debt issued in substitution for that debt) was acquired directly or indirectly from a person who does not form part of that group of companies; or (ii) that company or that other company became part of that group of companies after that debt (or any debt issued in substitution for that debt) arose; or(e)*

*(e) that is a company, where (i) that debt is reduced in the course, or in anticipation, of the liquidation, winding up, deregistration or final termination of the existence of that company; and (ii) the person to whom the debt is owed is a connected person in relation to that company, to the extent that reduction amount in respect of that debt does not, at the time that the debt is reduced, exceed the amount of expenditure contemplated in paragraph 20 incurred in respect of that debt by the connected person. Provisos in (aa) and (bb) also..... Provided that this sub item must not apply—*



#### Factual description of the relevant transaction

137. Section 19 of the Act addresses the income tax consequences of a loan waiver, while paragraph 12A of the Eighth Schedule deals with the capital gains tax implications thereof. No adverse tax consequences will arise on the waiver of debt between companies that form part of the same group of companies or companies that are placed in liquidation / deregistration to the extent that the borrowed funds were used to directly or indirectly fund capital expenditure in terms of paragraph 12A(6)(d) and (e) above.

138. The exclusion of these provisions from section 19(8) results in adverse tax consequences for group companies and companies placed in liquidation or deregistration to the extent that the borrowed funds were used to fund revenue or operating expenditure. Therefore, debt reductions for companies that used their borrowed funds for capital expenditure in a group company or liquidation or deregistration context are in a better position than those in the same position but where funds were used for revenue purposes.

#### Nature of the businesses impacted

139. The exclusion of paragraph 12A(6)(d) and (e) provisions from section 19(8) has a direct financial impact and adverse tax consequences for group companies and companies that are in liquidation and/or deregistration where the borrowed funds were used for revenue or operating expenditure.

#### Proposal

140. It is recommended that the same exclusion rules provided for in paragraph 12A(6)(d) and (e) be inserted and included in the section 19(8) provisions (i.e. companies forming part of the same group and debt reduced in the course of or in anticipation of liquidation, winding-up, deregistration or final termination or existence of that company) so that the tax treatment is identical under both sections.

### **NOT IMPLEMENTED-Section 42(5)(b) of the Act: Gross income inclusion of proceeds as an anti-avoidance rule in respect of asset-for-share transactions**

#### Legal nature

141. The anti-avoidance provision in section 42(5)(b) of the Act is amended by seeking to include in gross income the proceeds received by a seller of equity shares who acquired such equity shares under an asset-for-share transaction and disposes of such equity shares within 18 months of acquisition, to the extent that the proceeds is less than or equal to the market value of such equity shares at the beginning of such 18 month period.

142. In the current legislation, the anti-avoidance provision in this regard is given effect to by deeming the equity shares disposed of to be trading stock.



Factual nature

143. The deemed treatment of the equity shares as trading stock still allowed for a trading stock deduction resulting in the margin being subject to income tax as opposed to capital gains tax.

144. The proposed amendment results in the removal of the trading stock deduction rendering the entire proceeds to be taxed without any allowable trading stock deduction.

Nature of business impacted

145. 100% taxation of the deemed proceeds upon disposal without any allowable deduction.

Proposal

146. This seems an unintended consequence and propose that a similar allowable deduction against the deemed proceeds should be inserted.

**NOT IMPLEMENTED-Section 64M - Dividends Tax refunds**

147. Section 64L of the Act, which deals with refunds from a company which withheld Dividends Tax, provides for an amount that can be claimed by a company from the Commissioner in respect of a refund.

148. However, a similar provision is not found in section 64M, pertaining to regulated intermediaries, which merely indicates that amounts that are refundable must be refunded from an amount of Dividends Tax withheld by the regulated intermediary going forward. The payment of a refund of Dividends Tax to a client is problematic, as the Act clearly indicates that such amount is payable. It does not indicate that the amount is only payable to the extent that the regulated intermediary has received a refund from the Commissioner.

149. Although probably not foreseen by the legislation in this regard, it can create a problem for a regulated intermediary if the amount of the refund to the client involved exceeds Dividends Tax payable to the Commissioner in the respective month or even the expected Dividends Tax payments for the near future. In such instance the Commissioner currently applies a practice where said refund can be claimed from the Commissioner, but the process involved in transferring the amount from the regulated intermediary's Dividends Tax account at SARS to its Assessed Tax account from which it is then refunded causes undue delays.

150. Instances have occurred where the process could take as long as four months.

Factual description of the relevant transaction

151. Refer above.



### Nature of businesses impacted

152. All beneficial owners entitled to a dividend, who do not claim an exemption or reduced rate in terms of an applicable Double Taxation Agreement, together with all regulated intermediaries and companies.

### Proposal

Firstly, it is proposed that section 64M be amended to the effect that a regulated intermediary can also claim a refund from the Commissioner in instances where the Dividends Tax refund exceeds the next Dividends Tax payment due to the Commissioner.

## **CATEGORY – VALUED ADDED TAX & CUSTOMS**

### **NOT IMPLEMENTED-Definition of “enterprise” and secondment of staff to SA – creation of a VAT enterprise for foreign entities**

#### Legal nature

153. Paragraph (a) of the definition of ‘enterprise’ means in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club.

#### Detailed factual description

154. SARS has ruled previously on specific cases that a non-resident entity will be required to register for VAT in SA where it secondments employees to South Africa (‘SA’) for a consideration which exceeds R 1 million. For example: a non-resident entity secondments an employee to a group entity in SA over a fixed term. Despite the employee reporting directly to the SA group entity whilst on secondment in SA, the employee remains legally employed by the non-resident home entity. The non-resident home entity pays the salary costs of the employee and will recover the cost from the SA group entity.

155. Based on specific facts and circumstances, arguments have been put forward in the past that specific foreign suppliers need not register for VAT if inter alia, such activity was the only activity that was performed in SA.

156. In this regard, reference was drawn to SARS’ VAT News 37 dated February 2011 wherein SARS stated that where a non-resident receives royalties, franchise or agency fees from SA, conducts no other activities in SA and does not have a physical presence or fixed place of business in SA, SARS would not insist on the non-resident business having to register for VAT in SA. Although the IP is used in SA by the customer, the income



derived by the non-resident is considered to be passive in nature (i.e. no activity was performed by the non-resident in SA to earn such revenue).

157. In addition, we submit that the above registrations would only result in an additional administrative burden for the non-resident entity with no increase of the VAT collections in SA (this was to the extent where the SA entity is a fully taxable entity and could claim all its input tax deductions). If SARS had to register the non-resident companies as VAT vendors, this interpretation would not result in a net increase in VAT collections i.e. (the foreign supplier would be required to charge VAT, the customer being VAT registered would claim VAT, the resultant net effect is zero and same as the position where no VAT is charged at all). Further, SARS issued a Binding Private Ruling (BPR) 085 dated 27 May 2010 which examined the substance of an agreement over the form of an employment contract and regarded the SA company as the employer of the assigned employees for the purpose of the Double Tax Agreement with the relevant non-resident countries. BPR085 did not specifically deal with the VAT implications of the foreign company's assignment of employees to SA however the fact that the foreign company was not required to withhold tax in SA, in our view supported the view that such non-resident companies did not conduct an enterprise in SA by virtue of the staff seconded to SA.

158. We recommend that SARS considers the practical applications of applying the enterprise definition to the specific cases and circumstances as set out above. SARS should also consider providing written guidance to obtain clarity on the above subject matter.

159. Under rule 21(1), it is currently required that the parties agree to a recommendation at the commencement of the ADR process.

160. On the basis of the potentially adverse consequences of requiring a facilitator recommendation, the rules should be amended to the effect that the parties must agree to a recommendation within a reasonable period after the conclusion of the ADR proceedings. A specific time frame may be written into the rules for this.

#### *The nature of the businesses impacted*

161. All non-resident entities who second employees to group entities in SA.

#### *Proposal*

162. The rules should possibly clarify what the consequences are for a cost order if a recommendation is agreed on and if no recommendation is agreed on, having due regard to the possibility that the recommendation may be in favour of a party on one matter but unfavourable on another.

163. The rules should also clarify the position in relation to a partial recommendation agreed on, for example, a request for a recommendation only on specific issues in dispute.



## **NOT IMPLEMENTED-Adjustment of imported services**

### **Legal nature**

164. 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.
165. 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 previous declared value, if the nature or value of the offshore expense changed.
166. Currently 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 imply the inverse of the apportion methodology as envisaged in section 17(1) of the VAT Act.

### **Detailed factual description**

#### **Scenario 1**

167. Vendors making exempt supplies accounts 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. The 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.
168. We recommend that a specific section to be inserted to allow for such an adjustment.

#### **Scenario 2**

169. 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.
170. 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.
171. Currently there are no provisions allowing a vendor to make the necessary adjustment.



172. We recommend that a specific section to be inserted to allow for such an adjustment.

The nature of the businesses impacted

173. All purchasers (VAT vendors and any other person) that procures services offshore.

Proposal

174. We recommend that a specific section to be inserted to allow for such an adjustment.

**NOT IMPLEMENTED-Section 1(1) definition of “input tax”**

Legal nature

175. “Input tax” essentially means VAT charged under section 7 and payable in terms of that section by a supplier on the supply of goods or services made by the supplier to the vendor, or the vendor on importation of goods by that vendor, where the goods or services concerned are *acquired* by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies.

176. The meaning of the word “acquire” in this context is not clear, particularly with regard to the importation of goods into South Africa. In some instances the word “acquire” is construed to mean legal ownership and that the vendor must be the legal titleholder to the goods when they are imported for the section 7(1)(b) VAT to qualify as input tax.

Detailed factual description

177. A South Africa manufacturer enters into an agreement with a foreign supplier for the manufacturing and installation of a plant. The plant is manufactured outside South Africa and is then imported into South Africa on a DAP incoterm, delivery at the premises of the South African manufacturer. The South African manufacturer is liable for the clearing of the plant upon importation and is also liable for the payment of the import VAT in terms of section 7(1)(b). Risk in relation to the plant passes to the SA manufacturer upon delivery thereof at its premises, and ownership will only pass upon commissioning of the plant. The South African manufacturer is therefore not the legal titleholder of the plant at the time of importation, but it imports it for the purpose of making taxable supplies.

178. Similarly, an airline may acquire an aircraft in terms of an instalment credit agreement from a foreign supplier. The airline is liable for the payment of the import VAT upon importation in terms of section 7(1)(b), but it is not the legal titleholder of the aircraft upon importation. It imports the aircraft for the purpose of making taxable supplies.

179. We recommend that, in order to provide clarity in this regard, the definition of “input tax” with regard to the qualification contained in that definition be amended to read as follows:

*where the goods or services concerned are acquired or imported by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies or, where the goods or services are acquired or imported by the vendor partly for such*



*purpose, to the extent (as determined in accordance with the provisions of section 17) that the goods or services are acquired or imported by the vendor for such purpose.*

Nature of business impacted

180. All vendors that import goods into South Africa for the purpose of their taxable enterprise activities but who do not hold legal title to the goods at the time of importation.

