

18 August 2017

The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS, 299 Bronkhorst Street
PRETORIA
0181

BY EMAIL: Nombasa Langeni (Nombasa.Langeni@treasury.gov.za)
Adele Collins (acollins@sars.gov.za)

RE: DRAFT TAXATION LAWS AMENDMENT BILL (TLAB), 2017: COMMENTS PERTAINING TO KEY VALUE-ADDED TAX ISSUES

We have attached the comments from the SAIT Value-Added Tax Work Group on the 2017 draft Taxation Laws Amendment Bill pertaining to key value-added tax issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

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

Yours sincerely

Victor Terblanche
Chair of the Value-Added Tax Work Group

VALUE-ADDED TAX ISSUES

1. Leasehold improvements – barter transaction between lessor and lessee (Clauses 75(b), 76(1), 77(1) and 81(1) of the draft TLAB)

1.1 Proposal

The draft TLAB proposes an amendment to section 8 of the Value-Added Tax Act, 1991 (the VAT Act) by introducing a new sub-section 29 which provides that where a (vendor) lessee makes leasehold improvements for no consideration, there will be a deemed taxable supply by the lessee to the lessor in the course of the lessee's enterprise in circumstances where the lessee will use the leasehold improvements for the purpose of making taxable supplies or mixed supplies, that is, otherwise than "wholly" for the purpose of making non-taxable supplies. The draft TLAB further proposes the introduction of section 9(12) which deems the supply envisaged in the proposed section 8(29), that is, the supply of the leasehold improvements by the lessee, to take place at the time the leasehold improvements are completed. The proposed section 10(28) of the draft TLAB deems the value of the deemed supply as contemplated in section 8(29) to be nil.

In addition to the above, the draft TLAB proposes to introduce section 18C which provides that where goods have been supplied, as contemplated in section 8(29), to the lessor being a vendor, the lessor will be deemed to have made a taxable supply in the course of his enterprise where a deduction would have been denied in terms of section 17(2) or to the extent that the lessor will utilise the leasehold improvements for the purpose of making non-taxable supplies. This supply by the lessor is deemed to be made "at the time the leasehold improvements are completed" in accordance with the formula set out in the draft TLAB.

1.2 Problem statements and recommendations

1.2.1 Clause 75(b) – Deemed supply in respect of leasehold improvements

1.2.1.1 Problem statement

The proposed section 8(29) deemed supply is superfluous and introduces unnecessary ambiguity, since there is an actual supply of goods by the lessee to the lessor, in respect of leasehold improvements affixed to the immovable property belonging to the lessor, on the basis of accession. In other words, where an actual supply exists, there is no need for a deeming provision.

1.2.1.2 Recommendation

We recommend that the proposed section 8(29) not be introduced, but that National Treasury/SARS instead recognise that there are essentially two actual supplies made in a leasehold improvement scenario, namely a supply by the lessee of the improvements to the lessor and a supply of the right of use of such improvements to the lessee by the lessor that by accession immediately belong to the lessor once the improvements are affixed to the immovable property belonging to the lessor. Stated differently, a barter transaction takes place between the lessee and lessor in these circumstances. Where the lessee and lessor are vendors they are both required to account for VAT on their respective taxable supplies. The major issue is the value of such barter supplies and the time of supply thereof (see below)

1.2.2 Clause 76(1) – Time of supply of leasehold improvements

1.2.2.1 Problem statement

The proposed introduction of section 9(12) would provide clarity in some cases as to the time of supply of leasehold improvements. However, since there is no clarity on when leasehold improvements will be considered to be "completed", this may cause uncertainty where the lessee or lessor disputes the completion of the leasehold improvements. While the proposed section 9(12) would provide clarity as regards the time of supply of the leasehold improvements, it does not also apply to the barter supply by the lessor of the right of use of the leasehold improvements.

