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National Treasury
South African Revenue Service

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Dear Aneesa and Adele

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

1. We refer to your request for comments on the draft Regulation on Electronic services for purposes of the definition of "electronic services" in section 1 of the Value Added Tax Act, No 89 of 1991 (VAT Act) issued on 21 February 2018.

2. We herewith present our comments on behalf of the South African Institute of Chartered Accounts (SAICA) VAT Sub-Committee on the draft Regulation on Electronic Services released by the South African Revenue Service (SARS).

3. Please refer to Annexure A that contains our observations and recommendations.

4. We would like to thank National Treasury and SARS for the opportunity to provide constructive comments in relation to the draft Regulation. SAICA believes that a collaborative approach is best suited in seeking actual solutions to complex problems.

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

Yours sincerely

Christo Theron
Chairperson: SAICA VAT Subcommittee

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Project Manager: Tax

ANNEXURE A

GENERAL OBSERVATIONS

5. SARS and National Treasury mentioned during workshops held in relation to the initial introduction of the electronic services regulation and VAT legislation in 2014 and 2015, that the intention was always to extend the definition of electronic services to include a wider range of services.

6. The comments to follow are based on the draft Regulation, the explanatory memorandum to the draft Regulation and the sections of the VAT Act impacted by the Draft Rates and Monetary Amounts Amendment of Revenue Laws Bill of 21 February 2018.

7. The draft explanatory memorandum to the Regulation states that the intention with the new law dealing with electronic services is to "*include software and other electronic services and to broaden the scope of electronic services*". It further states that the intention is *"to widen the scope of the Regulation to apply to all "services" as defined in the VAT Act that are provided by means of an electronic agent, electronic communication or the internet for any consideration."*

8. The above objectives are aimed at reducing the risk of distortions in trade between foreign and domestic suppliers where VAT is one of the reasons for such distortions.

9. To achieve the above desired results the definition of "*enterprise*" in section 1(1) of the VAT Act has been extended by the introduction of a new paragraph (vii), including in the definition of "*enterprise*" "*the activities of any intermediary*" and a new definition of "*intermediary"*.

10. A new section 54(2B) of the VAT Act was also introduced deeming intermediaries to be carrying on the South African VAT enterprise on behalf of a non-resident supplier of electronic services under certain circumstances.

11. National Treasury also issued a new draft Regulation setting out the ambit of "*electronic service"* as defined in section 1(1) of the VAT Act.

12. Essentially the new draft Regulation includes all services supplied by way of electronic means as electronic services, excluding "*telecommunication services*" as defined in the draft Regulation and certain educational services.

Davis Committee Report

13. Further to the above the Davis Committee, Value-Added Tax: First Interim Report (Davis VAT Report) includes comments in relation to VAT and electronic services.

14. As stated in paragraph 7.6 of the Davis VAT Report, both Canada and the European Union (EU) has moved to *"categories"* of what constitute electronic services and it is recommended that South Africa follows suit. It is further recommended that the *"categories"* should then be further explained in a guide or interpretation note. As an

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

15. Other recommendations included in the Davis VAT Report in relation to the definition of electronic services are:

15.1 The Organisation for Economic Co-operation and Development (OECD) recommendations and guidelines should be followed and cognisance should be taken of other jurisdictions' application of definitions.

15.2 The manipulation of the list of qualifying electronic services should not be allowed in order to make a distinction between business-to-business (B2B) and business-to-consumer (B2C) transactions.

15.3 Although the current legislation may be sufficient to include on-line advertising (e.g. the supply of still images or a subscription to a web site) a guide should be published to clarify this and other issues.

15.4 A distinction must be made in respect of *"telecommunication services"*, and, in harmony with other VAT jurisdictions, South Africa should incorporate specific provisions addressing *"telecommunication services"*.

16. The Davis VAT Report also provides detailed comments in relation to the impact of the distinction between B2B and B2C transactions, including the consideration of OECD recommendations. It was noted that there is ultimately a cash flow benefit if B2B transactions were to be excluded as the South African customer will have a cash flow motivation to transact with a foreign supplier as it will not have to wait up to 2 – 3 months to obtain the input tax deduction benefit if it transacted with a local South African supplier.