**NOT IMPLEMENTED-Section 2(1)(k) of the VAT Act**

Legal nature

181. Section 2(1)(k) refers to the buying and selling of any derivative or the granting of an option.

Detailed factual description

182. Not all derivatives are traded. Certain derivatives such as swaps comprise a contract between two parties and are not traded on an exchange or over the counter, and are therefore not bought and sold. Section 2(1)(k) should therefore be amended to also include the *issue* or *provision* of a derivative.

The nature of the businesses impacted

183. All vendors who enter into derivative contracts.

**NOT IMPLEMENTED-Section 8(13) of the VAT Act – define the term “bet”**

Legal nature

184. Section 8(13) of the VAT Act provides that where any person bets an amount on the outcome of a race or on any other event or occurrence, the person with whom the bet is placed shall be deemed to supply a service to such first-mentioned person. (My emphasis).

Detailed factual description

185. The word “bet” is described in the Oxford Dictionary as meaning “risk a sum of money or other valued item against someone else’s on the basis of the outcome of an unpredictable event, such as a race or game”. Interpretation Note 84 (IN84) makes reference to other competitions and the National Lottery. It is thus not clear that amounts paid to enter a competition are indeed included in the provisions of section 8(13).

Nature of business impacted

186. All vendors who have competitions against payment of a fee for entering same.

Proposal

187. We recommend that the section 8(13) of the VAT Act be amended to specifically include competitions, so as to provide clarity and to provide substance to IN84.



**NOT IMPLEMENTED-Section 10(4) of the VAT Act – value of supplies between connected persons**

**Legal nature**

188. Section 10(4) of the VAT Act provides that the value of a supply between connected persons is equal to the open market value where the supply is made for no consideration, or for a consideration which is less than the open market value, and the recipient would not have been entitled to a deduction of the full amount of tax if the open market value was paid.

**Detailed factual description**

189. We are of the opinion that section 10(4) of the VAT Act can also find application in instances where zero-rated supplies are made by a vendor to a connected person who is not a resident of the Republic.

190. If section 10(4) indeed finds application, the consideration in money for the supply shall be deemed to be the open market value of the supply which could differ from the actual amount paid between the connected persons for the supply. Depending on the relevant zero-rated section applicable to the supply, difficulty will be experienced by the vendor to obtain and retain sufficient documentary proof to substantiate the application of the zero-rate if the amounts disclosed on the said documents as actual payment differ from the open market value.

**Nature of businesses impacted**

191. All vendors who make zero-rated supplies to connected persons.

**Proposal**

192. We recommend that section 10(4) of the VAT Act be amended to clarify that the said section is only applicable to standard rated supplies.

**NOT IMPLEMENTED-Section 10(18), 10(19) and 10(20) of the VAT Act – vouchers**

**Legal nature**

193. Section 10(18), 10(19) and 10(20) of the VAT Act sets out the VAT treatment of tokens, vouchers or stamps in various circumstances.

**Detailed factual description**

194. In many instances vendors issue an “electronic voucher”. Currently, electronic vouchers are not specifically included and we therefore recommend that section 10(18), 10(19) and 10(20) be amended to specifically include electronic vouchers.

**Nature of business impacted**

195. All vendors that issue electronic vouchers.



### Proposal

196. We therefore recommend that section 10(18), 10(19) and 10(20) be amended to specifically include electronic vouchers.

### **NOT IMPLEMENTED-Section 11(1) and section 12(e) of the VAT Act – export of moveable goods and the supply of land and improvements situated in an export country**

#### Legal nature

197. Section 11(1)(a) of the VAT Act zero rates a supply by a vendor of goods where the supplier has supplied movable goods in terms of a sale or instalment credit agreement (my emphasis).

198. Section 12(e) of the VAT Act exempts the supply of land (together with any improvements to such land existing on the date on which the supplier became contractually obliged to supply such land and such existing improvements to the recipient) where such land is situated outside the Republic and such supply is made by way of sale or by way of letting (My emphasis).

#### Detailed factual description

199. Where plant, for example, is supplied on a so-called turn-key basis (i.e. the ownership and risk in the plant only passes to the recipient after successful commissioning) the supply in question is considered to constitute a supply of goods and not a supply of goods and services. Where a supplier supplies plant on a turnkey project, where the plant is to be erected on land located outside the Republic, the goods (component parts) exported cannot be zero-rated in terms of section 11(1) read with section 1 of the VAT Act, on the basis that the goods exported are in fact not supplied to anyone, instead the complete plant is supplied upon completion. Since the completed plant being supplied may not constitute movable goods, the zero rate will equally not apply in respect of the sale of the plant located outside the Republic.

#### The nature of the businesses impacted

200. Vendors who export moveable goods as part of a turnkey project to construct/ erect/ assemble fixed property in an export country.

### Proposal

201. For these reasons, we suggest that VAT Act be amended to include a section which clarifies the VAT treatment of the said difficulties above.

### **IMPLEMENTED -IN TERMS OF SECTION 81(1)(a)(i) of TLAB2017-Section 11(1)(b) of the VAT Act – temporary importation of goods**



### Legal nature

202. Section 11(1)(b) of the VAT Act zero rates goods supplied by a vendor in the course of repairing, renovating, modifying or treating any goods to which, *inter alia*, section 11(2)(g)(ii) refers and the goods supplied-

- Are wrought to, affixed to, attached to or otherwise form part of those other goods; or
- Being consumable goods, become unusable or worthless as a direct result of being used in that repair, renovation, modification or treatment process.

203. Section 11(2)(g)(ii) zero rates services supplied by a vendor directly in respect of goods temporarily admitted into the Republic from an export country which are exempt from tax on importation under Items 470 and 480 of paragraph 8 of Schedule 1.

204. Item 470 of paragraph 8 of Schedule 1 deals with goods temporarily admitted for processing, repair, cleaning, reconditioning or for the manufacture of goods exclusively for export.

### Detailed factual description

205. As a result, where goods are temporarily imported under Item 470 of paragraph 8 of Schedule 1 for purposes of manufacturing goods exclusively for export, any services supplied directly in respect of such goods (e.g. toll manufacturing services) will be zero rated in terms of section 11(2)(g)(ii) of the VAT Act. However, any goods supplied (as envisaged in section 11(1)(b)) during the manufacturing process will be standard rated since section 11(1)(b) of the VAT Act does not include goods supplied in the course of manufacturing.

206. We suggest that the wording of section 11(1)(b) of the VAT Act be broadened to align the section with Item 470 of paragraph 8 of Schedule 1 and section 11(2)(g)(ii) of the VAT Act by including the word “manufacturing” in the section.

### The nature of the businesses impacted

207. Vendors that supplies goods during the manufacturing process relating to temporary imports.

### Proposal

208. We suggest that the wording of section 11(1)(b) of the VAT Act be broadened to align the section with Item 470 of paragraph 8 of Schedule 1 and section 11(2)(g)(ii) of the VAT Act by including the word “manufacturing” in the section.



### **NOT IMPLEMENTED-Sections 11(1)(q) & 11(2)(l) of the VAT Act – zero rate**

#### **Legal nature**

209. The interaction between section 11(2)(l) and 11(1)(q) gives undesired outcomes under certain circumstances.
210. Section 11(1)(q) provides for the zero-rating of a 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 them in the course or furtherance of his enterprise.

211. This is to avoid a cascading effect of VAT for the VAT registered purchaser.

#### **Detailed factual description**

212. The application of section 11(1)(q) is limited to the supply of goods to a non-resident. If the local vendor supplies services to a local recipient, who is the client of a non-resident, there is currently no provision available in section 11(2) to provide for the zero-rating of such services.
213. 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 applies if the services are supplied directly in connection with certain movable property. If the services provided by the local vendor to the non-resident are not supplied directly in connection with movable property, the zero rating will not apply.

#### **Nature of business impacted**

214. Supplies of services by local VAT registered suppliers, to non-resident non-vendors, where the supply is made to a SA recipient who is a registered vendor.

#### **Proposal**

215. 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.

### **NOT IMPLEMENTED-Section 12(h)(ii) of the VAT Act – other fees in respect of universities**

#### **Legal nature**

216. Section 12(h)(ii) of the VAT Act provides for a supply by a school, university, technikon or college solely or mainly for the benefit of its learners or students of goods or services (including domestic goods and services) necessary for and subordinate and incidental to the supply of educational services to be exempt, if such goods or services are supplied for



a consideration in the form of school fees, tuition fees or payment for board and lodging.  
(our emphasis)

Detailed factual description

217. Based on our experience, the said institutions supply various goods and/or services which are in our view necessary for and subordinate and incidental to the educational services, albeit that the supplies are made for separate fees, which may be argued, do not take the form of tuition fees. Consequently clarity is required whether these supplies are indeed exempt from VAT. The below are examples of typical fees charged for a separate consideration, which we recommend require clarity as to whether these are included in the exemption:

- Remark / Rewrite fees
- Acceptance fees
- Registration fees
- Examination fees
- Fees for access cards
- Residency Application Fees
- Disciplinary Appeals Fee
- Module Practical Levy

Nature of business impacted

218. All schools, universities, technikons or colleges.

219. Section 13(3) of and Schedule 1 to the VAT Act – exempt imports

Proposal

220. We recommend that section 12(h)(ii) be amended to remove the reference to “*in the form of school fees or tuition fees*”.

**NOT IMPLEMENTED-Section 13(3) of the VAT Act – Repairs**

Legal nature

221. Section 13(3) of the VAT Act exempts from importation VAT supplies listed in Schedule 1 to the VAT Act.



222. Customs Heading 470.00 deals with goods temporarily admitted into South Africa for processing, repair, reconditioning or for the manufacture of goods exclusively for export.

Detailed factual description

223. In practice goods are sometimes imported for repairs. It may subsequently transpire that the goods are not capable of repair and that it is not economically viable to re-export the goods. Such goods must then be cleared for home use in South Africa. If such goods are destroyed under Customs supervision, the goods are not subject to Customs Duty.

224. For VAT purposes only goods imported under Customs Heading 412.07 qualify to be cleared without VAT, if such goods are subsequently destroyed by or abandoned to Customs. As Customs Heading 412.07 has very limited application, imports under Customs Heading 470.00 will normally not qualify for the VAT exemption. In terms of 470.00 arrangements, the local service provider would generally speaking never be the owner of the imported goods; as such no input tax deduction of the importation VAT can be claimed. This gives rise to an unintentional VAT cost.

Nature of business impacted

225. Any business that repairs goods that are imported under Customs Heading 470.00, where such goods cannot be repaired and is destroyed under Customs supervision.