1.2.2.2 Recommendation

While the necessity to determine a time of supply in these circumstances is recognised, and the proposed section 9(12) is welcomed, a definition of "completed" should be introduced to avoid ambiguity in relation to the time of supply. The proposed time of supply should also apply equally to the lessor (which would seem to be the intention if one considers the proposed new section 18C).

1.2.3 Clause 77(1) – Value of supply of leasehold improvements

1.2.3.1 Problem statement

Where the lessee undertakes in terms of the lease agreement to effect leasehold improvements to the immovable property belonging to the lessor the lessee will make a taxable supply to the lessor in terms of the VAT Act. The consideration derived by the lessee for such taxable supply is the valuable benefit of reduced (usually nominal) rentals that it will be obliged to pay the lessor for the right of use of the improvements that by operation of law immediately becomes the property of the lessor once affixed to the lessor's immovable

property. Should leasehold improvements be effected to the property of the lessor and the lessee pays market related rentals for the use of such improvements, and the lessee does not charge the lessor any consideration for the leasehold improvements, section 10(23) of the VAT Act would apply (e.g. where the leasehold improvements were made voluntarily, this will most likely apply) and the value of the supply of the improvements by the lessee to the lessor would be nil. Where the lessee charges a consideration to the lessor the normal value of supply rules in terms of section 10 of the VAT Act would apply.

As regards the lessor, it will have made a taxable supply of the right of use of the leasehold improvements to the lessee for which it will receive consideration equal to the value of the leasehold improvements that it by operation of law becomes its property. While recognising that the value of the improvements effected on the lessor's property constituted "gross income" in the lessor's hands for income tax purposes (the lessor had derived income in kind), the difficulty of determining the "amount" of such benefit was recognised many years ago in the seminal Butcher Brothers case. In response to that court decision specific provisions were introduced in the Income Tax Act to regulate the position of the lessor in these circumstances. In essence, the amount that falls to be included in the lessor's hands in a leasehold improvement scenario is the amount stipulated in the agreement, or if no amount is stipulated, "the fair and reasonable value of the improvements".

As was recognised by the High Court in the recent Atlantic Jazz Festival case, in a barter transaction (which it is submitted is the case in a leasehold improvement scenario) the value agreed upon by the parties, "absence any indication to the contrary" is the value of the respective supplies.

1.2.3.2 Recommendation

Adopting the approach applied by the court in the Atlantic Jazz Festival case and that applied in the Income Tax Act, it is recommended that the value of the supply for both lessee and lessor in a leasehold scenario should be the amount stipulated in the agreement, provided that if no value is stipulated in the agreement, then the open market value of such

improvements as determined in accordance with section 3 of the VAT Act should apply. It would be expected that the value stipulated will in most instances accord with open market value where the parties are acting at arm's length. If the stipulated value is less than open market value and the relevant recipient would not be entitled to a full input tax deduction had an open market value been adopted, and the parties are connected persons, the provisions of section 10(4) of the VAT Act would apply and the value of the relevant supplies would be deemed to be at open market value. It will be evident that in adopting the income tax approach to value, there is alignment between the Acts and any mischief would be dealt with under section 10(4) of the VAT Act. In summary, we welcome the introduction of a value of supply rule in relation to leasehold improvement, but recommend that the approach applied in the income tax be adopted. However, no special spreading is required in relation to input tax, as is provided for in section 11(g) of the Income Tax, as VAT is a transaction tax and VAT should be accounted for in full when the time of supply is triggered.

1.2.4 Clause 81(1) – Adjustment for leasehold improvements

1.2.4.1 Problem statement

Where VAT on leasehold improvements is accounted for as per the current provisions of the VAT Act (e.g. whether made for a consideration or no consideration or whether a barter transaction), this section is not necessary since output tax will be accounted for and input tax will be subject to the general input tax requirements. Further, where any change in use occurs at a later stage, the relevant change in use adjustment as per the current section 18 will apply. It is further not comprehensible why a vendor (lessee) making mixed supplies will get the full input tax deduction as a consequence of the proposed section 8(29) whilst the lessor will have to account for output tax which it cannot recover.

