Reimbursing employees has VAT risks

Employers often reimburse staff for a variety of costs, most of which bear VAT.

The VAT Act allows vendors as an input tax credit, any VAT incurred in respect of items acquired for the purposes of making taxable supplies. Deduction is also allowed where the supply was made to a person, acting on behalf of such vendor, who is the principal for the purposes of that supply, where the tax invoice is issued to such agent.

Even in the absence of a valid agency agreement, SARS used to allow an input tax deduction in respect of reimbursed costs, presumably on the basis that it would be contrary to the spirit of the Act to have a cascading of tax. (Irrecoverable VAT forms part of cost of sales resulting on tax being levied on tax.)

Recent SARS rulings indicate that even where employment contracts stipulate that certain costs are incurred by the employee as the employer’s agent, reimbursed cell phone costs are not incurred by the employee as an agent, premised on the fact that the cell phone contracts are not concluded by the employee acting as agent but in his personal capacity.

The SARS approach seems to disregard the principle of the undisclosed principal, which is well entrenched in South Africa law. In practice, the supplier would sue the agent in case of default, with the agent having a right of recourse against the undisclosed principal.

Can one hold a cell phone contract as principal and yet agree to make certain calls as the agent of another? According to SARS, such costs are a necessary concomitant of the employee’s remunerated services; a simple reimbursement and not the refund of an agent’s costs.

May accommodation and travel costs be incurred as the agent of one’s employer? SARS recently ruled that SAICA membership cannot be held as agent of the employer as SAICA’s constitution does not allow for corporate membership and hence, no VAT deduction for the employer. Can one fly on behalf of someone? A corporate entity cannot fly, eat or sleep. SARS logic suggests that reimbursements of such costs would not allow the employer a VAT deduction as the individual would not be an agent of the employer.

A meal or hotel service can hardly be consumed as the agent of another. The VAT Act merely requires the supply to be made to a person acting as the agent of another person who is the principal for that supply – as he would be if instructing the employee to acquire the supply in a representative capacity. In such a case, it is submitted, the supply would be made to a person acting as an agent of another person, who would be the principal in acquiring such supply – so too where an employment contract determines that business calls are made in a representative capacity.

Simply have the tax invoices issued to the employer? Input tax is defined as tax charged by a supplier on supplies made to the vendor, not to its employees. If the individual were not acting as representative of the employer to begin with, having the invoices issued to the employer would arguably amount to tax evasion with potentially serious repercussions as the VAT would not constitute “input tax” as defined.

As it stands, many vendors appear to be contravening the SARS interpretation of the VAT Act when deducting the VAT in respect of costs reimbursed to employees and are at risk of being assessed for tax, penalties and interest.

Note a change in requirement when issuing a VAT invoice

Author: David Warneke

SARS recently issued a binding general ruling clarifying the requirement that the address of the recipient and supplier be reflected on a tax invoice, debit or credit note. The ruling is effective from 11 March 2014 and it applies for an indefinite period.

In terms of the ruling, a businesses may elect to reflect either:

- The physical address from where the enterprise is being conducted;
- The postal address of the enterprise; or
- Both the physical and postal addresses of the enterprise.

Will branches and divisions be exempt from this requirement?

Branches or divisions that are separately registered for VAT[1], the tax invoice, credit or debit note must reflect the address of the branch or division.

Will the same rule apply to the non-resident business?

A tax invoice, credit or debit note issued for a zero-rated supply of goods or services to a non-resident must reflect either:

- The physical address of the non-resident in the foreign country;

- The postal address of the non-resident; or
- Both the physical and the postal address of the non-resident.

The address of the supplier must always be reflected on tax invoices as well as on debit and credit notes issued by VAT vendors. The address of the recipient must also be reflected in a tax invoice, debit or credit note where the consideration for the underlying supply exceeds or, in the case of a debit or credit note, exceeded R5 000. This ruling sets out which addresses (of the supplier or the recipient) are relevant for these purposes.

The ruling implies that the address of the recipient need only be reflected where the recipient is a vendor or a non-resident. The address must also be reflected where the recipient is a resident but a non-vendor, provided that the consideration for the supply exceeds R5 000.[2]

The particulars required to be contained in tax invoices are however subject to 'what the Commissioner may otherwise allow'.

References:

[1] In terms of section 50(1) of the VAT Act.

[2] In terms of section 20(4) of the VAT Act.

The VAT registration amendments: will these

changes streamline the registration process?

The Taxation Laws Amendment Act, No 31 of 2013 introduced amendments to the VAT registration provisions contained in the Value-Added Tax Act 89 of 1991 ("**the VAT Act**"), aimed primarily at streamlining the VAT registration process. These amendments came into force on 1 April 2014.

Prior to the amendments, the VAT Act required any person who carried on an enterprise in South Africa to register as a VAT vendor, where the total value of taxable supplies made from the carrying on of such enterprise exceeded *or was reasonably expected to exceed* the R1 million threshold in a 12 month period.

Persons who did not meet the compulsory registration threshold were entitled to voluntarily register for VAT where the total value of taxable supplies made in a 12 month period had already exceeded R50 000. Where a person, as a result of regular or continuous activities reasonably expected that taxable supplies with a value in excess of R50 000 per annum will be made in the future, the person was also entitled to register for VAT.

In practice, SARS rarely registered anyone for VAT without detailed enquiry and explanation unless it could be proven that the VAT thresholds of R1 million or R50 000 respectively had already been exceeded, or there was a signed agreement in place in terms of which the applicant was obliged to make taxable supplies exceeding R1 million per annum.