Proposal

226. We recommend that the exemption of VAT in respect of goods imported under Customs Heading 470.00 be extended to goods that cannot be repaired and are destroyed under Customs supervision.

**NOT IMPLEMENTED-Section 16(3)(c)(iv) of the VAT Act – notional tax deduction denied where the goods are situated outside the Republic**

Legal nature

227. Section 16(3)(c) of the VAT Act provides that a vendor may make a deduction of an amount equal to the tax fraction on any payment to indemnify another person in terms of a contract of insurance where the contract of insurance was a taxable supply (either subject to the zero or standard VAT rate). Furthermore, section 16(3)(c)(iii) of the Act provides that Insurance Companies are only entitled to claim an input credit on a claims payment which relates to a zero rated policy where the person indemnified is a vendor or a resident of the RSA at the time of payment.

228. However, section 16(3)(c)(iv) of the VAT Act provides that the said input deduction “shall not apply where that payment **results from a supply of goods or services to that other person where those goods are situated outside the Republic** at the time of that supply” (e.g. the payment of medical costs incurred abroad by an insured or the payment for the replacement abroad of lost luggage in terms of an outward travel policy or the replacement of goods damaged or destroyed whilst outside the Republic). (Our emphasis)



229. Further, a vendor is, in terms of section 8(8) of the VAT Act, liable for output tax where the vendor receives any indemnity payment under a contract of insurance or is indemnified under a contract of insurance by the payment of an amount of money to the vendor or another person, the extent that the indemnity relates to a loss incurred in the course of carrying on an enterprise.

#### Detailed factual description

230. The use of the phrase “*where the payment results from a supply of goods to that other person where those goods are situated outside the Republic*” is slightly ambiguous since the use of the phrase “results from”, seems to suggest that goods which were damaged or destroyed must have been replaced outside the Republic before the insured is indemnified by the insurer. Based on this interpretation, it follows that the section will not find application where the insured is indemnified first and thereafter replaces the goods outside the Republic or where the insurer indemnifies the insured by virtue of a so-called trade payment (i.e. the insurance company acquires the goods from outside the Republic and provides same to the insured outside the Republic). This distinction does therefore not seem to achieve the seemingly intention namely, to not permit an input tax claim in respect of goods which have or will be replaced outside the Republic, since no South African VAT will be incurred on such supplies.

231. Further, section 8(8) of the Act does not contain an exclusion similar to the one in section 16(3)(c)(iv), with the result that there is no matching of the VAT. To illustrate, where a South African insurance company makes an indemnity payment to an Insured vendor (or another person) under a contract of insurance, the insurance company would not be entitled to a deduction in terms of section 16(3)(c)(iv) of the VAT Act, where a vendor Insured purchases goods outside the Republic and the goods are lost or damaged before importation into the Republic, and are replaced outside the Republic before the indemnity payment is made. However, the vendor insured would be required, in terms of section 8(8) of the VAT Act, to account for output tax at 14% on the indemnity payment received from the insurance company where the contract of insurance was a taxable supply (either at the zero or standard VAT rate). On that basis the insurance company is not entitled to claim an input credit on the indemnity payment made but the insured vendor has an output tax liability in terms of section 8(8), which results in cascading. It follows that since section 16(3)(c)(iii) prohibits an input claim where the insured is not a resident or not a vendor, the said discrepancies only apply where the insured is a vendor.

#### Nature of business impacted

232. All vendor insurance companies which supply zero rated inward and outward marine or travel insurance, zero rated insurance (including hull insurance) where the goods/ship/vessel is located outside the Republic for the duration of the cover.

#### Proposal

233. We recommend that the wording of section 16(3)(c)(iv) be amended to remove the ambiguities and obscurities by for example replacing the said phrase with the following



“where the indemnity payment is in respect of goods which have or will be supplied outside the Republic in terms of insurance supplied by the vendor to a person who is not a vendor”. This amendment will have the result that the restriction only applies to circumstances where the insured is not a vendor, hence removing the cascading effect and will be limited to circumstances where the indemnity payment will be used to replace goods outside the Republic (i.e. supplies where no South African VAT is incurred on the goods supplied). It is nevertheless acknowledged that the suggested amendment may still pose some difficulty for the insurer in some circumstances, in determining whether or not the indemnity payment made will indeed be used to replace goods outside the Republic.

**NOT IMPLEMENTED-Section 16(3)(h) of the VAT Act – final adjustment when goods are supplied by an enterprise**

Legal nature

234. Section 16(3)(h) of the VAT Act determines that a vendor is entitled to a final deduction when goods are supplied by the vendor. The deduction is computed by applying the formula  $A \times B \times C$ .

235. C in the formula represents the percentage that, immediately before the time of the supply, the use or application of the goods or services for the purpose other than that of making taxable supplies was of the total use or application of the goods or services.

Detailed factual description

236. The purpose of section 16(3)(h) of the VAT Act is to ensure that any input tax that a vendor could not claim due to the fact that the vendor makes mixed supplies, becomes recoverable at the time that the goods or services are supplied. This adjustment is necessary as section 8(16) of the VAT Act determines that the full consideration for the supply is subject to VAT, notwithstanding the fact that the vendor was not entitled to a full input tax credit at the time of acquiring the goods.

237. The requirement that the determination of non-taxable use must be made “immediately before the supply is made” will cause a distortion where the percentage taxable use has changed between the date of its last determination and the date of the supply of the good or services.

238. Section 16(3)(h) is also not linked to section 17(1), which means that a vendor can make any method to determine the non-taxable use for section 16(3)(h) purposes.

Nature of business impacted

239. Any business making mixed supplies of goods or services.

Proposal

240. We recommend that the section 16(3)(h) determination be linked to section 17(1) and 18 of the VAT Act.



**NOT IMPLEMENTED-Section 17(2)(c)(i) of the VAT Act – motor cars – meaning of “economic rental consideration”**

**Legal nature**

241. Section 17(2)(c) of the VAT Act denies an input tax deduction to vendors in respect of the supply or importation of a motor car (as defined).

242. Section 17(2)(c)(i) of the VAT Act determines that the general prohibition to claiming input tax on the acquisition or importation of a motor car does not apply where the 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 installment credit agreement or by way of rental agreement at an economic rental consideration.

**Detailed factual description**

243. The term “economic rental consideration” is not defined in the VAT Act. The term is also not explained in the Guide for Vendors (VAT 404) or Interpretation Note 82 (IN82).

244. The term “open market value” is defined in section 3 of the VAT Act, but this is not the same concept as economic rental consideration.

**Nature of business impacted**

245. Any business that rents cars to related parties for less than the open market value of the goods, but where all costs (direct and indirect costs) are covered (i.e. the rental consideration does not result in a commercial shortfall).

**Proposal**

246. We recommend that the term “economic rental consideration” either be defined in section 1(1) of the VAT Act, or be clarified in The VAT Guide for Vendors (VAT 404) or IN82.

**NOT IMPLEMENTED-Section 18(3) of the VAT Act – fringe benefits granted to employees through gift vouchers**

**Legal nature**

247. Section 10(18) of the VAT Act provides that where a right to receive goods or services to the extent of a monetary value stated on any token, voucher or stamp (other than a postage stamp as defined in section 1 of the Postal Services Act, 1998, and any token, voucher or stamp contemplated in subsection (19)) is granted for a consideration in money, the supply of such token, voucher or stamp is disregarded for the purposes of the VAT Act, except to the extent (if any) that the consideration exceeds the monetary value.

248. Where a vendor has or is deemed to have granted a benefit or advantage to an employee as contemplated in paragraph (i) of the definition of gross income in section 1 of



the Act, read with the Seventh Schedule to the Act, and such benefit or advantage consists of a supply of goods or services (other than exempt or zero rated supplies or supplies of entertainment) the benefit or advantage is deemed, in terms of section 18(3) of the VAT Act, to be a supply of goods or services made by the vendor in the course of his enterprise.

249. In this regard Interpretation Note 71 (IN71) issued by SARS, which applies to long service awards, provides guidance to what SARS considers a voucher to be. In terms of IN71, SARS states that it considers a [gift] voucher to be an asset which is a form of property and represents a right to acquire goods or services from a merchant.

250. Based on SARS' interpretation as to the nature of the supply of [gift] vouchers, it follows that the rights to acquire goods or services constitute "services" as defined in section 1(1) of the VAT Act. Since the supply of these services is neither exempt nor zero rated, the vendor will be required to account for VAT in terms of section 18(3) of the VAT Act.

#### Detailed factual description

251. Consequently, the vendor must account for output tax on the fringe benefit granted to its employees.

252. When the employee redeems the voucher, output tax will again be charged on the goods or services acquired by the employee with the voucher.

253. These results are undoubtedly contrary to the very principle in a VAT system to avoid double taxation/cascading.

254. However, if the nature of the supplies of gift vouchers is indeed considered to be the supply of services, there are no provisions in the VAT Act which could be relied upon to avoid the blatant obscure results. It thus follows that the mismatch is created by virtue of the classification of the nature of the gift voucher for purposes of the Seventh Schedule, and the fact that for VAT purposes the acquisition of the vouchers is disregarded.

#### Nature of business impacted

255. All vendors who provide gift vouchers to employees as fringe benefits.

#### Proposal

256. We suggest that the wording of section 18(3) be amended for it to exclude situations where [gift] vouchers are issued to employees as fringe benefits.



**NOT IMPLEMENTED-Section 18A of the VAT Act – adjustments re mixed going concern acquisitions**

**Legal nature**

257. Section 18A of the VAT Act deals with the adjustments that the recipient of a mixed supply going concern must make where the going concern has been supplied to the recipient at the zero-rate of VAT in terms of section 11(1)(e) of the VAT Act.

258. Section 18A(2) of the VAT Act determines that the value of the deemed supply is the **cost** to the vendor of acquiring the enterprise, reduced by the extent that the enterprise will make taxable supplies.

259. The value of a supply excludes VAT (section 10(2) of the VAT Act).

260. Section 18A(4) of the VAT Act determines that “For the purposes of this section and sections 10(9), 18(4) and (5), the cost to the vendor ... shall be deemed to be an amount equal to the aggregate of an amount ... the full cost to the vendor of the enterprise ... and an amount determined by applying the rate of tax applicable at the time of supply ...”:

**Detailed factual description**

261. The (VAT exclusive) value of the deemed supply is determined by section 18A(2) of the VAT Act. This is based on the cost of the acquisition.

262. Section 18A(4) adds VAT to the cost. This means that the amount of the value for the purposes of section 18A(2) of the VAT Act will be inflated by the addition of the VAT contemplated in section 18A(4).

**Nature of business impacted**

263. Any business that acquires a mixed enterprise going concern at the zero rate of VAT.

**Proposal**

264. We recommend that the reference to “For the purposes of this section” be removed. It should only apply to sections 10(9), 18(4) and 18(5) to bring the cost in line with the definition of “adjusted cost”.