17. It is further stated, *inter alia*, that taking VAT neutrality into account for B2B transactions would mean a discrepancy in the VAT obligations between foreign and local suppliers and an undue benefit is granted to foreign suppliers. If a similar benefit is to be granted to local suppliers (i.e. not to register for VAT as a result of B2B VAT neutral transactions) it would mean a change in the core VAT system globally.

18. Further, OECD recommendations are noted in relation to the benefits of introducing a reverse charge mechanism for B2B transactions where the recipient is liable to account for VAT.

19. Lastly of particular interest is the recognition that although the B2B and B2C distinction is prevalent in the EU, that it does not mean that it is the most effective, but rather the legacy of aged privileges.

EU VAT Legislation

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

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

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

SPECIFIC OBSERVATIONS

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

Registration requirements

22. Section 23(1A) of the VAT Act will be amended to require suppliers of electronic services to register as VAT vendors where the total value of the taxable supplies made by that person in the Republic has exceeded R50 000 within any consecutive 12-month period.

23. The consecutive 12-month period, consistent with the compulsory VAT registration threshold time frame, is welcomed, as it does not make logical sense not to fix a time period within which the threshold limit must be reached. The amendment abates the uncertainty regarding whether a person who supplies electronic services is required to register for VAT as soon as the R 50 000 threshold is reached, since the inception of its supplies, or whether registration is required if R 50 000 is reached within 12 months.

24. As a general comment, it is doubtful, without a specific place of supply rule, whether it could be held that the electronic services are supplied *"in the Republic*" as required by section 23(1A) of the VAT Act. Were the services supplied "*in the Republic"* the normal VAT enterprise rules would have applied (i.e. any activity carried on regularly or continuously in or partly in South Africa) and there would have been no need for paragraph (b)(vi) to the definition of "*enterprise*" in section 1(1) of the VAT Act.

25. If the services can be held to be supplied in the Republic, we are of the view that the R50 000 annual turnover registration threshold is no longer relevant as suppliers of electronic services would now essentially be taxed on all supplies of electronic services made in South Africa (with the exception of two specific categories of supplies). There is therefore, in our opinion, no basis to apply a differentiated compulsory registration threshold to suppliers of electronic services.

26. Submission: We propose that the normal compulsory and voluntary registration thresholds be applied to suppliers of electronic services.

Registration Threshold

27. In view of the broad definition of *"electronic services"* as proposed in the draft regulation, it is expected that a substantial number of foreign suppliers will be required to register for VAT in South Africa especially given the R50 000 threshold. This will not only increase the administration burden of the foreign suppliers, but also that of SARS with regard to the registration process and the administration, processing and reviewing of monthly returns.

28. The explanatory memorandum sets out that the intention of the amendment is to widen the scope of electronic services to ensure fairness is created between all suppliers, whether locally or internationally based. This is in line with the OECD guidelines of neutrality in that taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

29. The registration requirements of R50 000 for non-resident suppliers in a period of 12 months compared to the compulsory VAT registration threshold of R1 000 000, is however in contradiction of both the intention of the explanatory memorandum and the OCED guidelines.

30. Submission: We recommend that the registration threshold applicable to non-resident electronic service suppliers should be the same as local suppliers, i.e. R1 million for a 12-month period.

Reverse charge mechanism

31. Where a supplier is not required to register, the recipient must declare output tax on imported services – South Africa imported services not being in line with the United Kingdom (UK) reverse charge definition.

32. The *"imported services"* definition in section 1 of the VAT Act states where a vendor receives services from a non-resident relating to the making of non-taxable supplies, the vendor must declare output tax to the extent that the services cannot be directly attributable to making taxable supplies.

33. The EU reverse charge aims to eliminate the registration requirements on non-resident suppliers, furthermore where the resident recipient is liable for VAT in its country, the implications of the reverse charge result in a VAT neutral position for the vendor (i.e. declaration of output tax and input tax deduction).

34. However the proposed amendments require the non-resident supplier to register for VAT where its supply is more than R50 000 and two of the requirements set out in the definition of *"enterprise"* in section 1 are met.

35. Submission: Clarity should be provided on whether the onus to prove VAT registration is on the recipient or non-resident supplier and where the recipient cannot prove the VAT status of the non-resident supplier, what the appropriate VAT treatment will be.

Furthermore clarity should be provided as to what remedy is available in the event that both recipient and supplier declare VAT on the same supply.