Registering for VAT has proven to be quite a frustrating process for vendors and tax practitioners alike. The frustration stemmed in part from the inconsistent documentary requirements applied by the SARS consultants at the different

SARS branch offices, and applications were often submitted numerous times before they were accepted. The onerous SARS VAT registration process and procedures also resulted in significant time delays for VAT numbers issued. The VAT registration was generally made effective from a retrospective date, and the vendor was then assessed for VAT, penalties and interest on all supplies made from the effective date to the actual of date of registration.

In an effort to mitigate the problems associated with the VAT registration process and to address the perceived risk of SARS regarding the registration of illegitimate businesses, the following amendments to the VAT registration provisions contained in the VAT Act have been introduced with effect from 1 April 2014.

Compulsory registration

The predictive element associated with compulsory VAT registration has now been removed in that only persons who have already made taxable supplies exceeding the R1 million threshold, or persons who have a written contractual obligation to make taxable supplies exceeding the R1 million threshold in a period of 12 months, will be liable to register for VAT.

A new category of compulsory registration relating to foreign suppliers of electronic services has also been introduced. Foreign suppliers of electronic services will be required to register as VAT vendors if they make taxable supplies in excess of R50 000 in a 12 month period. The regulations specifying what constitutes ‘electronic services’ for purposes of the VAT Act will, however, only come into force on 1 June 2014. This has the effect that whilst the legislation is effective from 1 April 2014, foreign suppliers of electronic services have until 1 June 2014 to comply with their registration obligations. SARS has centralised and simplified the VAT registration process for foreign suppliers of electronic services who are obliged to register for VAT. As an example, they can apply for VAT registration via e-mail and are not required to open a South African bank account (the *VAT Registration Guide for Foreign Suppliers of Electronic Services refers* – available on the SARS website).

Voluntary registration

A person may still voluntarily register for VAT where the person has already made taxable supplies exceeding R50 000 in a 12 month period. A person may also now register voluntarily where the person carries on an enterprise and has not yet exceeded the R50 000 threshold, but reasonably expects that the R50 000 threshold will be exceeded within 12 months from the date of registration. Such persons will be registered to account for VAT on the payments basis. Once the value of taxable supplies has exceeded R50 000, that person must account for VAT on the invoice basis unless the person qualifies to continue to account for VAT on the payments basis.

A new category of persons entitled to register for VAT on a voluntary basis are those persons that carry on an enterprise of a nature as set out by the Minister in any regulation. The nature of the enterprise must be such that it is only likely to result in the making of taxable supplies after a period of time. The Minister has not yet published any regulations specifying the types of enterprises that will qualify for registration under this category even though this VAT amendment is applicable from 1 April 2014. The regulations are expected to include those types of activities that require a considerable capital outlay at commencement, but that are only expected to generate income from a future date, for example construction, plantation farming, mining exploration and research and development enterprises.

A business wishing to register for VAT must compile certain supporting documents and complete a VAT 101 application form which must be submitted in person at the SARS branch office nearest to the place that the business is situated or carried on, within 21 days from the date of liability to register.

The VAT registration amendments sound simple enough to comply with, but only time will tell whether the SARS VAT registration procedures will be adopted in line with the object of the legislation amendments to have the desired effect of streamlining the VAT registration process, and alleviating some of the frustrations experienced in the past.

Import VAT – New Rules

By Basil Dikobe, Tax Manager, Grant Thornton Johannesburg

The requirements for claiming VAT when importing goods to South Africa have always been contentious and the affected VAT vendors are often unsure about the documentary evidence they need to retain to survive a SARS VAT audit. Even SARS offices interpret or enforce the provisions of the VAT Act differently. For example, some allow the clearing agent’s invoice as proof of import and others accept payment to the clearing agent as proof that VAT has been paid. Even the timing for claiming the input tax deduction has been disputed. These uncertainties have resulted in many VAT vendors receiving significant assessments, penalties and interest charges from SARS.

However, pending changes to the requirements will now further restrict the options available to vendors wishing to claim import VAT.

Current requirements for claiming import VAT
The VAT Act currently provides that a vendor can only claim import VAT in respect of goods imported to South Africa, when the goods have been invoiced or paid, whichever is the earlier, during that tax period.
The documentary evidence required to claim import VAT includes the bill of entry or other document prescribed in terms of the Customs and Excise Act, together with a receipt proving that the necessary tax was paid in respect of the said import.

In practice, vendors proof to SARS is their proof of payment to their clearing agent, trusting that the agent has indeed paid the required amounts to SARS. However, this practice is actually not sufficient as documentary evidence.

Clearing agents are generally reluctant to provide a copy of their statement of account to vendors, as it contains confidential information regarding all its other clients' imports. However, some clearing agents provide statements to vendors that show when the VAT on the specific import was paid to Customs, and this is generally accepted by SARS.

These documents should be in the possession of the vendor or its agent, at the time the return is submitted.

In essence, this practice allowed vendors to import goods but defer the VAT and Customs payments until the time that the vendor submitted its return to SARS. Vendors could thus claim the VAT in one tax period while the clearing agent only paid Customs via its deferment account in the next tax period, but before the vendor submitted its VAT return.