**NOT IMPLEMENTED-Section 20(5A) and section 21(8) of the VAT Act – tax invoices, credit and debit notes issued within a period of six months from sale of enterprise**

**Legal nature**

265. Section 20(5A) of the VAT Act provides that where a vendor acquires an enterprise from another vendor and as a result of that acquisition, the supplier immediately ceases to be a vendor, and the recipient, within a period of six months from the date of the acquisition, issues or receives a tax invoice in respect of the acquired enterprise, that tax invoice may reflect the name, address and VAT registration number of the supplier.



266. Similarly, section 21(8) the VAT Act provides that where a vendor acquires an enterprise from another vendor and as a result of that acquisition, the supplying vendor immediately ceases to be a vendor, and the purchasing vendor, within a period of six months from the date of acquisition, issues or receives a credit note or debit note, as the case may be, in respect of the acquired enterprise, that credit note or debit note may reflect the name, address and VAT registration number of the supplying vendor.

#### Detailed factual description

267. It follows from the above that the period of six months to issue tax invoices or credit or debit notes reflecting the name, address and VAT registration number of the supplying vendor is only applicable to a situation where the vendor acquires an enterprise from another vendor.

268. Based on experience we have found that where a vendor changes its legal name, it is required to obtain and issue invoices and debit/credit notes in its new legal name from the date it was so changed and registered through the Companies and Intellectual Property Commission (CIPC).

269. However, practical difficulty arises to obtain and issue tax invoices and credit/debit notes with these particulars immediately from the date its legal name has changed. The difficulties include that a certain time period is needed to enable the vendor to notify its customers and suppliers of the name change which must be accompanied by the CIPC notification.

270. Currently there are no provisions in the VAT Act which grants the vendor a specified time period to enable it to notify its suppliers and customers of the name change and to provide that tax invoices, credit and debit notes are permitted in its old name until such time period has lapsed.

#### Nature of business impacted

271. Any vendor which changes its legal name at the CIPC.

#### Proposal

272. We therefore recommend that the VAT Act be amended to provide for the difficulties discussed above.

### **NOT IMPLEMENTED-Section 21(1) of the VAT Act – credit and debit notes**

#### Legal nature

273. Vendors that make 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.



Detailed factual description

274. Where a vendor have issued a tax invoice with the incorrect name of the recipient, 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.

Nature of business impacted

275. All vendors that issue tax invoices.

Proposal

276. We recommend that the scenarios in section 21(1) of the VAT act be expanded to include any scenario where a tax invoice had been issued in error. In practice we experience that SARS allows for credit notes to be issued in these scenarios but it is not supported by the current legislation.

**NOT IMPLEMENTED-Section 21(3)(a) of the VAT Act – credit notes for supplies after sale of an enterprise as a going concern**

Legal nature

277. Company A sells its enterprise to Company B. Subsequent to the acquisition of the enterprise a customer of Company A returns goods acquired from Company A, but the return is made to Company B.

278. Section 21(3)(a) provides that where the amount shown as tax charged in a tax period exceeds the actual tax charged in respect of a supply, the supplier shall provide the recipient with a credit note.

279. In the instance where the enterprise has been sold and the goods are returned to the purchaser, this creates an issue since the purchaser cannot issue a credit note from a VAT perspective and will accordingly not have the requisite documentary evidence to claim the input tax deduction.

Detailed factual description

280. Similar to the provisions of bad debts written off where it has been acquired on a non-recourse basis.

Nature of business impacted

281. All vendors where goods can be returned subsequent to a sale of the business.

Proposal

282. We suggest an amendment to legislation that will allow the purchaser of an enterprise to issue a credit note in respect of goods supplied by the supplier of the enterprise but returned to the purchaser of the enterprise.



**NOT IMPLEMENTED-Section 21(3)(a) and section 21(3)(b) of the VAT Act – credit and debit notes**

**Legal nature**

283. Section 21(3)(a)(i) and section 21(3)(b)(i) provide that when a credit note/ debit note is issued the credit note/debit note must contain the words “credit note” or “debit note”.

**Detailed factual description**

284. Certain international IT systems require customization to include the prescribed wording.

**Nature of business impacted**

285. All vendors who issues and/or receives credit and/or debit notes.

**Proposal**

286. We recommend that section 21(3) of the VAT Act be amended to provide for the use of the alternative wording for a “credit note” or debit note” such as “credit memo” or debit memo”.

**NOT IMPLEMENTED-Section 22 of the VAT Act**

**Legal nature**

287. Section 22(1)(iv)(aa) of the VAT Act provides that where a vendor has transferred an account receivable at face value on a non-recourse basis to any other person, the vendor may not make any deduction of VAT on irrecoverable debts in respect of the debts being transferred. This section was introduced in 1997 and in terms of the Explanatory Memorandum On The Taxation Laws Amendment Bill, 1997, “[t]he reason is that the factoring cost incurred by the vendor is not an amount of consideration for the underlying taxable supply which is written off as irrecoverable. The factoring cost is incurred to earn factoring income and the factoring income is consideration for the transfer of a debt security which is exempt from VAT in terms of section 12(a) read with section 2(1)(c).”

288. Proviso (1A) of Section 22(1) provides that where a vendor has made a taxable supply on which it has accounted for output tax and subsequently transfers the account payable to another vendor on a non-recourse basis, the recipient of the account payable may claim a VAT deduction equal to the tax fraction of the face value of the account receivable, limited to the amount paid by the recipient, on any amounts (excluding finance charges or collection costs) written-off as irrecoverable.

289. Section 22(2) provides that where any amount in respect of which a deduction has been made in accordance with subsection (1) is at any time wholly or partly recovered by the vendor, or becomes recoverable by him by virtue of the reassignment to him of the underlying debt, that portion of the amount of such deduction as bears to the full amount of such deduction in the same ratio as the amount of the irrecoverable debt recovered or



reassigned bears to the debt written-off shall be deemed to be tax charged in relation to a taxable supply made.

290. Section 22(3) provides that where a vendor, who accounts for VAT on the invoice basis, has made a deduction of input tax on any taxable supply made to him, but has not paid the full consideration within a period of 12 months from the tax period in which the input tax deduction was made, the vendor is required to account for output tax equal to the tax fraction of the unpaid amount.

291. We have considered a scenario where a vendor rightfully claimed the input tax on an irrecoverable debt and thereafter sells the irrecoverable debt to a third party on a non-recourse basis.

292. The first aspect that we considered is the meaning of the phrase “account payable” as used in section 22(1)(iv)(aa). In this regard it should be noted that this term is not defined in the VAT Act. The ordinary meaning of the term means amounts owing by one person to another. Thus, since a debtor is not relieved of its obligations to pay a debt owing to his creditor by virtue of the fact that the creditor may have written the amount off as irrecoverable, it follows that irrecoverable debts remain “accounts payable” until the debt legally prescribes. It is for this reason that a creditor is entitled and able to legally dispose of its rights of recovery to another person.

293. Based on the provisions of section 22(1)(iv)(aa) it follows that the section only disallows the deduction of input tax by the creditor if the creditor transfers its rights on a non-recourse basis before writing-off the irrecoverable debt. Consequently, if a creditor has, like in the scenario described above, written-off an amount as irrecoverable, claimed an input tax deduction, and then transferred the rights, the said section cannot find application. It should be noted that in these circumstances, creditors would generally be prepared to sell the irrecoverable debts only on a non-recourse basis since a sale on a recourse basis defeats the objective – i.e. the creditor has already determined that the debt is irrecoverable – and it will generally be sold for an amount far below the face value of the debt (sometimes for as little as 5% or less).

#### Detailed factual description

294. Thus, if a creditor sells the irrecoverable debt on a non-recourse basis, the first question is whether (and if so, in which tax period) the creditor is compelled to reverse the input tax previously claimed in respect of the irrecoverable debt, so that it can be said that the vendor “shall not make a deduction” in respect of the debt written-off as envisaged in section 22(1)(iv)(aa). Should this be true, the creditor will account for output tax which is greater than the actual amount received for the irrecoverable debts sold, which will cause the creditor to realise a loss on the transaction equal to the VAT which the debtor was liable to pay. And should the creditor be required to reopen the VAT return in which the VAT in respect of the irrecoverable debt was claimed in order to reverse the input tax incorrectly deducted, the creditor’s loss will increase by the 10% late payment penalty and interest which will become payable by no fault of its own.



295. Further, should the recipient not recover any of the debts, it will, in terms of section 22(1A) be entitled to claim an input tax deduction limited to the amount paid for the debtors book (i.e. say 5% of the face value). Considering that the debtor is, in terms of section 22(3) liable to account for output tax on the amounts which remain unpaid after a period of 12 months, it follows that the debtor is liable for output tax on the full unpaid amount whereas the input tax by the recipient of the debtors book is limited to the amount paid for the debtors book, leaving the fiscus in an advantageous position at the expense of the first creditor (possibly compounded by the said penalty and interest).

296. Alternatively, if the creditor is not compelled to reverse the input tax claimed on the irrecoverable debts written-off in order to give effect to section 22(1)(iv) which provides that “a deduction shall not be made” on the amounts written-off as irrecoverable, the provisions of the VAT Act will function so as to have the effect that a creditor will not be able to dispose of such irrecoverable debts on a non-recourse basis.

297. In this regard it is submitted that the VAT Act cannot and should not serve to dictate the terms on which the creditor wishes to dispose of its irrecoverable debts. Moreover, if the creditor does sell the irrecoverable debts on a non-recourse basis, the VAT, penalties and interest liability is triggered as a result of the contractual arrangement with the recipient, which is typically beyond the control of the creditor. In addition, the fact that this liability exists, does not entitle the recipient of the irrecoverable debts to claim any input tax on the amounts which remain irrecoverable, with the result that, as indicated above, the fiscus will get the VAT twice (once from the creditor when the input tax deduction is reversed and again from the debtor in respect of the unpaid debt at the 12 month mark).

#### Nature of business impacted

298. Any vendor who disposes of debts written off and on which input tax was claimed on a non-recourse basis to another vendor.

#### Proposal

299. In order to remove the anomalies, it is recommended that section 22 be amended to:

- Specifically permit a creditor who has claimed input tax on debts written-off, to transfer same on a non-recourse basis;
- To provide that should the recipient of the debt recover any of the debts, the recipient will be liable to account for output tax on the debts so recovered; and
- To not permit any further input tax claims by the recipient in respect of any debts which remain unpaid.



