



# VAT

# Alert

26 July 2019

## Let's talk

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## VAT treatment of foreign donor funded projects

### In brief

It was announced in Budget 2019 that legislative amendments to address the current difficulties with the VAT treatment of foreign donor funded projects ("FDFP") and the practical application thereof. On 22 July, the Draft Taxation Laws Amendment Bill, 2019, was released for public comment and contains proposed amendments in this regard.

A FDFP is a development project that is funded by a foreign government (or other International Development Agency) under an international agreement with the South African government.

These international agreements, referred to as Official Development Agreements, provide that the funds donated should only be used for specific, mutually agreed upon programmes and activities, and that such funds cannot be utilised for any taxes imposed under domestic law.

### In detail

#### Current legislation

The receipt of international donor funds by a FDFP under an agreement to which the South African government is a party is zero-rated for VAT purposes. This is on condition that (1) the agreement is binding on South Africa in terms of the Constitution of the Republic of South Africa, 1996, and (2) the agreement provides that the funds may not be used to pay any tax (including VAT).

A FDFP could register as a VAT vendor and the receipt of the foreign donor funds is deemed to

be a supply of services that is zero-rated. The VAT incurred can then be claimed as input tax.

All third parties making taxable supplies to the Project will have to charge 15% VAT, which may be claimed as input tax by the Project.

#### Difficulties with current legislation

Currently, there is significant confusion regarding what qualifies as a FDFP, who must register the project as a FDFP for VAT, and who is entitled to the input tax claims.

In addition, difficulties arise where

SARS selects the VAT return for verification, on the basis that all documents and agreements would not be in the name of the person who is registered for VAT.

### Reason for change

Amendments have been proposed to address the current difficulties with FDFPs, to clarify the policy intent, and to improve the compliance aspects in this regard.

### Reason for change

- An official development assistance agreement will need to be approved by the Minister of Finance as a qualifying project. Guidelines will be issued outlining the requirements to obtain approval, and a streamlined process in this regard will be introduced.
- The concept of an “implementing agency” will be inserted. This will be the person appointed by the foreign government or agency to implement, operate, administer or manage the FDFP.

- The implementing agency will register a separate VAT branch for the FDFP, which ring-fences these activities from the other activities of the enterprise.
- SARS will only register a project as a FDFP for VAT purposes once written approval from the Minister of Finance is obtained.

### Effective date

It is proposed that the amendments come into operation on 1 April 2020.

### Issues going forward

While the proposed amendments should provide more certainty regarding qualifying FDFP projects, it is likely that the compliance burden for both foreign funders and local implementing agencies will increase. This is likely to result in delays in the receipt of the funding.

Further, additional contracting will be required to ensure that all parties take cognisance of their obligations to ensure the correct outcome is achieved, especially from a VAT perspective.

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