New timing rules
However, a recent change in VAT legislation will affect businesses importing goods to South Africa as it even further limits the period when import VAT can be claimed.
From 1 April 2014, import VAT can only be claimed during the same tax period when the goods were imported and the same

period when VAT is paid to Customs. It means that when vendors using the services of a clearing agent that only pays the import VAT to Customs in the next tax period via its deferment scheme, they can only claim the import VAT during the tax period in which the clearing agent pays the required VAT to Customs.

Clarification of documentary evidence
The documentary evidence requirements remain the same as before for now. However, the Minister of Finance proposed in his 2014/2015 Budget Speech that clarification will be provided on the documentary evidence that will be acceptable to claim the import VAT. Until this issue is clarified, there is a potential risk that vendors might not have sufficient documentation to support the input tax deduction on imported goods, resulting in SARS raising assessments, penalties and interest.

We recommend that vendors ensure that after 1 April 2014, they only claim the import VAT in the tax period when the VAT has been paid to Customs and that they obtain at least the SAD500 form, the Customs release notification and proof that the clearing agent has paid the VAT to Customs.

Deductions for income tax and VAT

Broadly speaking, in their ordinary business operations, certain entities are entitled to claim certain deductions for income tax and value-added tax (VAT) purposes. In this article we discuss the tests used by South African courts and in practice, for income tax and VAT purposes, in order to determine whether a taxpayer will be entitled to such deductions. Consideration will be given specifically to the deduction of legal expenses incurred by a taxpayer in terms of section 11(*c*) of the Income Tax Act No. 58 of 1962 (the Act) and the deduction of input tax in respect thereof in terms of section 1 read with section 7 of the Value-Added Tax Act No. 89 of 1991 (the VAT Act).

An income tax perspective

Section 11(*c*) of the Act provides, most relevantly, for a deduction from income of –

"any legal expenses … actually incurred by the taxpayer during the year of assessment in respect of any <u>claim, dispute or action at law arising in the course of or by reason of the ordinary operations undertaken by him in the carrying on of his trade</u>…"

The phrase "arising in the course of or by reason of the ordinary operations undertaken by him in the carrying on of his trade" has been considered by our courts and has been interpreted to mean that <u>the deductibility of expenditure in terms of section 11(*c*) of the Act does not depend on the purpose of the expenditure, but rather the causal connection of the relevant events with the taxpayer's trade</u>. Accordingly, it would be sufficient if the causal connection between the ordinary trading operations of the taxpayer and a claim, action or dispute is sufficiently close that it can be regarded as having arisen in the course of or by reason of the trading operations. For example, in the case of *ITC 1710* [1999] 63 SATC 403, an employee of the taxpayer who was the owner of a farm producing grapes, had while working in the vineyards, negligently set a neighbour's farm alight causing severe damage thereto. The High Court, in an action for damages brought against the taxpayer, had found that the employee in question had acted within the course and scope of his employment and the taxpayer was accordingly liable for the damages caused by the employee as a result of the fire. The taxpayer, in order to defend the legal action, had incurred legal costs and the issue to be decided by the court was whether such costs were deductible in terms of section 11(*c*). It was found that the costs in issue were connected by chance with work performed by the employee on the farm, as part of the taxpayer's business and that there was a sufficient causal connection with the taxpayer's farming operations. Accordingly, it was held that the legal costs incurred by the taxpayer were deductible in terms of section 11(*c*).)

In light of the above, it appears that the test for determining whether expenditure will be deductible in terms of section 11(*c*) would be to consider the causal connection with the taxpayer's trade. The purpose for which the expenditure is incurred or the purpose of the events giving rise to the costs is not the deciding factor.

A VAT perspective
Section 7(1)(*a*) of the VAT Act provides, *inter alia*, that:
"there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as value-added tax-
(a) on the *__supply by any vendor of goods or services supplied by him__* *on or after the commencement date* *__in the course or furtherance of any enterprise carried on by him__*

Essentially a VAT vendor is entitled to an input tax deduction on the acquisition of goods or services to the extent utilised for making taxable supplies in the course or furtherance of his enterprise. In order for a taxpayer to claim an input tax deduction in terms of section 16 the VAT Act, the taxpayer must be a registered VAT vendor, be carrying on an enterprise and must have paid VAT on goods or services which the vendor acquired wholly for the purpose of consumption, use or supply in the course or furtherance of any enterprise carried on by him, as envisaged in section 7(1)(*a*) of the VAT Act.

In the fairly recent case of the *Commissioner for the South African Revenue Service v De Beers Consolidated Mines Limited*

[2012] 74 SATC 127, an aspect that the Supreme Court of Appeal (SCA) had to consider was whether the VAT charged to the vendor on fees for certain local advisory services qualified for deduction as input tax. De Beers Consolidated Mines Limited (DBCM) engaged the services of a range of South African advisors and service providers, including attorneys (local suppliers), to assist in finalizing a proposed transaction. DBCM treated the amounts expended to obtain such services as deductible input tax in its VAT returns. The Commissioner disallowed the input tax claim, against which DBCM lodged an objection. The objection was disallowed by the Commissioner and DBCM lodged an appeal to the Tax Court held in Cape Town which also found, *inter alia*, that the VAT paid by DBCM in respect of certain local services was not deductible as input tax. The test was whether the services acquired by DBCM were acquired for the purpose of consumption, use or supply of goods or services in the course or furtherance of the enterprise. The SCA had to, *inter alia*, clarify the meaning of and nature of the word “enterprise” since the purpose of acquiring the services and whether they were consumed or utilized in making taxable supplies could only be determined in relation to a particular enterprise. This involved a factual enquiry as to what constituted DBCM’s enterprise. The SCA, in adopting a restrictive approach, found that DBCM’s enterprise, for the purposes of the VAT Act, consisted of mining, marketing and selling diamonds. It was found that the services provided by such local suppliers were provided for multiple purposes, but ultimately not for the purpose of making taxable supplies by an enterprise which mines, markets and sells diamonds.