**NOT IMPLEMENTED-Section 41B of the VAT Act – provisions to allow backdated rulings for 5 years to allow for equity and fairness – section 17(1) proviso (iii) read with Section 16(3) Proviso (i)**

**Legal nature**

300. A taxpayer's liability for VAT is calculated as the sum of output tax attributable to a tax period, less the amounts of input tax to which the taxpayer is entitled, as supported by documentary evidence. This is the basic premise of a value-added tax system.
301. Section 1 of the VAT Act defines the term "input tax" to mean the VAT incurred by a vendor in respect of goods or services acquired where the goods or services concerned are acquired for the purpose of consumption, use or supply in the course of making taxable supplies.
302. Where goods or services are acquired for another purpose, no deduction of input tax is allowed and in terms of section 17(1) of the VAT Act, where the goods or services are acquired for a dual purpose, the deduction of input tax is allowed proportionally (apportioned) based on the intended taxable use, usually expressed as a percentage of total "intended use".
303. There is generally a five year period within which input tax may be deducted (see the proviso to section 16(3) of the VAT Act). This balances fairness and the necessity for efficient tax administration.
304. In terms of section 17(1) proviso (iii) of the VAT Act, where SARS has previously issued a ruling as to the method by which the "intended taxable use" should be determined (i.e. an apportionment ruling), the method may subsequently only be changed from a future date. This provides for certainty.

**Detailed factual description**

305. Input tax apportionment occurs throughout the year with every VAT return which is submitted, calculated by applying the ratio calculated in respect of the previous financial year. At the end of the current financial year, the apportionment ratio is recalculated and any over- or under recoveries of input tax is corrected in one adjustment. Should it be determined that the method is inequitable, whether in favour of the taxpayer or SARS, SARS is only permitted to issue a ruling on an alternative method to be applied from a future date. This leaves the year in which the inequality prevailed, unaltered.
306. Although SARS may acknowledge that the turnover based method of apportionment yields a grossly unfair and obscure result, where a taxpayer, for whatever reason, did not apply the standard turnover based method of apportionment in the absence of an apportionment ruling, SARS has no discretion but to assess using the standard turnover basis.



### Nature of business impacted

307. This matter will influence all vendors applying for apportionment rulings, where the turnover-based methods yields inequitable results.

### Proposal

308. For these reasons we recommend that SARS be granted discretion to issue rulings retrospectively for five years in line with both the general timing rule for input tax deductions and the general prescription period (section 41(d) of the VAT Act).

### **NOT IMPLEMENTED-Section 50 of the VAT Act**

#### Legal nature

309. Section 50 of the VAT Act provides that a vendor (e.g. a company who is liable to be registered as a VAT vendor, hereinafter referred to as “the Vendor”) may apply to the Commissioner to register branches or divisions of the Vendor as separate vendors. Where the Commissioner has approved such application and the branches and divisions are registered separately (hereinafter referred to as the Branches) section 50(2) provides that the Branches shall be deemed to be carried on by a person separate from the Vendor.

310. Section 17(1) read with the definition of “input tax” provides that the tax incurred by the vendor on the acquisition or importation of goods or services, constitute “input tax” only to the extent to which the goods or services are acquired/imported for purposes of consumption, use or supply in the course of making taxable supplies. The extent of taxable application, use or supply is to be determined in accordance with a method prescribed by the Commissioner, which is the standard turnover basis, envisaged in BGR 16.

311. Section 10(23) provides that where a supply is made for no consideration, the value of the supply is deemed to be nil. In this regard the Court held in the KCM case that section 10(23) only functions in respect of taxable supplies. It was further held that since taxable supplies are, in terms of section 7(1) required to be made in the course or furtherance of the vendor’s “enterprise”, it is necessary to have regard to the definition of “enterprise” to determine whether the supply can be said to be made in the course or furtherance of an enterprise. The definition of “enterprise” specifically requires that supplies need to be made to another person for a consideration and specifically excludes exempt supplies. Also refer to IN 70 issued by SARS which deals with the VAT treatment of supplies made for no consideration.

312. The provision which deems the Branches or divisions to be persons separate from the Vendor, has the effect that goods or services made available by one Branch to another constitutes a “supply” of “goods” or “services” by one vendor to another vendor and that such a supply may be taxable as if the Branches are separate legal persons from one another. Consequently, where such a supply is taxable, the supplying vendor is liable for VAT at either the standard or the zero rate of VAT and is required to issue a tax invoice in the ordinary course as if the supplies were made to a separate legal person, whereas the



recipient vendor is entitled to claim such VAT charged to it as input tax subject to the general rules for input tax, including apportionment where relevant. Equally, where any exempt supplies are made by one Branch to another, such exempt supplies need to be reflected on the supplying vendor's VAT return.

313. From the said provisions and effects, it follows that the ultimate amount of tax payable to SARS should be identical to the amount that would have been payable, had separate VAT registrations not been effected. However, at least two scenarios exist where the aim is not achieved, i.e. where the ultimate amount of tax payable will increase due to the separate registrations, albeit that all of the Branches only make taxable supplies.

314. These two scenarios occur where:

- One Branch (typically the Branch where the treasury function is housed) borrows funds to be used by another Branch wholly in the course of making taxable supplies (typically an operational Branch). In this instance, for VAT purposes, the borrowing Branch makes an exempt supply to the other Branch by on-lending the funds acquired, and in the ordinary course may or may not elect to account for a notional amount of "interest" for management accounting purposes – notional since a legal entity cannot legally charge itself interest and where it is accounted for, it will accordingly be eliminated in the "consolidated" financial statements of the company. Where the borrowing Branch elects to account for the so-called notional interest, such interest may have the effect that the lending Branch may be required to apportion input tax incurred on overhead/administration costs, on the basis that it receives this non-taxable income. However, where the borrowing Branch elects not to account for this notional amount of interest, section 10(4) of the VAT Act does not find application to deem the value for this notional amount of interest at a market related rate, since firstly, it is arguable whether a notional amount of interest constitutes interest, and secondly, since the receiving Branch is not required to apportion input tax on the basis that it makes only taxable supplies.
- One of the Branches acquires goods or services which are used by another Branch. For VAT purposes, the first-mentioned Branch who acquired the goods or services once again supplies the acquired goods or services to the last-mentioned Branch. And as is the case with notional interest, the acquiring Branch may decide, for management accounting purposes, to account for the value of the goods or services supplied or not to account for such a value. Where the decision is not to account for any amounts, SARS' view at the moment is that, instead of regarding the goods or services supplied and deeming it supplied for no consideration (as envisaged in section 10(23) of the VAT Act), SARS deems such supplies made otherwise than in the course of the first-mentioned Branch's enterprise. This has the effect that no input tax is claimable by either of the Branches. Furthermore,



should SARS' logic be followed and be extended to any other scenario where one Branch supplies goods or services for no consideration to another Branch in any other circumstance (i.e. not being goods or services acquired expressly with the intention of use by the other Branch), the supplying Branch's deemed non-supply of the goods or services will imply a change-in-use by the supplying Branch which will require an output tax adjustment by the one Branch with no corresponding deduction by the other.

Detailed factual description

315. It thus follows from the above that the current VAT implications effectively depend on the accounting treatment, which is clearly undesired.

Nature of business impacted

316. All vendors who was given approval by SARS to register its branches or divisions as separate vendors and who provide goods or services to one another.

Proposal

317. We recommended that the value of any supply by one person to another person as contemplated in Section 50 of the VAT Act, be deemed to be nil.

318. This is not uncommon in other jurisdictions like the EU.

**NOT IMPLEMENTED-Export Regulation R316 – 4 May 2014 Part 2 Section A & B**

Legal nature

319. Paragraph 10(1)(b)(ii) stipulates that the supplying vendor must obtain the trading licence or equivalent document of the qualifying purchaser to prove that the qualifying purchaser carries on a business outside South Africa.

320. Paragraph 10(1)(b)(ii) further stipulates that the supplying vendor must also obtain "the letter of authorisation authorising the person to represent the qualifying purchaser and a copy of the authorised person's passport".

321. The above requirement is also stipulated in paragraph 13(1)(b)(ii).

Detailed factual description

322. It is not clear as to whom such authorised person is intended to be and what such person must be authorised to do in terms of the letter to be obtained. It seems that these requirements regarding to the person authorised to represent the qualifying purchaser are duplicated from Part 1, where the qualifying purchaser authorises a person to submit the VAT refund claim to the VRA on behalf of the qualifying purchaser. Such authorisation is not required under Part 2 of the Regulation.



Nature of business impacted

323. All vendors who zero rate supplies under Part 2 of the Regulation.

Proposal

324. We recommend that the requirement to obtain a letter of authorisation authorising the person to represent the qualifying purchaser and a copy of the authorised person's passport in paragraph 10(1)(b)(ii) and in paragraph 13(1)(b)(ii) be deleted.

**NOT IMPLEMENTED-Export Regulation R316 – 4 May 2014 Part 3**

Legal nature

325. Paragraph 15 stipulates that the movable goods must be exported from South Africa within 90 days from the time an invoice is issued or the time any payment of consideration is received by the vendor. Paragraph 16 stipulates the time periods within which the documentary proof to substantiate the entitlement of the vendor to apply the rate of zero per cent must be obtained.

326. Paragraph 16 of the Regulations stipulates that the *supplying vendor* is required to obtain the documentary proof within a period of 90 days calculated from the time the goods are required to be exported. The supplying vendor is, however, not responsible for the exportation of the goods.

327. Paragraph 15(1)(a) of the Regulations stipulates as a general rule that the movable goods must be exported within 90 days from the earlier of the time an invoice is issued or the time any payment of consideration is received by the vendor.

328. Paragraph 15(2) provides for certain exceptions to the general rule stipulated in paragraph 15(1)(a).

329. There is, however, a contradiction between paragraph 15(2)(f)(i) and paragraph 15(2)(f)(ii) of the Regulations.

330. In paragraph 15(2)(f)(i) the Regulations stipulate that the Commissioner may extend the period within which movable goods supplied by a vendor to a qualifying purchaser may be exported if the delay is beyond the control of the vendor or due to exceptional commercial delays or circumstances. It requires that the *vendor* must, *before* the expiry of the 90 day period submit a written application to the Commissioner requesting a private binding ruling confirming the extension of the 90 day period.

331. Paragraph 15(2)(f)(ii) provides that in the event that the *qualifying purchaser* is unable to submit the application as set out in paragraph 15(2)(f)(i), the *qualifying purchaser* must submit the application to the Commissioner within a period of 30 days from the expiry of the period within which the application should have been submitted, also providing the reasons as to why the application could not have been submitted timeously.



#### Detailed factual description

332. The Regulations are issued to clarify paragraph (d) of the definition of “exported” in section 1 of the VAT Act. Paragraph (d) of that definition contemplates the situation where goods are removed from South Africa *by the recipient or the recipient’s agent* for conveyance to an export country. The vendor supplying the goods therefore has no control over the exportation of the goods supplied, as it is the recipient that is responsible to export the goods. Any delay in the exportation of the goods will therefore in all circumstances be beyond the control of the vendor.
333. The supplying vendor further does not have any insight into any practical or commercial difficulties which the qualifying purchaser may face to export the goods from South Africa.
334. It is often only after the 90 day period has expired that the supplying vendor becomes aware or is made aware of the fact that the goods have not yet been exported by the qualifying purchaser.