Classification of supplies

36. You indicate in the explanatory memorandum that *"Supplies that are exempt for VAT in the Republic or subject to the zero-rating provisions in the Republic will be equally applicable to the supply of "electronic services" as defined in section 1(1) of the VAT Act."*

37. We are not clear under which circumstances electronic services supplied in South Africa can be zero-rated or exempt. In this regard kindly note that the exemption applicable to imported services of R100 per instance does not extend to the supply of electronic services supplied by a VAT vendor.

38. We are concerned that the reference to zero-rated supplies may be interpreted as referring to supplies made outside South Africa by suppliers of electronic services based on the definition of *"enterprise"* (activities carried in or partly in South Africa). If this is the case non-resident suppliers of electronic services might be required to declare their world-wide supplies on their VAT returns.

39. Submission: We propose that the relevance of the paragraph in the explanatory memorandum be explained or that the paragraph be removed from the explanatory memorandum.

Total value of taxable supplies: abnormal circumstances

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

41. Submission: We recommend that the same exclusion is made available to suppliers of electronic services.

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

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

Telecommunication services

43. The meaning and ambit of *"telecommunication services"* are critical to the new legislation, but is not been dealt with in the draft explanatory memorandum.

44. Submission: We recommend that the nature and identification, together with supporting examples, be dealt with in the final explanatory memorandum. This is a

critical exclusion to the general ambit of electronic services and likely to result in confusion in practice.

45. We note that *"telecommunication services"* as defined in the draft Regulation is to be excluded from the term *"electronic services"*.

46. The implication is that broadcasting services and radio transmission services will be excluded from the VAT net. This is a typical B2B transaction that would result in a vendor recipient merely claiming the VAT incurred as an input tax deduction. The exclusion from the South African VAT system is appropriate in curbing unnecessary VAT registrations.

47. Submission: We agree that the supply of telecommunications content should be included as an electronic service, albeit that these are typically B2B supplies.

48. The imposition of the words *"relating to"* at the beginning of the definition arguably creates scope for installation of transmission systems/infrastructure to also be excluded from the ambit of electronic services.

49. Submission: We submit that clarity should be provided if this is the intention of the legislator.

50. The specific inclusion in the definition of the phrase "*access to global information networks"* implies that selling access to the internet (a global information network) and server/cloud storage services will also be excluded from the VAT net. We are of the view that this may incentivise South African suppliers of these services to merely register entities outside South Africa so the supply falls within this exclusion.

51. The definition of *"telecommunications services"* specifically excludes *"content of telecommunications"*. However, no guidance or definition of what the phrase of *"content of the telecommunications"* is provided.

52. Submission: We recommend that a definition or a description of what is meant by the phrase *"content of the telecommunications"* be included in the regulation to clarify this aspect.

Educational services

53. This amendment has the same effect as the current Regulation 3. This exclusion places a non-resident making supplies of educational services in the same economic position as a local supplier of educational services – that is, excluded from the South African VAT net.

54. As *"telecommunication services"* is defined, the draft Regulation should also contain a definition of *"educational services"* as there is currently no guidance regarding the meaning of *"educational services".*

55. This definition would also be necessary to ascribe a meaning to educational services for the purposes of section 12(h) and section 14(5)(c) of the VAT Act. A non-resident

may provide a combination of training programmes, some of which are regulated by an authority and others not.

56. Submission: We recommend that in order to create certainty the term *"educational services"* be defined in, either in section 1 of the VAT Act or in an interpretation note.

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

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

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

58. In our view the above paragraph sets out the nature of one of the categories of services that would constitute *"electronic services"* and that would require the non-resident supplier to register as a VAT vendor in South Africa.

59. The above issue should be dealt with under paragraph (A) of the draft Regulation explaining the framework of services falling within the ambit of the definition of *"electronic services"* in section 1(1) of the VAT Act, as it does not deal with intermediaries.

60. Submission: We propose that the last paragraph under the heading *"Intermediaries and Platforms"* be moved to the heading *"Persons required to register for VAT"*.

61. We further propose that a new heading be added to the explanatory memorandum providing examples of the various potential categories of supplies that will be considered *"electronic services"*. This does not need to be exhaustive, but needs to provide a framework within which affected.

Definition of "intermediary"

62. Intermediaries are deemed to be the supplier only if invoices and payments are administered by them, excluding intermediaries only responsible for providing payment platforms.

