www.pwc.co.za

Charting the changes, 21 years of VAT in South Africa

VAT 21

September 2012

pwc

Contents

VAT 21 foreword

Gerard Soverall
Leader, PwC Gauteng Indirect Tax Practice

30 September marks the 21st anniversary of the introduction of Value-Added Tax (VAT) in South Africa, a system of taxation which has proven profitable for the fiscus, difficult to administer for the taxpayer and a silent cost to many of its consumers.

Worldwide, governments have been seduced by the prospect of VAT's ability to generate large amounts of tax revenue at an extremely low cost when compared to direct taxes such as personal and corporate income tax. VAT has become particularly important in the wake of current global economic difficulties. The tax has been introduced in more than 151 countries, with the US being one of few major developed economies still clinging to old fashioned General Sales Tax.

A number of countries, such as the UK, have raised the VAT rate to address deficits in their government budgets having regard to the slow or negligent GDP growth brought about by current economic uncertainty. Policymakers in Washington are also giving serious consideration to introducing a VAT system to address the US fiscal deficit, which almost reached the monthly amount of $1 trillion in July 2012, giving cause for concern that US deficit levels, in relative terms, are close to those of Greece and Ireland. More recently, China announced proposals to introduce new VAT reforms across ten cities and provinces, including Beijing and Guangdong province on 1 September 2012, in a bid to boost its services industry.

On the African continent, the majority of Africa's 54 countries have VAT systems in place. Other countries are looking into introducing VAT into their systems as a means of efficiently collecting revenue. For example, Swaziland recently introduced a VAT system on 1 April 2012. The Democratic Republic of Congo also has plans to introduce a VAT system in 2013. However, the multiplicity of VAT systems across Africa tends to expose multinational companies to tax risk through errors and inconsistencies in the application of the law, with the compliance burden also tending to be high for organisations.

Closer to home, the debate continues to rage as to whether South Africa's Government will raise the VAT rate. The standard rate of VAT has remained at its current level of 14% for almost two decades, having been raised only once in 1993. There are a number of reasons to believe that the status quo for the VAT rate will remain. Furthermore, its is believed that any attempts to increase the rate of VAT will be met with strong resistance from key stakeholders in society, such as the trade unions.

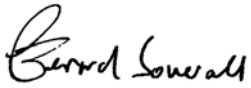
The biggest and most exciting change with respect to VAT compliance has been the move from a paper-based system to that of electronic filing of VAT returns. According to PwC's 'Paying Taxes Report' for 2012, the introduction of electronic systems for filing and paying taxes has been shown to significantly reduce the tax burden on businesses. The study looks at a sample of countries that have implemented e-filing and e-taxing systems and found for this group that the time devoted to tax compliance was cut by 30%.

Although the basic principles of VAT are similar in most jurisdictions, the administrative practices and rules and regulations applied tend to differ. This can have an effet on the compliance burden of the taxpayers. The study shows that the VAT compliance burden in South Africa is extremely high, with it taking far longer for business to comply with VAT rules than corporate income tax.

Globally, the shift continues towards indirect taxes, rather than direct taxes. This is why it is so important for Governments to get the VAT or GST model right. The ideal VAT system is one that is simple, efficient, neutral and promotes legal certainty and compliance among taxpayers.

Our work outlines the numerous reforms and administrative processes that have taken place in South Africa and on the African continent and highlights the increasing focus on improving the administrative aspects of VAT, including the use of electronic filing of VAT returns. We hope that you enjoy reading this publication.

We welcome feedback and constructive dialogue and encourage the readers to provide additional input and comments.



Gerard Soverall
Leader, PwC Gauteng Indirect Tax Practice

The VAT rate – a third decade at 14%

by Dr Roelof Botha, Economic Advisor to PwC

The standard rate of value added taxation (VAT) in South Africa has remained at its current level for almost two full decades, having been raised only once (in 1993) since inception in 1991.

What has been amended on several occasions, however, is the list of items that are zero-rated for VAT, as part of a fairly comprehensive macroeconomic policy framework aimed at alleviating poverty and lowering the degree of income inequality.

There can be no doubt that the combination of VAT zero-rating of basic foodstuffs, the expansion of the welfare grant system to about one-third of the total population, the building of more than three million so-called RDP houses and the provision of free (capped) water to more than 10 million people has significantly reduced the number of households living in abject poverty.

Dr Roelof Botha
Economic Advisor to PwC

Fiscal pressures

The Government nevertheless remains under pressure to further expand the reach of basic service provision. Key priorities that are likely to put some strain on the fiscus in coming years include:

- improvements to the standards of public education
- improvements to public health care facilities
- expansion of electricity supply capacity
- road building and maintenance
- expansion and upgrading of rail transport
- water infrastructure, and
- implementation of an ambitious universal system of health insurance.

The latter issue, in particular, may revive the debate on whether the standard VAT rate should be increased over the next couple of years.