Conclusion

In light of the above, it would seem that there are two distinct tests, from an income tax and VAT point of view, in determining whether a taxpayer can claim a deduction. From an income tax perspective, the test is whether there is a causal connection between the relevant events (giving rise to legal expenditure) and the taxpayer's trade whereas from a VAT point of view, the test is whether the expenditure incurred in procuring legal services was acquired for the purpose of consumption, use or supply of goods or services in the course or furtherance of the taxpayer's enterprise. Another (perhaps over simplified way) summary of the position is that for income tax purposes, deductions in respect of overhead and general business expenditure not aimed directly at the taxpayer's income earning activity will be allowed whilst for VAT purposes, our courts tend to require VAT expenditure to be incurred by the taxpayer, significantly more directly in connection with the earning of (vat-able) income.

ENSAfrica
ITA: Section 11(*c*)
VAT Act: Sections 7 and 16
SARS AND NEWS

Value Added Tax – Tax invoices and the payment of VAT

Cash-strapped companies that are staring liquidation in the face sometimes resort to desperate measures to convince the court hearing an application for winding-up that they are not, in fact, insolvent and should not be wound up.

A novel and imaginative method was adopted by the company, a VAT vendor, in *ITC 1865* [2013] 75 SATC 250, though it is unlikely to become popular or to find its way into tax-planning manuals.

The taxpayer issued fictitious VAT invoices to create the illusion of a revenue stream

In an effort to show the court hearing the liquidation application that it was not insolvent, the taxpayer company generated VAT invoices (ostensibly genuine, but in reality bogus, and never actually given to the addressee) reflecting fictitious income as due and payable, and attested on oath that its assets included the right to the invoiced amounts.

The background was that the taxpayer, a property-owning company trading as a landlord, had rented out commercial premises to three companies in a corporate group, but only one of the companies actually took occupation of the leased premises. The arrangement with the other two companies was, according to the taxpayer, a mere “pre-emptive measure”, anticipating “a future arrangement”. However, in respect of all three companies, the taxpayer issued some 54 tax invoices for monthly rental.

As was noted above, this was done for the purpose of using the invoices to oppose an application in the High Court for the winding up of the taxpayer company.

The taxpayer sinks deeper into the mire

The taxpayer seems not to have realised that this ploy would merely drive it deeper into the mire, for SARS now joined the queue of creditors and demanded the output tax reflected on the invoices.

The taxpayer, with its back firmly against the wall and with no more income than before, and yet another creditor in the form of SARS, hammering on its door, resorted to arguing that since it had not in reality rendered the supplies reflected in the invoices, it had not under- declared output VAT.

The taxpayer claimed that the invoices in question were “pro forma invoices” that “were merely intended to demonstrate a potential revenue stream” in order to oppose the liquidation application, and argued that, since the ostensible lessee companies had not utilised the invoices to claim input tax, no output tax was due to SARS.

The taxpayer also averred that the Commissioner's assessment letter – issued by SARS after a VAT audit into the taxpayer's output tax liabilities – did not constitute an "assessment" as envisaged in section 31(1) – (4) of the Value-Added Tax Act (the VAT Act).

The court ruled that VAT became payable immediately once the invoices were issued

In the result, the Tax Court ruled that there had indeed been a determination, as defined in the VAT Act, by way of an assessment and, moreover, that the taxpayer, in lodging an objection, had implicitly acknowledged that there had been such an assessment.

The invoices in question, said the Tax Court, complied in all respects with the statutory requirements for VAT invoices and, in terms of the VAT Act, the taxpayer became liable for VAT as soon as the invoices were issued.

The court pointed out that the VAT Act specifically states in section 9(1) that the supply of goods or services by a vendor is deemed to take place, at earliest, at the time a VAT invoice is issued. The court commented (see paragraphs [51] – [52]) in this regard that –

"As such, whether or not the appellant received payment for renting its property, and whether or not the appellant actually enforced payment of rentals by C (Pty) Ltd and D (Pty) Ltd, are of no consequence in relation to the appellant's liability for declaring output VAT … Furthermore, declaration of output tax … to SARS is not dependent upon a correlating claim for input tax by a vendor …. Similarly, declaration of output tax by a vendor … who rents out property, is not dependent upon whether such vendor elects to

enforce performance by a lessee in terms of a lease agreement during the term of the lease.”

The Tax Court said (at paragraph [53]) that, in the final analysis, VAT became payable as soon as the taxpayer issued the tax invoices in question and that it did not avail the taxpayer to contend that the invoices were fictitious.

The court also said that the taxpayer had not provided a credible explanation of the tax invoices it had generated (in short, that the taxpayer could not be believed when it said that it had lied on oath to the court hearing the winding-up application) and that, irrespective of the explanation, the taxpayer was liable, in terms of the VAT Act, for the payment of output VAT as indicated on the invoices.

The court refused to overrule the Commissioner’s decision to exercise his discretion by not remitting penalties and interest, but said that it would not be appropriate, in the circumstances of this case, to impose additional tax, given the imposition of the penalty and interest.