63. The current VAT Act does not define *"agent"* or *"intermediary".* In practice, the legal definition is used, therefore an agent/intermediary may issue invoices and collect payments on behalf of its principal under an agreement without taking over the principal's legal obligations.

64. The proposed amendments therefore contradict the legal definition and deems the agent/intermediary to be the supplier and therefore liable for the output tax declaration and payment.

65. Submission: Clarity is required on whether a definition in the VAT Act will be added to cater for this amendment and address the possibility of double taxation where the intermediary/agent cannot prove VAT registration of the non-resident supplier.

66. In the event that an intermediary/agent is responsible for providing a payment platform and administration of invoicing and collections, guidance will also be required as to whether such intermediary will be allowed to apportion the output tax on the deemed supply.

Section 54(2B) of the VAT Act

67. Section 54(2B) of the VAT Act could potentially apply in different scenarios. Firstly, where a non-resident parent entity supplies *"electronic services"* to its local VAT registered subsidiary for on-supply to the market, the section deems the supply to be made by the intermediary and as a result the non-resident is not required to account for VAT on the basis that it (the principal) does not make the supply.

68. Another scenario is where the operator of a global platform, which is already registered for VAT in South Africa as an electronic services supplier, also facilitates the supply of content of various other non-resident electronic services suppliers to South African customers. In these circumstances, the South African intermediary would need to ascertain and keep track of the VAT status of each non-resident supplier.

69. Based on the wording of section 54(2B) of the VAT Act the intermediary will be required to account for the VAT where the principal chooses not to register for VAT. This places a burden on the intermediary to ascertain whether the principal honours its VAT obligations.

70. It is proposed that where an *"intermediary"* is involved that it would be the intermediary's responsibility to account for the VAT. The non-resident supplier (principal) needs to be informed to ensure that the non-resident deregisters for VAT (provided the non-resident supplier is not registered for other reasons).

71. It is therefore proposed that where the non-resident is registered for VAT for other supplies, but an intermediary accounts for the VAT on electronic services, the foreign registered vendor should not be required to account for the electronic services VAT.

72. Furthermore, it should be clarified whether the concessions applicable to electronic services suppliers will also apply to intermediaries and whether the intermediary will be entitled to input tax deductions relating to costs incurred on behalf of the non-resident principal.

73. In addition, it should be clarified that where the intermediary renders services to a VAT registered principal, the services would qualify for zero rating in terms of section 11(2)(l) of the VAT Act on the basis that the services are supplied to a non-resident who is not in South Africa.

74. Submission: Based on our above comments we recommend that:

74.1 National Treasury clarifies the application of section 54(2B) of the VAT Act where the intermediary acts for various principals who may or may not be registered for VAT;

74.2 The concessions applicable to electronic services suppliers should also apply to intermediaries; and

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

Proposed implementation of 1 October 2018 is not feasible

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

76. Submission: We propose an implementation date of 6 months after the legislation is finalised.

Local supplier of electronic services

77. The implication of this amendment is that a non-resident, non-vendor electronic services supplier is able to shift its registration liability to the intermediary, which is deemed to be the principal supplier.

78. Submission: We recommend that consideration be given to the position of a local supplier of e-commerce services who is not registered for VAT, nor required to be registered for VAT who may want to utilise the services of an intermediary which appears to be on the increase in other jurisdictions.

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

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

80. Submission: We recommend that the legislation is amended to specifically exclude the non-resident electronic services supplier from the VAT net to the extent that the intermediary is required to account for VAT in terms of section 54(2B).

Compliance (Part D of the explanatory memorandum)

81. It is stated in the explanatory memorandum that *"Electronic Service Suppliers may register for VAT in the Republic using the simplified registration procedures as provided for in the SARS (South African Revenue Service) VAT Registration guide for Foreign Suppliers of Electronic Services."*

82. The VAT registration form requires the company registration number. Under the applicants' details for a company/trust/partnership and other entities of the VAT registration guide, it states that only the club, collective investments schemes, a partnership or body of persons that can leave the registration number blank, as it is not applicable.

83. The VAT registration guide further states that the company registration number is the number supplied by Companies and Intellectual Property Commission (CIPC) or Master of High Court on successful registration of the entity.

84. This implies that the nature of entity not mentioned to leave the registration number blank will have to first obtain the South African registration number before they can register for VAT. In practice once the company (local/foreign) is registered with the CIPC the income tax number is automatically issued, thus creating the administrative process and compliance burden with other taxes.