#### Nature of business impacted

335. All vendors who zero rate supplies under Part 2 of the Regulation.

#### Proposal

336. The period within which the supplying vendor must apply for extension for the goods to be exported must therefore be either be extended, or the vendor must be liable for the VAT at the expiry of the 90 day period, but must then be allowed to apply the rate of zero per cent if it can be subsequently shown that the goods were not exported from South Africa due to exceptional commercial delays or circumstances experienced by the qualifying purchaser.

#### **NOT IMPLEMENTED-Export Regulation R316 – VAT claim – VRA refund timing**

##### Legal nature

337. Part 1 section of the export regulations R.316 provides for procedures for granting of refunds of tax to qualifying purchasers residing in or conducting business in export countries.
338. Paragraph 6 of part 1 requires the VRA to (in terms of section 44(9) of the Act to make a refund of tax to the qualifying purchaser where the VRA is satisfied, inter alia, that the QP has submitted all the required documentation within the prescribed time periods or any extended time periods provided in the regulations.
339. The proviso to Paragraph 6(6) states that the extended period may not exceed 12 months in the case where the QP is unable to obtain all the required documentation within the prescribed period due to circumstances beyond the control of the QP.



#### Detailed factual description

340. And in the case where a vendor incorrectly levied tax at the 0% on the supply of the goods to the QP and subsequently the QP paid the tax that should have been charged by that vendor, the extension period may not exceed 5 years from the date of the original zero rated tax invoice.

#### Nature of business impacted

341. All businesses acquiring goods from SA and are charged VAT at 14% as well as intercompany exports between holding companies acquiring goods from their branches in SA.

#### Proposal

342. We propose that the extensions granted to claim VAT from the VRA be standard at 5 years and not 12 months and 5 years as provided for in paragraph 6(6) (a) and (b) respectively. The reason is, some companies do not claim the VAT back in the 90 days or 12 months (extended period granted) due to administrative constraints and sometimes only realise the unclaimed VAT after these periods. This puts the companies at financial risk due to unforeseen VAT costs.

343. This proposal will align with section 16(3) proviso, IN30 and claw back clause in the Export Regulation (input tax can be claimed once export docs are obtained), i.e. the 5 year period.

#### **NOT IMPLEMENTED-IN 30 (7d) and (7f) wording – proof of payment time periods**

#### Legal nature

344. Interpretation Note 30 (IN30) sets out the documentary proof which is acceptable in instances where goods are consigned or delivered to a recipient at an address in the export country in terms of section 11(1)(a) of the VAT Act.

345. On this basis and in terms of section 11(1)(a)(i) of the VAT Act, read together with section 11(3) of the VAT Act, certain documentary requirements should be met for the supply of the goods to qualify for a VAT to be levied at the zero-rate.

346. Section 11(3) of the VAT Act requires that where the rate of zero percent is applied, the vendor shall obtain and retain such documentary proof substantiating the vendor's entitlement to apply a zero rate as is acceptable to the commissioner.

347. The documentary proof required to be obtained according to IN30 includes inter alia the proof of payment of the goods exported.

348. IN30 requires that where the vendor does not obtain the proof of payment (or any of the prescribed documentation) within the prescribed 90 day period, the vendor will be required to account for output tax levied at a standard rate of 14% on the goods exported



through an adjustment in block 12 of its VAT return for the tax period in which the said 90 days ends. However, should the vendor receive the documentation within five years, the output tax adjustment may be deducted in block 18 of the VAT return for the tax period in which the documentation is received.

Detailed factual description

349. Paragraph 7(d) of IN 30 specifies certain exceptions to the general rule with regard to the time period within which the requisite documentary proof must be obtained by the vendor.

350. We set below the provisions in 7(d) of IN 30 that, if applicable, would result in the vendor not required to account for output tax as a result of not obtaining the required proof of payment:

<b>7(d)</b>	<b>Provisions IN 30</b>
<i>i</i>	<i>the vendor has entered into a written contract with the recipient for the payment of the consideration for the supply to be made after or over a period exceeding the 90 days but not exceeding six months;</i>
<i>ii</i>	<i>the vendor has entered into a written contract with the recipient for the payment of the consideration for the supply to be made after or over a period exceeding six months but not exceeding 12 months and has the relevant approval from a dealer in foreign exchange authorised by the South African Reserve Bank;</i>
<i>iii</i>	<i>the vendor has entered into a written contract with the recipient for the payment of the consideration for the supply to be made after or over a period exceeding 12 months and has the relevant approval from the South African Reserve Bank;</i>
<i>iv</i>	<i>a written contract provides for a retention amount to be withheld for a period exceeding five years due to the nature of the goods supplied and proof of payment of the retention amount has not been obtained;</i>
<i>v</i>	<i>the recipient is unable to effect the payment due to the restrictions imposed on foreign exchange by the country in which the recipient conducts its enterprise;</i>
<i>vi</i>	<i>the vendor has the relevant approval from the South African Reserve Bank or a dealer in foreign exchange authorized by the South African Reserve Bank not to repatriate any foreign currency for that supply;</i>
<i>vii</i>	<i>in the case of exports via air or sea, the time of export has occurred but the movable goods have not yet been removed from the Republic. This exception is limited to a period of six months from the time of export; or</i>
<i>viii</i>	<i>the vendor has written off the said consideration as irrecoverable.</i>



351. However, it appears that the subsequent paragraphs 7(f) and (7g) in IN30 require that the proof of payment should nevertheless be obtained, failing which, the vendor must account for VAT at the standard rate, as mentioned above.

352. The anomaly in paragraph 7 of IN30 is as follows:

- Subsequent to paragraph 7(d), paragraph 7(f) requires that in the event that the required proof of payment for the total consideration is not obtained by the vendor within the prescribed periods set out in 7(d) excluding (vi) and (viii), the vendor would not comply with the requirements of section 11(3) and is therefore not allowed to levy VAT under section 11(3).
- Further, paragraph 7(g) requires that the vendor accounts for output tax on the supply to the extent of payment not received if the provisions of 7(d) excluding (vi) and (viii) are applicable and the vendor has not received proof of payment for the total consideration within the period allowed. , calculated by applying at tax fraction to the consideration for the supply.

#### Nature of business impacted

353. All vendors exporting goods to countries where foreign exchange restrictions exist.

#### Proposal

354. We propose that paragraph 7(d)(v) should be included in the exclusions under paragraph 7(f) and 7(g), otherwise 7(d)v is rendered superfluous. The omission of paragraph 7(d)(v) in the exclusions in the subsequent paragraphs 7(f) and 7(g) creates uncertainty.

### **Practical difficulties experienced in dealing with SARS**

#### **NOT IMPLEMENTED-Section 23 of the VAT Act – VAT registration of a foreign branch**

#### Legal nature

355. Section 25 of the VAT Act makes provision for vendors to notify SARS of certain changes. However, this section does not make provision for the vendor to notify SARS of a change in its company registration number.

#### Detailed factual description

356. Any person, who continuously or regularly carries on any enterprise or activity in SA, whereby goods or services are supplied for a consideration has an enterprise in SA for VAT purposes. If such person's taxable supplies exceed or is expected to exceed R1m in a 12 month period, the person must register for VAT purposes:

- at the end of any month where the R1m threshold has been exceeded; or



- at the commencement of any month where taxable supplies will exceed R1m for the next 12 month period, in terms of a contractual obligation to be made in writing.

357. It follows from the above that a person, including a foreign company, may have a VAT registration liability even if it does not have to register as a branch or company at CIPC.

358. However, a difficulty arises where a foreign company, who is registered for VAT subsequently becomes liable to also register as an external company with the CIPC.

359. Currently SARS requires that the company applies for a new VAT registration as it cannot update the foreign company registration number with the CIPC registration number, presumably since the VAT Act does not make provision for the change in company registration numbers.

#### Nature of business impacted

360. Foreign companies who are VAT vendors and who become liable, in terms of the companies Act, to also register as an external company.

#### **NOT IMPLEMENTED-SARS verification audits**

##### Legal nature

361. Section 93 of the TAA makes provision that SARS may make a reduced assessment despite the fact that no objection has been lodged, *inter alia*, if SARS is satisfied that there is a readily apparent undisputed error in the assessment by SARS or the taxpayer.

##### Detailed factual description

362. Vendors often receive a VAT verification audit request letter in which SARS requests certain information/documentation to verify the accuracy of a VAT return submitted. We have experienced numerous instances where the vendor duly submits the information/documentation timeously where SARS issues an assessment by either disallowing all input tax, or imposing standard rate VAT on all zero rated supplies or both, citing the reason for the assessment as “burden of proof not discharged”.

363. Where the vendor under these circumstances re-submits the information/documentation requested and requests that SARS makes a reduced assessment in terms of section 93, SARS insists on an ADR1 and a formal objection. Since objections are costly and time consuming and since SARS’ consideration of the objection further delays the process, to the detriment of the taxpayer, this approach by SARS is clearly unjust towards a vendor who was fully compliant in submitting the required information/documentation to SARS.



Nature of business impacted

364. All enterprises who timeously provide the information/documentation requested by SARS by virtue of verification letters issued by SARS.

Proposal

365. We recommend that the TAA be amended to provide for a particular process/request to be submitted by the taxpayer in these circumstances.

**NOT IMPLEMENTED-Voluntary Disclosure Programme (VDP) – VAT number required when application is submitted**

Legal nature

366. Currently, SARS requires a vendor to have a VAT registration number prior to submission of a VDP application.

Detailed factual description

367. For example, a company has a liability to register as a VAT vendor in terms of section 23 of the VAT Act due to its enterprise activities carried on in the Republic in the course of making taxable supplies.

368. The vendor fails to register for VAT and subsequent to it ceasing all enterprise activities in the Republic after a period of time, identifies the error and elects to apply for VDP relief.

369. By implication this causes administrative difficulties as the VAT registration of the vendor must be finalized in order for the vendor to obtain a VAT number which can then be used for the VDP application.

370. Furthermore, based on the said example, the vendor will have to deregister again for VAT purposes after applying for VDP relief as it ceased all enterprise activities in the Republic.

Nature of business impacted

371. Mostly non-resident VAT vendors which are not registered for VAT purposes and intends to apply for VDP relief where after that VAT vendor should deregister for VAT purposes due to it not carrying on any enterprise activities in the Republic anymore.

Proposal

372. We therefore recommend that a process be made available in terms of which the vendor can do voluntary disclosure without having to register and immediately de-register for VAT. Potentially a simplified registration and de-registration process can be catered for.