But, said the court, the grounds of appeal relied on by the taxpayer were frivolous and an adverse costs order was warranted.

A possible sequel

Although it is not foreshadowed in the judgment, there may be a sequel to the taxpayer’s failure in the Tax Court in the form of a criminal charge of statutory perjury against its directors in relation to the affidavits filed in the liquidation proceedings, falsely attesting to rental income being due and payable to the company.

In that event, the directors may well find themselves declared delinquent in terms of section 162(5)(c), read with section 77 of the Companies Act No. 71 of 2008, and housed in genuinely rent-free accommodation for an extended period.

(**Editorial comment:** *It is interesting that no consideration was given as to whether output VAT can be payable if no goods or services are supplied*.)

PwC
VAT Act: Sections 9 and 31
Companies Act: Sections 77 and 162(5)(c)

Davis Committee considering VAT at 16%?

Author: Ingé Lamprecht|

JOHANNESBURG – An increase in the standard value-added tax (VAT) rate of 14% by one or two percentage points could reduce the pressure on the fiscus and would bring South Africa more in line with a number of international jurisdictions around the world.

However, it will be an extremely unpopular move with unions and other political groups, who argue that it will be to the detriment of the poor.

The Tax Review Committee, headed by Judge Dennis Davis, is currently considering potential amendments to the VAT system, with a specific focus on efficiency and equity.

Potential ways of increasing fiscal revenue have been a topic of discussion for some time. The minister of finance is under pressure to reduce the budget deficit amidst heightened scrutiny from ratings agencies. The budget deficit is projected to be 4% of gross domestic product (GDP) in the

2014/15 fiscal year.

A higher rate?

Tax experts agree that it is premature to comment on the likelihood of an increase in the standard VAT rate of 14%; however there are a number of things that the Tax Review Committee will likely take into account.

Andrew Wellsted, director at Norton Rose Fulbright, says that an increase in the VAT rate makes sense, considering the small income tax base.

There is very little room to manoeuver with respect to the group of taxpayers, since they are basically stretched to the limit, given the percentage of the total tax receipt that they are paying.

Wellsted says objectively that, given the pressure on the fiscus, an increase in the VAT rate would appear to be a sensible move and a much more equitable move from a broad-based perspective.

He says it will also bring South Africa more in line with international trends – the local VAT rate is lagging slightly behind comparative jurisdictions. But while the numbers might point to a higher VAT rate as a potential solution, the issue is all but a simple one.

Wellsted says that it is a political issue. Increasing the VAT rate will be seen as an inequitable move, given the disparity in wealth in the country. He says that the Davis Committee may well recommend an increase in the rate, but whether it will actually be implemented is another question. It remains a controversial issue.

If the committee does recommend an increase, he expects that it would rise to around 16%.

Gerhard Badenhorst, executive at ENSafrica, says that an increase in the VAT rate of just one percentage point, would translate into additional income of around R15bn or R16bn for the fiscus [Around R899bn of tax revenues will be collected in the 2013/14 budget year].

Badenhorst says that this is a substantial amount of money and would require virtually no systems changes.

But while an increase in the VAT rate is one of the 'easy' ways to generate additional income, it will have implications, for example, with regards to the cash flow of businesses.

Badenhorst explains that the vast majority of businesses account for VAT on an invoice or accruals basis. If it sells items on credit, it has to pay over VAT to the South African Revenue Service (Sars), regardless of whether it has received payment from debtors.

An increase in the VAT rate would mean that these businesses would have to find additional sources to fund the VAT payment to Sars until such time as its debtors settle their accounts, he says.

Any potential increase would also have an impact on the poor. While public transport and residential rental accommodation are exempt items, and most basic foodstuffs are zero-rated, other items like meat, is subject to VAT at the standard rate.

Badenhorst says that, in his view, any potential increase in the VAT rate has to be considered together with a reduction in personal income tax, in such a way that relief is provided for lower-income groups.

Multi-tier

Dr Anne Bardopoulos, VAT manager at Deloitte, says that, considering all the factors that need to be examined as well as the potential political issues, there is probably a high possibility that a multi-tier tax rate system may be explored as an alternative to an increase in the standard rate of 14%.

Multi-tier systems are used in Europe and other jurisdictions, and effectively mean using three or more VAT rates.

South Africa currently uses two VAT rates – a standard rate of 14% and a zero-rate (for example, on basic food items).

Bardopoulos says that a multi-tier system could include applying a higher rate to luxury items such as CDs, movies and cigars, while still keeping the standard rate at 14% to ensure a level playing field between the different wealth groups.

What a higher VAT rate on luxury goods is likely to amount to, is difficult to say at this point, she says.

Wellsted also believes that a multi-tier rate would probably be more palatable. However, it would have to be introduced in a simplified fashion, to ensure that the tax system does not become more complicated.

Badenhorst says that, while such a system is a possibility, it could create a lot of practical problems. One challenge relates to the definition of goods that are taxed at a higher rate.

He explains that any vehicle that exceeds a certain retail price may be regarded as a luxury item. However, if children's clothing, for example, should be taxed at a lower rate, what would be regarded as children's clothing? The same goes for books. Does the definition include textbooks, magazines and e-books?

Another potential challenge would arise in the insurance industry. It is very difficult for insurers to set premiums under these circumstances, since certain goods in the household would be taxed at a lower rate, and others at a higher rate.

Badenhorst says that the third practical issue is that such a system will interfere with consumer choice, because higher rated goods will become less affordable and people may choose to buy items that are taxed at a lower rate. This, in turn, has implications for revenue.