85. Submission: We submit that consideration be given not to create inappropriate compliance burden for businesses to comply with VAT registration, that the companies/other entities be able to also leave the company registration blank, especially those companies that would just exceed the minimum total value of taxable supplies required.

Amendments to Regulation 1

Deletion of the definition of "electronic services supplier"

86. It is noted that the current Regulation 1 does not define the term *"electronic services supplier"*. Accordingly, there is no definition to be deleted.

87. Submission: We recommend that the term *"electronic services supplier"* be inserted as a definition in section 1(1) of the VAT Act, in line with the draft amendment of the VAT Act.

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

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

Amendment of Regulation 2

Ambit of the definition of "electronic services"

88. The current Regulation provides for a specific list of services which fall within the ambit of *"electronic services"* as defined. As some of the terms used in the current

Regulation are not defined, it create uncertainty amongst non-residents as to whether their services qualify as *"electronic services"* in South Africa.

89. The definition of *"electronic services"* contained in the draft Regulation seems to mirror the classification of electronic services as seen in certain other jurisdictions. The broad definition of *"electronic services"* could lead to double taxation of services where the services are taxed, both in the foreign and local jurisdiction. An example is the broadcast of a live event which takes place in the EU the supply is taxed in the EU.

90. The ambit of the definition of *"electronic services"* is extremely wide, and no clear guidance as to the type of services which are included or excluded is provided. To simply include a reference to the Electronic Communications and Transactions Act in respect of the definitions of *"electronic agent"* and *"electronic communication"* is not helpful, as it does not provide any guidance with regard to the specific services to be included. Foreign suppliers may not have access to the Electronic Communications and Transactions Act or be in apposition to properly interpret the provision of that Act.

91. Submission: We recommend that instead of merely referring to definitions in the Electronic Communications and Transactions Act, that the specific categories of services which are to be included in the definition of *"electronic services"* be described in the Regulation.

The meaning of "supplied by means of"

92. Clear guidance should be given to the interpretation of the phrase *"any services supplied by means of an electronic agent, electronic communication or the internet for a consideration"*. In this regard the distinction between a stand-alone service, the outcome of which is delivered by electronic means, and the actual supply of a *"by means of"* must be explained and examples given on how the distinction must be made in practice.

93. With the advancement in technology over the years, an increasingly wide array of services are being provided via electronic means.

94. For example, if a London based attorney prepares a legal opinion in London and sends the opinion to a client in South Africa in a PDF file format, is the supply an electronic service supplied by means of an electronic agent, or has the outcome of an independent service merely been delivered by electronic means? To take the enquiry to the next level, if for example the opinion is not delivered in the form of a PDF file, but merely a written email, does this change the situation?

95. The Regulation should clarify whether professional or consulting services would constitute *"electronic services"* simply because the written advice or report is emailed to the recipient.

96. Another example is on-line auctioneering platforms. If a non-resident supplies the use of the platform to a South African on-line auctioneering enterprise for a consideration, it is clear that the supply is an electronic service supplied by the non-resident to the South African user. Where the South African auctioneering company in turn charges a

fee to participants in an on-line auction, the South African auctioneering company could be viewed as an *"intermediary"* of the non-resident supplier. This is clearly not the case based on the wording of the proposed legislation and the draft Regulation, but causes uncertainty in the relevant industries. The confusion is exacerbated by the paragraph in the draft explanatory memorandum being included under the heading *"Intermediaries and Platforms"* in the explanatory memorandum.

97. Submission: We propose that the application of the *phrase "any services supplied by means of"* be explained and examples be provided on how it will be applied in practice.

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

Use of the term "includes"

99. The current Regulation 2 presently reads as follows:

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

100. The amendment to Regulation 2 proposes the following:

*"For the purposes of the definition of "electronic services" in section 1(1) of the Act, "electronic services" **includes** any services supplied by means of […]" (our emphasis)*

101. It appears that the current Regulations have the effect of prescribing an exhaustive list of services which are prescribed as electronic services, with Regulations 3 to 7 specifically stipulating the scope of services within categories.

102. Whereas the draft amendment, by imposing the word *"includes"*, appears to broaden the scope of electronic services to beyond the draft Regulation. That is, where a service does not fall within the requirements of the draft Regulation, the service may still be regarded as electronic services in the ordinary sense of the term. We envisage this consequence as misaligned to the intention of the legislator.