In the event of National Treasury being forced to consider an increase in the rate of any of the key sources of taxation, VAT is certainly the preferred option. Authoritative empirical research has been conducted on the topic of the effects on both efficiency and equity of changes in the tax mix and the global trend is to switch to indirect taxation.

In a study on the merits of a further expansion of the system of VAT zero-rating (commissioned by National Treasury in 2006), a PwC research team found that substantial economic evidence existed to favour a change in the tax mix whereby indirect taxes (such as VAT) are increased and direct taxes (such as individual and company tax) are decreased.

Sound increase in tax revenues

A number of compelling reasons exist, however, to believe that the *status quo* for the VAT rate will remain. First and foremost amongst these is the return to taxation revenue growth for all three of the key sources of government revenue, namely individuals, companies and value added in the economy.

Total government revenue collection for the 2011/12 fiscal year was 10% higher than the figure for 2010/11, fuelled mainly by stable economic growth of around 3% (in real terms) and a welcome return to formal sector employment creation.

South Africa also enjoys fundamental fiscal stability, as reflected in a ratio of gross government debt to GDP that is considerably lower than most of its major trading partners. At a level of 40%, this ratio compares favourably to countries such as Brazil (65%), India (68%), Germany (79%) and the UK (88%).

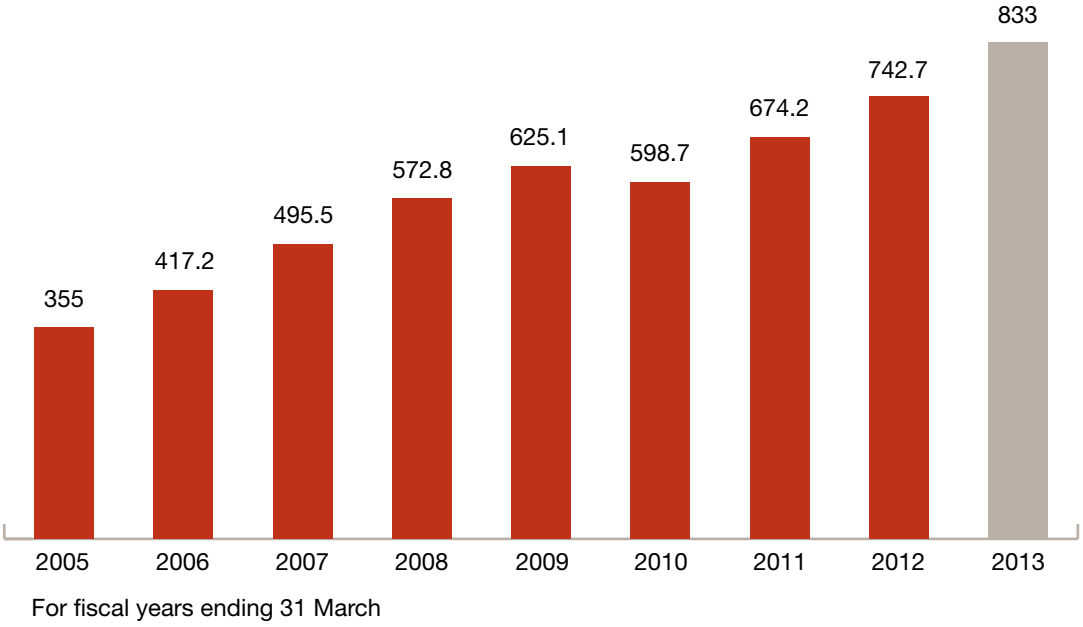
A fortuitous combination of positive real GDP growth and taxation revenue growth implies that sufficient fiscal resources should become available over the medium term to expand infrastructure and basic service provision to poor communities, without having to resort to a higher rate of VAT.

It is also worth noting that South Africa's VAT rate is well-positioned on a global scale. Several high-income countries and emerging markets possess higher rates of VAT, but a number of key trading partners also have lower rates.

From the perspective of sound public finance principles, an increase in any particular rate of a key source of taxation should be avoided for a number of reasons.

In a society where large segments of the population receive pensions and welfare grants or find themselves operating in the informal sector, the tax base for individual income will tend to be relatively narrow. Furthermore, higher rates of personal income tax may reduce the motivation to work and encourage outward migration of highly skilled people.

Total tax revenue in South Africa with forecast for 2013 (R billions)



Erosion of competitiveness

Secondly, any increase in the effective rate of tax on private companies will tend to erode a country's international competitiveness. This occurs through lower shareholder returns. Thirdly, higher rates of corporate tax directly reduce the financial ability for new capital formation by businesses and can therefore be regarded as a tax on future output capacity and employment creation.

Recent developments in the country's political milieu also suggest that any attempts to increase the rate of VAT will be met with vehement resistance from key stakeholders in society, especially the trade union federation Cosatu.

Despite the existence of a sound business case and substantial net economic benefits of electronic tolling on the 586 km of new road infrastructure in Gauteng, Cosatu's opposition to the funding model played a major role in the recent decision by the Government to postpone its implementation.