The Davis Committee definitely has their work cut out for them.

South Africa’s VAT changes: The impact on e-commerce

Author: Bowman Gilfillan

The buying and selling of services over the internet has become ubiquitous. This article provides an update on the efforts of the South African Revenue Service (‘SARS’) and National Treasury (‘Treasury’) to bring foreign e-commerce suppliers on to a level tax playing field, by requiring them to register under the Value-Added Tax Act 1991 (‘the VAT Act’).

In South Africa, it is usually the case that an entity selling goods or services will (i) be charged VAT (normally at a standard rate of 14%) on its inputs by its suppliers, (ii) charge VAT on its outputs to its customers, and (iii) will have to register with SARS in order to claim back the tax paid in step (i) and pay over the tax collected in step (ii).

This system has functioned fairly smoothly, until recently. Technological advances have meant that many goods and services – music, films, books, gambling, education, and so on – are now easily consumable over the internet, from suppliers based anywhere in the world.

The VAT Act requires anybody conducting an enterprise in South Africa to register as a so-called 'VAT vendor.' In the past, typical e-commerce transactions were taxed in terms of a 'reverse charge mechanism,' where the onus was on the consumer to pay VAT on imported e-commerce goods and services. This system has been practically unenforceable and compliance levels were low. Local e-commerce suppliers have been unable to compete with their foreign counterparts, because they are forced to incorporate a 14% premium into their prices, to account for VAT.

To address these issues, the VAT Act was amended (by the Tax Laws Amendment Act 2013) to oblige suppliers of 'electronic services' (a) to South African residents, or (b) where payment for such services originates from a South African bank, to register as VAT vendors.

On 30 January 2014, the Minister of Finance published draft regulations clarifying what exactly constitutes 'electronic services.' These regulations will be open for public comment, until 20 February 2014.

The regulations list electronic services as including educational services, games and gambling, information system services, internet-based auction service facilities, maintenance services (in relation to, for example, a website or blog), subscription services (for example, online newspapers and magazines) and the supply of e-books, films and music.

One can expect that electronic service providers such as Amazon or Kalahari.com could be required to charge VAT on e-books and other electronic publications they sell to numerous South Africans on a daily basis. Such services have become commonplace in many South Africans' day to day lives and the charging of VAT thereon seems to be the logical progression. Other such items that could be subject to VAT in respect of online purchases include: audio clips, for example 'iTunes';

the streaming of live performances; music videos; and television series. All of these items, amongst others, have been specifically listed in the regulations.

However, the regulations go further and have included a wide variety of services that one would not ordinarily expect to be charged VAT. For example, the supply of any internet-based or multiplayer role-playing game has been specifically included, which could see your average South African indirectly paying VAT on a virtual sword purchased during the course of a multiplayer role-playing online game.

Furthermore, VAT could be charged on the numerous upgrades for games or other options available on Facebook and other social networking services. The regulations have gone as far as to specifically include, inter alia: home-made videos, jingles, desktop images, ringtones and screensavers as electronic services that could be subject to VAT.

The legislation would apply to foreign suppliers of electronic services, as well. Initially the SARS and the Treasury had proposed a monetary threshold of zero for foreign e-commerce suppliers. This was far too onerous a threshold, and the threshold has been increased: a foreign e-commerce supplier will be liable to register under the VAT Act at the end of any month in which the total value of its supplies of electronic services exceeds R50 000 (approx. 3,291 Euros as of 10.2.14).

There will also be no distinction between business-to-business and business-to-consumer suppliers, to guard against regulatory arbitrage (for example, private consumers may masquerade as businesses to avoid VAT) and to mitigate the compliance burden already placed on foreign e-commerce suppliers. These amendments will become effective from 1 April 2014.

It is worth re-iterating that these amendments do not technically create a new revenue stream for the fiscus – the transactions targeted have always been subject to VAT, but the reverse charge mechanism rendered the proper collection thereof practically impossible. While they may be a bitter pill for foreign e-commerce suppliers to swallow, the introduction of these changes is certainly not surprising and brings South Africa’s VAT regime up to speed with the burgeoning digital economy.

This article first appeared on bowman.co.za.

Income tax and VAT consequences of e-tolls

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Introduction

The levying of tolls for the use of certain highways in Gauteng, the so called e-tolls, took effect on 3 December 2013. It is therefore appropriate to consider the income tax consequences arising from the payment of e-tolls in those cases where an employee is reimbursed for business travelling or is provided with a vehicle owned by their employer or where an employee receives a travelling allowance to finance the expenditure incurred whilst travelling on the employer’s business. In addition, brief reference will be made to the income tax consequences facing fleet owners and cartage contractors.

Reimbursement at prescribed rate

An employer may decide not to provide an allowance for travelling to their employees nor a company owned vehicle and instead reimburse staff for the actual distance travelled on the business of the employer. Where an employee travels on the employer’s business and does not exceed 8 000 kilometres during a year of assessment and the employee does not receive any other compensation from the employer in the form of a further allowance or reimbursement, the prescribed rate per kilometre, which may be paid without attracting income tax, is R3.24.