## **CATEGORY - TAX ADMINISTRATION**

### **NOT IMPLEMENTED-Part A Chapter 5- Empowering provision for verification**

#### Legal Nature

373. Part A of Chapter 5 envisages that SARS use various processes to gather information.
374. One of the listed processes as referred to in the heading of the Part and also in section 40 is verification.
375. However unlike audit, investigation and inspection (i.e. the other 3 listed), no empowering provision is created to state what exactly verification entails and what the taxpayers rights and obligations are.

#### Detailed factual description

376. A taxpayer receives a letter from SARS for verification to provide certain documents.
377. The content of the request is exactly the same as for audit though usually for a shorter period on a specific tax.
378. However SARS applies exactly the same procedure as for audit, including further request for detailed information and the time periods even extend in some instances beyond that for audit.
379. In contrast, not obligation to inform the taxpayer exists and no explanation of the exact process is detailed in the legislation.

#### Nature of business impacted

380. All taxpayers.

#### Proposal

381. .An additional provision should be inserted in Part B of Chapter 5 that sets out the procedure for verification and the taxpayers rights and obligations, including his rights to be notified and a time frame for the process to be completed. The latter, given that it is not an audit, should be substantially less and should not in our view exceed 21 business days, given the preliminary nature of verification. See also below regarding the right to reasons before assessment.
382. Should SARS require more detailed information an audit should be conducted.

### **NOT IMPLEMENTED-Meaning of an “audit” in section 42**

#### Legal nature

383. Where a SARS official is involved in or responsible for an audit, section 42(2)(b) of the TAA requires that SARS, upon conclusion of the audit in the instance where the audit



identified potential adjustments of a material nature, must provide the taxpayer with a document containing the outcome of the audit including the grounds for the proposed assessment.

384. Upon receipt of such document, the taxpayer is afforded the opportunity to respond in writing within a period of 21 days from the delivery of the document by SARS to the facts and conclusions set out in SARS' document.
385. The legal nature of the problem is that the term "audit" is defined neither in section 42 nor in section 1 of the TAA with the resultant ambiguity whether the "other audit" procedures performed by SARS in respect of a taxpayer's return are subject to section 42 of the TAA or not given the ordinary meaning of the term "audit" being "a systematic review or assessment of something<sup>2</sup>".
386. For example desk audits and forensic audits etc. are all audits and should be subject to the same requirements in section 42.

Detailed factual description

387. SARS in numerous instances, particularly with regards to individuals, notifies taxpayers of a "verification" of the taxpayer's return following submission of that return. The "verification" process usually involves the taxpayer submitting to SARS extensive supporting documentation in respect of the amounts and disclosures contained in the tax return. Following submission of the documentation:
388. Where relevant, SARS compares this to information that it obtains in respect of the taxpayer from external sources (IRP5 submissions by employers, IT3b submissions by financial institutions etc.);
389. Where relevant, SARS raises queries or requests for further information particularly in the case of an individual who carries on a trade in his/her personal capacity such as the letting of a property or the carrying on of a business.
390. Following its "verification" or other audit procedures, SARS will often raise an additional assessment without providing the reasons for the additional assessment or affording the taxpayer the opportunity for responding to the conclusions reached by SARS upon completion of their procedures.
391. Such an approach is in conflict to the process set out in section 42 of the TAA.
392. The manner in which SARS raises additional assessments without providing the taxpayers with reasons therefor and an opportunity to make a submission to refute the SARS' grounds of additional assessment prior to the assessment being raised by SARS is also in conflict with the Supreme Court of Appeal judgment in SARS v Pretoria East Motors

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<sup>2</sup> Per the Oxford on-line dictionary <https://en.oxforddictionaries.com/definition/audit> [last accessed on 10 November 2016].



(Pty) Ltd (291/12) [2014] ZASCA 91 delivered on 12 June 2014 where the learned judge at paragraph [11] said as follows:

*“As best as can be discerned, [SARS’s] approach was that if [it] did not understand something [it] was free to raise an additional assessment and leave it to the taxpayer to prove in due course at the hearing before the Tax Court that she was wrong. [This] approach was fallacious. The raising of an additional assessment must be based on proper grounds for believing that, in the case of VAT, there has been an under declaration of supplies and hence of output tax, or an unjustified deduction of input tax. In the case of income tax it must be based on proper grounds for believing that there is undeclared income or a claim for a deduction or allowance that is unjustified. It is only in this way that SARS can engage the taxpayer in an administratively fair manner, as it is obliged to do. It is also the only basis upon which it can, as it must, provide grounds for raising the assessment to which the taxpayer must then respond by demonstrating that the assessment is wrong. This erroneous approach led to an inability on [SARS’s] part to explain the basis for some of the additional assessments and an inability in some instances to produce the source of some of the figures [it] had used in making the assessments.” [our insertions]*

393. If SARS followed due process in terms of section 42 of the TAA, the number of disputed assessments which is a time consuming and expensive process for taxpayers and SARS alike would reduce dramatically.

#### Nature of business impacted

394. All taxpayers subject to SARS’ verification or other audit procedures.

#### Proposal

395. Section 42 of the TAA should be amended to include reference to a “verification” as well as all “other audit” in order to make the legislation clear that the verification procedures performed by SARS, which typically involve the review of information supporting the amounts and disclosures by taxpayers in their tax returns and the assessment of such information, falls within the ambit of the section.

#### **PARTIALLY IMPLEMENTED-VDP application for pending audit/investigation (sections 42 and 226)**

#### Legal nature

396. Clause 62 of the TALAB, 2016, seeks to amend section 226 of the Tax Administration Act, 2011. The proposed amendment is aimed at preventing taxpayers from applying for VDP where the taxpayer is notified of a pending audit or investigation.

397. If there is a delay between the notification of the audit and the commencement of the audit, taxpayers could be prejudiced by not being permitted to apply for VDP.



398. Section 42 of the TAA requires SARS to provide taxpayers with the progress of audits/investigations which have commenced already but does not address the situation where the audit/investigation has not yet commenced.

399. We submit that it is unreasonable for taxpayers to prepare for an audit where there is uncertainty with regard to the timeframe of the commencement of the audit.

400. Even though the notification of an audit may generally set out the initial scope of an upcoming audit, there are instances where the notification is very vague with regard to the scope of the audit.

#### Detailed factual description

401. Were SARS to disallow taxpayers from applying for VDP once notification of an audit has been issued and there is a delay in the commencement of the audit, this could prejudice taxpayers.

402. In circumstances where the notification of the audit is vague with regard to the scope it is difficult for the taxpayer to adequately prepare for the audit as the taxpayer is uncertain of the specific area which is to be the subject of the audit. The result of this is that the taxpayer has to set aside significant time to adequately prepare for the audit which may cause delays in finalizing of the audit.

#### Nature of business impacted

403. All legal entities subject to a SARS audit.

#### Proposal

404. We hereby request NT to set specific timeframes for SARS to commence its audit after it has issued a notification of an audit or alternatively to provide for a specific timeframe to apply during which taxpayers cannot apply for VDP.

405. We request that the notification of the audit be specific with regard to the accounts and taxes that are subject of the audit.

### **PARTIALLY IMPLEMENTED-Reduced assessments – section 93**

#### Legal nature

406. SARS is only empowered to issue a reduced assessment in circumstances in which no objection has been lodged, if there is a 'readily apparent' undisputed error in an assessment (section 93(1)(d) of the Tax Administration Act No 28 of 2011).

407. Section 93(1)(d) was substituted by section 49 of the Tax Administration Laws Amendment Act of 2015. The substitution entailed inter alia the insertion of the words 'readily apparent' as a qualification to the words 'undisputed error'.



408. The result is that even in cases in which there is an undisputed error in a return, SARS is not empowered to issue a reduced assessment to correct the error unless the error is 'readily apparent'.

409. The determination of whether or not an error is 'readily apparent' is entirely subjective and in our view is likely to lead to many deserving cases being rejected with serious consequences for taxpayer perception of the fairness of the tax system.

#### Nature of businesses impacted

410. This issue potentially affects any taxpayer in any industry.

#### Proposal

411. We are of the view that the qualification 'readily apparent' should be removed as it unnecessarily restricts the discretion afforded to SARS in terms of the section.

412. If the words 'readily apparent' were removed, SARS would in any event still have to be satisfied that the error was 'undisputed' prior to issuing a reduced assessment.

#### **NOT IMPLEMENTED-Objection to a self-assessment – section 104**

##### Legal nature

413. Section 104(1) of the TAA provides that a taxpayer who is aggrieved by an assessment made in respect of the taxpayer may object to the assessment.

414. On the basis that section 104(1) does not distinguish between assessment and self-assessment, the definition of "assessment" must be considered.

415. Section 1 defines "assessment" as the determination of the amount of a tax liability or refund, by way of self-assessment by the taxpayer or assessment by SARS. Furthermore, the term "self-assessment" is defined to mean a determination of the amount of tax payable under a tax Act by a taxpayer and

- Submitting a return which incorporates the determination of the tax; or
- If no return is required, making a payment of the tax.

416. Having regard to the above it is therefore clear that a taxpayer may object to an assessment by SARS and to a self-assessment by the taxpayer. There are however issues around the time-frame for objection in the case of a self-assessment as set out below.

417. On the basis that the date of assessment will determine the procedural timeframe within which an objection must be lodged it is important to consider what the date of assessment is in the case of a self-assessment. This is defined in section 1 of the TAA as the date the return is submitted if a return is required.



418. If no return is required the date of the last payment of the tax for the tax period will be the date of assessment. If no payment was made in respect of the tax for the tax period, the effective date will be the date of assessment. The effective date may also differ depending on the tax type, and this may need to be considered further.

#### Detailed factual description

419. For PAYE and VAT purposes, a return is required and therefore the date of submission of the relevant PAYE or VAT return is the date of assessment, and this date is used as the starting point to calculate the correct 30 business day objection time frame.

420. If the 30 days are exceeded, one may need to request condonation for lateness based on reasonable grounds (currently up to 51 business days, but proposed to be extended by 9 days in terms of the TALAB 2016) or exceptional circumstances (between 52 business days (proposed 60 days) and 3 years).

421. In the case of a self-assessment, this is the established tax liability and no further assessment is required from SARS.

422. The problem is that although SARS may issue an additional assessment within a period of five years after the date of assessment of a self-assessment, a taxpayer who is aggrieved by his own self-assessment may only object within the first three years of the date of assessment.

423. This is regardless of what the grounds of the objection are.

424. For example, there may have been an incorrect calculation based on a particular view taken by the taxpayer on the PAYE deducted for its employees, and this is uncovered through a comprehensive review by the newly appointed external tax advisors.

425. If SARS therefore does not of its own accord issue an additional assessment (to which the taxpayer may lodge an objection within three years) within the first three years after the original self-assessment being submitted, the taxpayer does not have the right to lodge an objection for a two year period after that, and is at the mercy of SARS to take the next procedural step within the next two year period.