1.2.4.2 Recommendation

We recommend that section 18C should not be introduced.

1.3 *Conclusion*

It should be recognised that leasehold improvements are barter transactions that stand to be dealt with in terms of the existing provisions of the VAT Act. Any leasehold improvement related amendments to the VAT Act should be limited to those necessary to provide certainty to the time and value of supply, as discussed above.

We note that it might be useful if SARS issues an Interpretation or Practice Note on leasehold improvements.

2. National Housing Programmes – interim arrangements and ultimate impact Clauses 75(1)(a), 75(2), 82(1) and 82(2)

2.1 *Proposal*

Section 8(23) of the VAT Act deemed a vendor to supply services to any public authority or municipality to the extent of any payment made to or on behalf of that vendor in terms of a national housing programme, provided the requirements were met. In turn, Section 11(2)(s) zero-rated such services. The effect of these two sections working together was that such recipient of a grant/financial support did not have to pay a portion of the grant/support to SARS as output VAT, yet could claim input its VAT. PBO's involved in providing housing have relied on this dispensation, knowing that the full grant would be available to use in providing housing. These sections have been deleted with effect from 1 April 2017, subject to the discussion below.

The draft TLAB proposes an amendment to section 8(23) of the Value-Added Tax Act, 1991 ("the VAT Act") by deletion of the following: [which is approved by the Minister by regulation after consultation with the Minister responsible for Human Settlements]. Section 8(23) of the VAT Act was originally deleted by section 129(1) of the Taxation Laws Amendment Act, 2015 ("TLAA") with effect from 1 April 2017 where after it was reintroduced in section 20(1) of the 2017 Draft Rates and Monetary Amounts an Amendment of Revenue Laws Bill ("RMA").

The RMA has not been promulgated on date of submission of this document and section 129(1) of the TLAA will therefore currently apply. If the RMA is promulgated in the interim, it will result in the deletion of section 8(23) and 11(2)(s) of the VAT Act being postponed to 1 April 2019 in line with an announcement made by the Minister of Finance in the 2017 budget. In the draft TLAB, it is proposed that section 8(23) of the VAT Act no longer require a regulation issued by the Minister to apply the provisions of section 8(23) and 11(2)(s), effectively from 1 April 2017.

In AB CC and the Commissioner for the South African Revenue Service (Case No: VAT 1005), the Court held that due to various interpretational issues, the contra fiscum rule must be applied in zero rating supplies in terms of section 11(2)(s) read with section 8(23) of the VAT Act.

One of the main objectives of the “national housing program” as defined in section 1 of the Housing Act, 1997 is to assist persons who cannot independently provide for their own housing needs. There are various Public Benefit Organisations (“PBO’s”) who qualify for social housing grants in the ordinary course of their activities - to provide needy persons with affordable housing. Most of these PBO’s will only receive a portion (normally between 60% and 70%) of the actual development costs via housing grants which results in the balance having to be obtained through loans and/or donations.

The Draft also proposes to introduce section 40D in the VAT Act effective from 1 April 2017. Section 40D(1) proposes a retrospective application to section 8(23) of the VAT Act, for transactions prior to 1 April 2017.

Section 40D(2) of the proposed additions to the VAT Act will result in the Commissioner having to amend assessments raised by it for periods prior to 1 April 2017 where the services were deemed to be zero rated in terms of section 8(23) read with 11(2)(s) of the VAT Act. However, this will only apply to cases where the assessments were raised but not yet paid on the date

of having applied for the assessments to be amended. Further, the proviso to section 40D(2) prohibits a reduced assessment by SARS if same will result in a refund of tax to the vendor. Section 40D(3) of the proposed addition to the VAT Act then prohibits the Commissioner from making assessments for periods before 1 April 2017 where section 8(23) read with 11(2)(s) of the Act were applied by a vendor.