The rate per kilometre was set before e-tolls became effective and future regulations governing the amount payable by an employer to an employee for travelling on the employers business should be clarified to provide that the employer may reimburse the employee in respect of the cost of e-tolls. Currently, the rate per kilometre fixed for purposes of section 8(1)(b)(iii) of the Income Tax Act, No. 58 of 1962 (‘the Act’) provides that the amount of R3.24 may only be paid without any adverse tax consequence arising when no other compensation in the form of a further allowance or reimbursement is payable by the employer to the recipient of the reimbursement at the specified rate. The payment of the allowance is also not subject to VAT as a fringe benefit in terms of section 18(3) of the VAT Act.

Company Owned Vehicle

Where the employer owns or leases a motor vehicle and makes that available to an employee the employee will be subject to fringe benefits tax on the value and usage of that vehicle in the manner set out in paragraph 7 of the Seventh Schedule to the Act.

In principle, the employee is subject to fringe benefits tax at a rate of 3.5% of the determined value of the motor vehicle for each month for which the employee is provided with the use of the vehicle by their employer. The determined value of the vehicle for fringe benefits tax purposes is normally the cash cost thereof, including VAT. In the event that the motor vehicle, at the time of acquisition, is the subject of a maintenance plan, the rate of fringe benefits is reduced to 3.25% of the determined value of the motor vehicle on a monthly basis.

In the case of an employer owned vehicle, the vehicle will be owned by the employer and thus the employer will be liable to pay the e-tolls to the extent that the motor vehicle in question travels on tolled highways.

The employer will be entitled to deduct the cost of e-tolls as an expense incurred in the production of income in that it relates directly to the provision of the motor vehicle by an employer to an employee for purposes of its business.

The employer will, so long as the travelling was for the purpose of making taxable supplies and they receive a valid tax invoice which complies with the provisions of section 20 of the Value-added Tax Act, Act No. 89 of 1991,('VAT Act'), be entitled to recover the VAT paid on the e-tolls as an input credit when submitting its VAT returns to SARS.

Where the employee retains accurate records of business distance travelled it will be possible to reduce the taxability of the fringe benefit by taking account of the ratio of business kilometres to total kilometres travelled by the employee. Furthermore, where the employee pays for certain expenses relating to the motor vehicle, the value of the taxable fringe benefit may be reduced by taking account of the business kilometres travelled as a proportion of the total kilometres travelled during the tax year.

In accordance with the provisions of the Fourth Schedule to the Act the employer is required to deduct PAYE on 80% of the value of the fringe benefit arising from the use of the employer owned vehicle unless the employer is satisfied that at least 80% of the employee's travel is related to the business of the employer. In these cases the PAYE deduction is based on 20% of the value of fringe benefit in question.

Employee Owned Motor Vehicle

In this case the employee will receive an allowance as part and parcel of their remuneration package with the result that the travelling allowance received will be subject to PAYE such that 80% of the allowance paid per month will attract PAYE. Where the employer can be satisfied that 80% or more of the travelling undertaken by the employee is for business purposes only 20% of the allowance paid will attract PAYE.

It is essential for the employee to retain a log book recording distance travelled on the business of the employer and the nature thereof so that they may determine the total business kilometres travelled during the tax year and that portion of travelling with constitutes private travel for which no deduction is available.

When the employee completes their annual tax return they will be entitled to claim expenditure regarding the motor vehicle against the allowance received by taking account of actual business kilometres travelled during the tax year. The taxpayer is entitled to use either actual costs incurred in respect of operating the motor vehicle during the tax year or alternatively may rely on the table of costs prescribed by the Minister of Finance.

Where the employee chooses to claim expenditure based on actual expenditure incurred they will be entitled to take account of the cost of insurance, maintenance and other direct costs relating to the operation of the motor vehicle including fuel, depreciation on the motor vehicle and the cost of e-tolls. The table of costs prescribed by the Minister takes account of the fixed cost attributable to the motor vehicle which is an attempt to recognise the depreciation in the value of the a motor vehicle depending on the cost thereof as well as the fuel cost and maintenance cost. The table of costs currently in existence does not take account of the cost of e-tolls. The table of costs is unlikely to be amended because e-tolls are only applicable on certain highways in Gauteng and not in South Africa generally.

The alternative for the employee is to seek the reimbursement of the actual e-toll costs incurred from the employer in respect of business travelling. This will be neutral for tax purposes from the employee’s point of view. The employer should be entitled to claim the reimbursement of e-toll costs as a deduction for income tax purposes under section 11(a) of the Act.

Where an employer reimburses an employee who travelled for taxable business purposes for e-toll costs that employer will be entitled to recover the VAT relating thereto even though the tax invoice will be issued in the name of the employee and not in the name of the employer. This is based on the provisions of sections 16(2)(a) and 54 of the VAT Act which regulates the position of input tax borne by an agent on behalf of their principal. Also, section 20(5) of the VAT Act does not require that the name, address and VAT registration number of the employer be reflected on a tax invoice where the consideration for the supply does not exceed R5 000.

Fleet owners and cartage contractors

Those businesses which own a large number of vehicles, such as the car rental companies will face an increase in their operating costs as a result of the introduction of e-tolls. Similarly, the transport contractors will experience an increase in their costs of moving goods around the country as a result of the imposition of e-tolls. The cost of e-tolls are directly related to the business conducted by such taxpayers and will be deductible under section 11(a) of the Act.

Where the affected businesses are registered for VAT, they will be entitled to recover the VAT incurred on the e-tolls if the vehicles were used in the course of making taxable supplies and so long as they are in possession of a valid tax invoice which meets the requirements of section 20 of the VAT Act.

The introduction of e-tolls will no doubt result in an increase in the cost of goods transported by road which will ultimately be carried by the consumer in South Africa.