#### Nature of business impacted

426. All taxpayers subject to self-assessment taxes (i.e. VAT, PAYE, dividend tax, etc.)

#### Proposal

427. We are of the view that in the case of a self-assessment a taxpayer should be given the right to lodge an objection within five years from the date of assessment (i.e. from the original date of self-assessment).



428. This must also be seen against the backdrop that the basis on which a taxpayer may request a reduced assessment is entirely watered down by virtue of the latest amendments to section 93 of the TAA.

429. In this regard, we submit that consideration should be given to restoring the ability for a taxpayer to request a reduced assessment for a much broader spectrum of eventualities, and also to afford a taxpayer the opportunity to request a reduced assessment for five years following on the original assessment date of the self-assessment.

### **NOT IMPLEMENTED-Section 187 of the TAA read with section 45 of the VAT Act – interest on delayed refunds**

#### Legal nature

430. If SARS requests information, which may in some instances be quite onerous and in extreme cases unreasonable for the taxpayer, for verification of a VAT refund, section 45(1)(i)(bb) of the VAT Act provides that interest on delayed refunds does not accrue to the taxpayer until the requested information was received by SARS.

#### Detailed factual description

431. 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 22<sup>nd</sup> business day.

432. Where a taxpayer claims a refund, SARS may elect to request the taxpayer to provide information to verify the refund. In our experience, on numerous occasions, SARS only requests the information shortly before the expiry of the said 21 day period.

433. Again, in numerous instances, the information requested rarely achieves any results other than a delay in SARS paying the refund to the taxpayer. In our view, the current legislation results in an unfair cash flow disadvantage, being a delay in the refund amount as well as a loss of interest, to the taxpayer.

434. 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.

435. We therefore suggest that interest on delayed refunds must accrue from the day following the 21 business days as provided for (i.e. day 22), 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 22<sup>nd</sup> business day after



the date on which the vendor's return in respect of a tax period is received by an office of SARS.

436. Where manual overrides for delays are done, SARS should be compelled to provide reasons for why they view the delay to be the taxpayers fault and the number of days excluded for the running of interest.

#### *The nature of the businesses impacted*

437. All vendors who are in a refund position, or who will claim a refund from SARS in future.

#### **NOT IMPLEMENTED-Section 187(6) & (7) of the TAA – interest remittance**

##### *Legal nature*

438. Section 187(6) of the TAA provides that if a senior SARS official is satisfied that interest payable by a taxpayer under subsection (1) is payable as a result of circumstances beyond the taxpayer's control, the official may, unless prohibited by a tax Act, direct that so much of the interest as is attributable to the said circumstances is not payable by the taxpayer.

439. Section 187(7) of the TAA provides that the circumstances referred to in subsection (6) are limited to:

- a natural or human-made disaster;
- a civil disturbance or disruption in services; or
- a serious illness or accident.

##### *Detailed factual description*

#### ***Interest only if no loss to the fiscus***

440. It is commonly known that interest is charged /paid for the use of another's funds. As a result, we believe that the interest remittance criteria should consider whether the non-compliance in questions resulted in a financial loss or financial gain to the fisc and that interest must not be charged by SARS if there is no loss to the fisc.

#### ***Interest remittance if error made by SARS***

441. Currently, there are no provisions contained in the TAA in terms of which SARS can remit interest where the interest resulted from an error made by SARS, e.g. incorrect allocation of payments, incorrect date used when processing journals, etc.

442. We understand that interest resulting from the aforementioned should be remitted through an internal SARS process, without requiring any formal request by the taxpayer. However, our experience in practice is that SARS does not in fact remit such interest automatically, requiring the taxpayer to lodge a formal request. Since section 187(7) does



not specifically include errors by SARS, SARS often contend that it has no discretionary powers to remit the interest.

443. We recommend that the circumstances listed in section 187(7) of the TAA be amended to also include the following (i.e. similar to the circumstances listed in section 218(2)(e) of the TAA which relate to penalty remittance):

- any of the following acts by SARS:
- a capturing error;
- a processing delay;
- provision of incorrect information in an official publication or media release issued by the Commissioner;
- delay in providing information to any person; or
- failure by SARS to provide sufficient time for an adequate response to a request for information by SARS.

*Nature of business impacted*

444. All vendors where interest was imposed where there was no loss to the fiscus or interest was charged as a result of an error made by SARS.

**NOT IMPLEMENTED-Section 208 of the TAA – “first incidence” read with section 217 of the TAA – “reasonable grounds”**

*Legal nature*

445. Section 213 of the TAA imposes a percentage based penalty on the late payment of VAT.

446. Section 217 of the TAA allows a taxpayer to request the Commissioner to remit the penalty imposed if the non-compliance results from a first incidence of non-compliance if SARS is satisfied that reasonable grounds for the non-compliance exists.

447. In terms of the definition of ‘first incidence’ in section 208 of the TAA, the term means an incidence of non-compliance by a person if no ‘penalty assessment’ was issued in the preceding 36 months, whether involving an incidence of non-compliance of the same or a different kind. It also provides that a ‘penalty assessment’ which was fully remitted by SARS, must be disregarded for this purpose.

*Detailed factual description*

*Reasonable Grounds*



448. Based on our experience, the term “reasonable grounds” appears to be interpreted differently by different SARS offices.
449. Often non-compliance results from circumstances beyond a taxpayer’s control, such as where a taxpayer’s internet connection may not be functioning, or payments made via an EFT are not executed successfully, or where a taxpayer made a calculation error or capturing error that is only discovered after the return is submitted.
450. Currently, taxpayers are severely prejudiced when the non-compliance occurs due to a bona fide inadvertent error.
451. We recommend that section 217 of the TAA be amended to allow a taxpayer to request the Commissioner to use its discretion to remit a late payment penalty if the non-compliance resulted from a bona fide inadvertent error and that the term “reasonable grounds” be deleted.
452. The implication is that SARS does not have discretion in any case which falls outside the ambit of the above, such as where there was one or more previous incidents in the same or a different tax type, regardless of the significance of the non-compliance in question, or the nature thereof.

#### *First Incidence*

453. If the non-compliance occurs more than once within a period of 36 months a taxpayer is without any remedy to request SARS to remit the penalty. For tax types which require one return and one assessment per year, this equates to only three possible penalty assessments to be tested; for tax types with several returns and assessments per year, such as is the case of VAT and PAYE where up to 36 returns are required, testing 36 penalty assessments is excessive.
454. For this reason we recommend that the 36 months requirement should only apply in respect of penalties resulting from the same or substantially similar circumstances.
455. Furthermore, where a penalty was imposed and paid in full without contest by the taxpayer, such a penalty should not continue to prejudice the taxpayer. For this reason, any penalty imposed and paid in full by a taxpayer, should be disregarded in the same way as penalties which were remitted in full.

#### *Nature of business impacted*

456. All vendors who receives a penalty assessment.



## **PARTIALLY IMPLEMENTED-Section 225 of the TAA – definition of the term “default”**

### Legal nature

457. A vendor may only apply for Voluntary Disclosure in terms of section 226 read with section 227 of the TAA where the disclosure involves a “default” which has not occurred within 5 years of the disclosure of a similar “default”. (our emphasis)

458. Section 225 of the TAA defines the term “default” to mean the submission of inaccurate or incomplete information to SARS, or the failure to submit information or the adoption of a tax position, where such submission, non-submission, or adoption resulted in an understatement.

459. Section 221 defines the term “understatement” as including any prejudice to SARS or the *fiscus* as a result of-

- A default in rendering a return;
- An omission from a return; or
- An incorrect statement on a return;

### Detailed factual description

460. It is unclear what is meant by “similar default”. By way of an example a vendor applies for VDP since it was erroneously not registered for VAT with the result that output tax was under declared. The vendor subsequently (i.e. within a period of 5 years from the said understatement) realizes that it incorrectly accounted for VAT at the zero rate on certain supplies and wishes to apply for VDP.

461. In this instance it is evident that the first default was a default in rendering a return, whereas the second was an incorrect statement on a return, both of which resulted in a prejudice to the *fiscus*. However, if the first default was for example input tax erroneously claimed on entertainment related expenses, it is unclear whether the second default will constitute a “similar default” since in both cases the default was an incorrect statement on a return.

462. We recommend that the reference to “*similar default*” be amended to read “of a default that is in all material respects similar in nature”.

### Nature of business impacted

463. All vendors who want to apply for relief under the Voluntary Disclosure Program in respect of different types of errors which result in “understatements”.



**Paragraph 20 of the 4<sup>th</sup> schedule to the act pertaining to the 20% underestimation penalty**

**Legal nature**

464. Previously, the 20% penalty for underpayment of provisional tax as a result of underestimation of provisional tax did not apply in relation to any final or last estimate referred to in paragraph 20(1) of the 4th Schedule to the Act, if the Commissioner has under the provisions of paragraph 19(3) increased such final or last estimate.
465. Section 10 of the Tax Administration Laws Amendment Act, 2014 deleted this exception contained in subsection 3 and hence the penalty now also applies where the Commissioner has increased such final or last estimate in terms of paragraph 19(3).
466. It is possible for companies with volatile income to make a bona fide underestimation based on provisional results, in which instance a harsh penalty is levied on the taxpayer in such circumstances.
467. It is proposed that it would be more equitable to allow taxpayers an opportunity to rectify such underestimate through the paragraph 19(3) process.
468. The Commissioner is not prejudiced in the process, as the paragraph 19(3) process is normally completed shortly after the year-end results are available.

**Factual description of the relevant transaction**

469. Refer above.

**Nature of businesses impacted**

470. Provisional taxpayers.

**Proposal**

It is proposed that paragraph 20(3) of the 4th Schedule to the Act be reinstated as it was before above mentioned deletion.

**NOT IMPLEMENTED-Section 70 – Information sharing between SARS and RCB's**

**Legal nature**

471. RCBs are registered with SARS with the purpose to regulate tax practitioners.
472. However some of the requirements that SARS expect such as tax compliance and criminal clearance status is time consuming and costly to obtain on an individual basis.
473. Section 70(2) € allows limited disclosure in respect of matters in section 240(2)(a) and section 240A(3) which is insufficient to perform the regulatory function.



Factual description of the relevant transaction

474. The Efiling system requires an income tax number for an RCB to submit registrations and reports. However where RCB must verify compliance SARS are unable to share that exact same information with RCBs.

475. Furthermore RCB must confirm whether a member was removed by any other RCB and the only person with such central information is SARS.

476. This makes it untenable to match data with SARS or to practically verify compliance.

Nature of businesses impacted

477. All Recognised Controlling Bodies.

Proposal

478. Section 70(2)(e) should be amended to allow SARS to share all such information necessary on a taxpayer who is a registered tax practitioner for the RCB to confirm its members compliance with Chapter 18 of the TAA.

479. This information should also include whether a member was removed by any other RCB in the last 5 years.

480. Added to this we also propose that specific reasons for the removal be provided by SARS.