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

Amendments to Regulations 3 to 7

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

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

105. The introduction of the requirement for foreign suppliers of electronic services to register for VAT in South Africa has ensured that VAT is efficiently collected and paid on the value of electronic services consumed in South Africa, as the requirement for recipients to account for VAT in terms of section 7(1)(c) was difficult to enforce.

106. The proposed significant broadening of the Regulations with regard to the supply of electronic services and the low registration threshold is expected to result in a substantial number of foreign suppliers to come within the South African VAT net. The administration in relation to the registration of these suppliers and the submission and processing of VAT returns is expected to place a significant burden on both the suppliers concerned and on SARS.

107. When drawing a distinction between B2B and B2C transaction, B2B activities will always result in a neutral position as the non-resident would levy VAT and account for the output in their VAT return and the South African recipient would be able to claim an input tax deduction in their VAT return.

108. B2C transactions is where the problem lies as the non-resident electronic service supplier would levy VAT at 14% and include this in their VAT return. As the consumer may be a non-VAT vendor and may not be able to claim an input tax deduction on the electronic service purchase, the VAT would become a cost to the consumer, and this is where the revenue authorities would benefit.

109. To the extent that the suppliers render their services to VAT registered vendors in South Africa, it will not result in any additional revenue for the *fiscus* as any VAT payable will be deductible in total by the recipients, yet both the suppliers and SARS will be burdened with the associated administration. The current electronic services treatment is very wide and may be creating an unnecessary administrative burden by charging VAT, which the consumer would ultimately be able to claim back when dealing with B2B transaction. It may furthermore also have a negative impact on foreign companies considering conducting business in South Africa.

110. The OECD has acknowledged the compliance burden and obligation of businesses having a VAT registration liability in other jurisdictions, which often becomes burdensome. This has led to the OECD using B2B and B2C to distinguish between the place of supply and tax obligation.

111. The OECD recommends the following general place of supply rules to distinguish between B2B and B2C transactions. For B2B transactions the place of supply will be in the country in which the recipient belongs, and B2C the place of supply will be the country in which the supplier belongs. Therefore with B2C transactions you must account for VAT, regardless of where the customer resides.

112. One method put forward by the OECD was a simplified registration and compliance regime for B2C supplies, which states that there will be a much higher level of compliance by foreign suppliers where the tax obligations are limited to what is strictly necessary for the effective collection of the tax. This is especially important for

businesses that trade in multiple jurisdictions. The OECD further points out that *"complexity may create an uneven playing field between foreign and domestic suppliers resulting in market distortions and, ultimately, substantial impacts on governments' VAT revenues."*

113. It is expected that if a distinction is made between B2B transactions and B2C transactions, then a substantial number of cross-border inter-company transactions will be excluded, where the recipient company is either entitled to a full input tax deduction, or where compliance with section 7(1)(c) of the VAT Act is simpler to enforce than in the case of B2C transactions.

114. If B2B transactions were not to be included in the electronic service Regulations they will fall back into the VAT net as imported services where the recipient's revenue consist of exempt income exceeding 5%, the reverse charge mechanism would then be applicable. This will also result in the compliance burden falling on the South African recipient and not the non-resident.

115. Submission: We recommend that a distinction be made between B2B transactions and B2C transactions. Such a distinction is also recommended by the OECD where such treatment is consistent with the overall design of a national consumption tax system. The application of the rules to B2B transactions would alleviate the significant and unnecessary administrative burden for foreign suppliers, as well as for SARS.

116. VAT registration would be applicable to B2C participants, as well as participants dealing with both B2C and B2B transaction.

117. B2B transactions would need to be substantiated by proof of the consumers VAT registration in South Africa to exclude these transactions from forming part of the VAT net.

118. Alternatively, in the absence of the aforementioned consideration to implement rules that distinguish between B2B and B2C transactions, we submit that National Treasury and SARS consider the introduction of a reverse charge mechanism in line with the EU rules.

119. In the meantime we submit that SARS should hold off on the introduction of the new draft Regulation until all due consideration could be taken into account and a conclusion could be reached. In our view the benefits would result in alleviating the VAT registration administration burden for both foreign suppliers and SARS, the difficulty in collecting the VAT from foreign suppliers etc.