Conclusion

Where an employee receives a reimbursement of travelling at a rate not exceeding the amount specified by the Minister of Finance it may be possible to seek the reimbursement of e-toll costs without adverse tax consequences. However, it would be preferable if the rules regulating such reimbursement are clarified in this regard.

In the case of a company or employer owned vehicle, the employer will be liable to pay the e-tolls and should be entitled to deduct that cost as a deduction for tax purposes. No adverse tax consequences should arise in so far as the employee is concerned who is subject to fringe benefits tax on the usage of the motor vehicle in any event.

In those cases where an employee receives a travelling allowance to finance the cost of travelling on the employer's business a decision will need to be made whether to claim the actual expenditure incurred regarding the motor vehicle, including the cost of e-tolls or to rely on the table of prescribed costs as set out by the Minister of Finance from time to time.

Those businesses which own a fleet of vehicles for renting out to clients or which own trucks to transport goods around the country will face an increase in costs which will, no doubt, be recovered from their clients. The cost of e-tolls will be deductible for tax purposes in terms of section 11(a) and the VAT element should be recoverable where the business is registered for VAT purposes and the vehicle is used for taxable business purposes.

VAT registration of foreign online suppliers not limited to supplies of e-books

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The recent amendments to the VAT legislation introduced by the Taxation Amendment Act, No 31 of 2013, gives effect to government’s proposal that all foreign businesses supplying e-books, e-music and other digital goods and services in South Africa be required to register as South African value-added tax (“VAT”) vendors. Government indicated that the proposal is in line with international trends such as regulations adopted by the European Union requiring such suppliers to register for VAT in the country where the consumer resides.

The amendment has the effect that from 1 April 2014, all persons supplying electronic services from a place outside of South Africa will be required to register as VAT vendors where they make supplies of electronic services to South African customers who are either tax resident in South Africa, or where payment for the services by such customers originates from South African banking accounts. Suppliers of electronic services will be considered to be carrying on an enterprise in South Africa and will be required to register as VAT vendors if they makes taxable supplies in excess of R50 000 in a 12 month period. Once registered, they will be required to levy and account for VAT on supplies made by them.

The amendments were introduced mainly to address the concerns of local publishers and booksellers with respect to VAT not being declared and paid on purchases of e-books by South African consumers from foreign suppliers. This placed the local industry at a competitive disadvantage owing to the fact that the foreign suppliers enjoying an effective 14% VAT discount on their prices as compliance with the reverse charge mechanism was virtually non-existent.

The Minister of Finance recently released draft regulations in terms of which he prescribes what constitutes 'electronic services' for purposes of the VAT Act and for which foreign suppliers must register for VAT in South Africa. The scope of these draft regulations is, however, far reaching and much wider than originally anticipated.

In terms of the draft regulations, it is not only the suppliers of e-books, e-music or similar digital products to South African consumers who will be required to register for VAT. The draft regulations also include the provision of "information system services" as defined in the Electronic Communications and Transactions Act No. 25 of 2002. This definition is extremely broad and includes the provision of connections, the operation of facilities for information systems, the provision of access to information systems, the transmission or routing of data messages between points and the processing and storage of data. This means that all forms of electronic supplies such as information system services; internet based courses; webinars; the administration, maintenance and technical support of a web site, database or information system; data storage and the supply of software are all included.

Examples of foreign businesses that will be drawn into the VAT net in addition to suppliers of e-books and digital music or videos are the following:

Foreign entities that arrange video conferencing facilities for South African businesses to communicate with their foreign customers, branches, divisions, or head offices;

Foreign entities that provide South African business customers the facility to store digital data offsite; and

Foreign holding or group companies that have a centralised service function, supplying information technology services, credit vetting, back-up and support services, etc.

The draft regulations therefore not only apply to Business-2-Consumer (B2C) transactions but it also apply to Business-to-Business (B2B) transactions. It is questionable as to what benefit would accrue to the fiscus on B2B transactions if the net impact on the fiscus is nil, as any VAT charged by the supplier will be deductible as input tax by the recipient, coupled with the increased administration for both the South African Revenue Service ("SARS") and the foreign supplier. No concern has been expressed by the SARS regarding the compliance with the current reverse charge mechanism in the case of partially taxable recipients who need to account for VAT on the imported services.

A further challenge is the implementation date of 1 April 2014 in view of the uncertainty as to which foreign entities are required to be registered for VAT whilst the regulations are not yet finalised. The current wide reach of the draft Regulations will potentially bring an innumerable number of foreign entities into the South African VAT net. In light of the current onerous registration process, particularly for foreign entities, it is questionable whether SARS will be able to cope with all of the VAT registration applications in time for the 1 April 2014 implementation date. A further impediment with the registration of foreign entities lies in the opening of a South African bank account, which is a requirement before an entity can even apply for VAT registration in South Africa. This is owing to the requirement of South African banks to comply with the Financial Intelligence Centre Act, 2001.

It is not an option for a foreign entity supplying electronic services to South African entities not to register for VAT in South Africa. A person who is liable to register and fails to do so is guilty of an offence and is liable to a fine or imprisonment for a period not exceeding two years. Furthermore, a person may also be subject to further penalties for failure to register, as well as penalties and interest on output tax not accounted for from the time such person first became liable to register. Once the regulations listing the type of electronic services that are to be subject to VAT in South Africa are finalised, foreign suppliers should carefully consider their VAT registration obligations in South Africa, and apply for registration timeously.