In terms of the proposed section 40D(4) of the VAT Act, the Commissioner may not refund any tax, penalty or interest where the vendor incorrectly declared and paid VAT at the standard rate on transactions which complied with section 8(23) read with 11(2)(s) of the VAT Act prior to 1 April 2017.

2.2 Problem statements and recommendations

2.2.1 Clause 75(1)(a) and (2) – Deemed supply in respect of national housing programmes

2.2.1.1 Problem statement

The proposed amendment section 8(23) of the VAT Act will only apply to transactions from 1 April 2017 to 1 April 2019. Section 8(23) read with 11(2)(s) is a necessity in providing housing to the poor and needy people of South Africa. Housing for all is a right enshrined in the Constitution and by taxing the grants after 1 April 2019 may result in PBO's no longer being in a position to provide this basic necessity to the citizens of South Africa.

2.2.1.2 Recommendation

Even though we support the extended period to 1 April 2019, more research must be done to determine the effect of repealing this section and specifically the affordability of delivery by PBO's thereafter.

We recommend that the proposed section 8(23) not be deleted until Government has conducted research and is geared towards increasing the grants with the VAT portion which may become a future cost to PBO's.

2.2.2 Clause 82(1) and (2) – Liability for tax and limitation of refunds in respect of national housing programmes.

2.2.2.1 Problem statement

Section 40D(2) allows for assessments to be revised retrospectively for periods prior to 1 April 2017, on written application, where section 8(23) was initially applied but subsequently assessed by SARS. This means that the PBO's impacted by this application initially budgeted for the zero rate and was subsequently out of pocket as a result of the assessments. The proviso seeks to "ring fence" the assessments to avoid paying VAT refunds, which will not remedy the PBO's financial position and/or loss incurred. This will certainly not be equitable and PBO's who received refunds without assessments will be in a better position financially than their peers. We do not regard this as fair administrative process and all PBO's must be entitled to apply section 8(23) and 11(2)(s) without prejudice. This was also supported in AB CC and the Commissioner for the South African Revenue Service (Case No: VAT 1005) in which the zero rating was allowed.

The introduction of section 40D(2) will also have a further negative impact where the assessments were raised and paid by the vendor. In these circumstances, the vendor will not be able to apply for a correction to be made by the Commissioner. The finances to settle the assessments were not budgeted for by the PBO's, hence the application of the zero rate initially. Currently, the draft TLAB seeks to penalise such PBO's by not providing it with an opportunity to obtain a revised assessment from SARS and most likely had to finance the assessments with loans and/or donations which could have been productively utilised in the course of their activities.

The proposed introduction of section 40D(3) prohibits the Commissioner from making assessments for periods prior to 1 April 2017. We agree with this provision.

Section 40D(4) again results in prejudice to vendors who incorrectly accounted for VAT on its grant income. PBO's are commonly not in a position to seek expert advice on VAT related matters and this section seeks to penalise them. Allowing these entities to correctly account for VAT will result in them being refunded VAT which was incorrectly paid to SARS and which can be utilised productively in reaching their mandates in terms of the national housing programme.

2.2.2.2 Recommendation

The proposed proviso to section 40D(2) of the VAT Act must be removed to allow for full refunds where the provisions of section 8(23) and 11(2)(s) were correctly applied. The 5-year prescription can be invoked where a refund is sought by a vendor.

Vendors who already paid the assessments raised by SARS must be afforded an opportunity to obtain a VAT refund as this was always the intention of the law to zero rate land and housing grants.

We agree with the introduction of section 40D(3).

Section 40D(4) should allow for the vendor to submit a ruling application for the Commissioner to consider the submission of a correction. Such application should be favourably considered if the transactions were in compliance with section 8(23) read with 11(2)(s), taking into consideration that the requirement for a "regulation" not be enforced as reflected in section 8(23) prior to its amendment by The Draft.