120. We are aware that this issue has been raised in the past, but in our view it needs to be reconsidered in the light of the potential significant impact the proposed legislation might have on the liability of foreign enterprises to register as VAT vendors in South Africa.

121. While there may be merit to not exclude B2B supplies on a blanket basis, consideration should be given to the introduction of group relief. In many instances international group holding companies may be required to register as VAT vendors

solely for the reason that they supply electronic services to their South African entities. Where the South African entitles would be entitled to full input tax deductions in respect of charges by international holding companies, the VAT registration of such companies in South Africa will not result in any additional revenue for the *fiscus,* but will result in potentially significantly more administrative efforts to SARS.

122. Submission: We propose that in addition to the consideration to be given to general relief with regard to B2B supplies as a future policy issue, immediate consideration should be given to group relief where the South African entities will be entitled to full input tax credits.

Software and other user royalties

123. In the past SARS ruled that where a South African user of intellectual property pays royalties or similar fees to a non-resident, being the owner of the intellectual property, the non-resident will not be required to register as a VAT vendor in South Africa, provided that the non-resident has no presence in South Africa and conducts no other enterprise activities in South Africa.

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

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

Additional comments

Exemptions from Services

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

127. Section 14(5) of the VAT Act provides for specific exemptions from VAT imposed of in terms of section 7(1)(c) of the VAT Act. In this regard section 14(5)(b) of the VAT Act makes provision that if that supply was made in South Africa and would be charged with tax at the rate of zero per cent applicable in terms of section 11 or would be

exempt from tax in terms of section 12 of the VAT Act it will not be subject to VAT at in terms of section 7(1)(c) of the VAT Act.

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

Online subscription platforms and advertising services

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

130. One example on the complexities relating to advertising and subscription services as well as consideration for the services is what is known as *"Pay Per Click"* (PPC) advertising. Under the PPC advertising model, a foreign supplier provides e.g. electronic/digital global job websites on a PPC model on which potential employees are directed to the website of an advertiser (i.e. direct employers, recruiting agencies etc.) The foreign supplier of the website receives a fee when its customer's (the advertiser) advertisement is clicked by a potential employee. There are two main models to determine fees under the PPC model, i.e. a fixed rate or bid-based rate model. The bid-based rate model is quite complex and the fees are based on the maximum bid amount by the advertiser and the amount of clicks on its advertisements. Furthermore, advertisers may also place adverts for free.

131. Another example is the provision of a global online marketplace via a website whereby third party suppliers can sell their range of products. Customers worldwide can purchase a South African or foreign third party supplier's goods through the foreign supplier's website. The products are manufactured by third party manufacturers (outside South Africa). No fee is charged by the foreign supplier solely for the use of the website by the third party suppliers or their customers.

131.1 However the foreign supplier enters into Service Agreements with the South African and foreign third party suppliers for the provision of certain services for which it receives a service fee. The said services are provided by the foreign supplier as an independent contractor to the third party suppliers and include, *inter alia*:

- The facilitation of the sale of the goods on behalf of the third party supplier including the marketing and processing of customers' orders;
- The facilitation and arranging of the manufacturing of the goods by an independent third party (outside South Africa) as agent on behalf of the third party supplier;
- The use of the online marketplace by the third party supplier; and

- Other support services provided to the third party suppliers such as payment collection and customer support.

131.2 The foreign supplier does not own or become the owner of any of the designs or finished goods and merely acts as agent for the facilitation of the sale and the manufacturing of the goods on behalf of the third party suppliers.

131.3 The service fee charged by the foreign supplier to the third party suppliers include the following:

- Hosting of the marketplace; and
- Facilitation of the transaction on behalf of the third party supplier, i.e. the sale and manufacture of the goods.

131.4 Furthermore, the foreign supplier is contractually liable in terms of the service agreement to provide delivery of the goods to the Customers for which the Customers pay a delivery fee.

132. A final example is also in relation to the provision of web applications by foreign suppliers where the term *"subscription service"* encompasses both, the scenario where subscription fees are paid in advance for a particular service using the web application, or where a person subscribes to a web application free of charge where fees are only due if and to the extent of the actual use of the services to which access is gained via a web application. In some instances subscriptions generally paid in respect of web applications are indeed not paid to have mere access to the application, but rather to those services to which the application provides access to.

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

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