Against the background of electoral losses suffered by the tri-partite governing alliance to the country's main opposition party, the Democratic Alliance (DA), the political risk of raising the VAT rate is high, particularly due to its negative effect on the purchasing power of the middle-income group.

Poor expenditure control

The Government will also find it difficult to justify an increase in the rate of a key taxation source to fund additional expenditure at a time when the public sector corporate governance record is embarrassingly poor.

In the latest report on national audit outcomes released by the office of the Auditor-General, the incurrence of irregular expenditure by national and provincial departments and entities was highlighted as a serious concern.

For provinces alone, the total figure classified as unauthorised, irregular or wasteful expenditure amounted to a staggering R20.6 billion – roughly the same as the total budget for housing development in the 2012 fiscal year.

The report states that irregular expenditure arises, among other reasons, from a mix of deliberate fraud, ignorance of the Public Financial Management Act and inadequate understanding of supply chain management legislation.

It stands to reason that an improvement in the competency levels of managers in South Africa's public service holds the potential of significant fiscal gains, which could be utilised for improved service delivery while also obviating the need for an unwelcome, albeit unlikely increase in the VAT rate.

Any increase in the effective rate of tax on private companies will tend to erode a country's international competitiveness

Compliance burden for VAT is high and can complicate matters for the taxpayer

VAT tends to complicate matters, as it takes the model company 123 hours to comply with VAT compared to 74 hours for corporate income tax.

These are some of the findings of PwC's annual 'Paying Taxes' 2012 study, issued jointly with the World Bank and the International Finance Corporation. The Paying Taxes Report 2012 measures the ease of paying taxes by assessing the administrative burden for companies to comply with tax regulations, and by calculating companies' total tax liability as a percentage of pre-tax profits, also known as the Total Tax Rate.

The Paying Taxes Report looks at the effect of tax systems in 183 economies worldwide using a case study company. In doing so, it allows an effective comparative of these tax regimes. During the seven years in which the study has been carried out, tax reform has been high on the Government's agenda with more than 60% of the 183 economies implementing changes aimed at simplifying tax administration and reducing the tax burden. For instance, in the 2010 – 2011 fiscal year, 33 economies made it easier to pay tax or reduced rates. Introducing electronic systems was the most common feature of tax reform for the first time since 2004. Other characteristics that countries had in common were reduced tax rates, the introduction of electronic systems and the simplification of tax compliance by reducing the frequency of filing or allowing joint payment and filing of several taxes.

To date, VAT has been implemented in 151 economies worldwide.

Charles de Wet, PwC Indirect Taxes Leader for Southern Africa, says: "The time needed by companies to comply with VAT varies considerably around the world and even between neighbouring countries.

"For instance, the VAT compliance burden in South Africa is extremely high. It takes far longer for companies to comply with VAT rules than corporate income tax.

"In South Africa, companies have to complete three tax returns for company tax purposes. Companies with an annual income of more than R1 million have to complete 12 tax returns for VAT purposes."

The report shows that among the European Union (EU) member states there is a common legal framework for VAT systems, but the time needed to comply still varies considerably from 24 hours in Finland and Luxembourg to 195 in Bulgaria.

De Wet says that although the basic principles of VAT are similar in most countries, the administrative practices, and rules and regulations applied tend to differ which can affect the compliance burden for businesses. For example, VAT returns are required at different frequencies; monthly, bi-monthly, or quarterly. "This will have a significant effect on how long it takes a business to comply with VAT," he says.

De Wet says the frequency at which VAT returns are required, and the amount of data requested in the returns, also affects the time to comply. The compliance burden also increases where invoices have to be submitted with VAT returns. The Paying Taxes report shows that in the years spanning before and after the financial crisis (January 2008 to June 2011), 40 economies changed their VAT rate. Of these, 74% were an increase, and 26% a reduction. Eleven economies changed their rate more than once. For example, in the UK the rate of 17.5% was reduced to 15% from December 2008, returned to 17.5% on 1 January 2010, and increased to 20% on 4 January 2011.

Value-Added Tax (VAT) is the most common form of consumption tax used around the world, according to a report issued by professional services firm PwC.

He says that the introduction of electronic systems for filing and paying taxes has been shown to reduce the tax burden on businesses; "The fiscus also stands to benefit from such a system." The study looks at a sample of countries that have implemented e-filing and e-taxing systems and found for this group that the VAT compliance time was cut down by 30%.

"The benefits of e-filing are that it reduces the amount of paperwork associated with doing taxes and lowers the cost of administration. It also improves transparency in interactions with the tax authorities," explains De Wet. Furthermore, increased automation allows a more targeted and risk based approach to audit and compliance. Electronic payments, rather than cash or by cheque, reduce interactions with tax officials and can help eliminate corruption. "If done correctly, it can also lead to an improvement in collections of tax revenue."

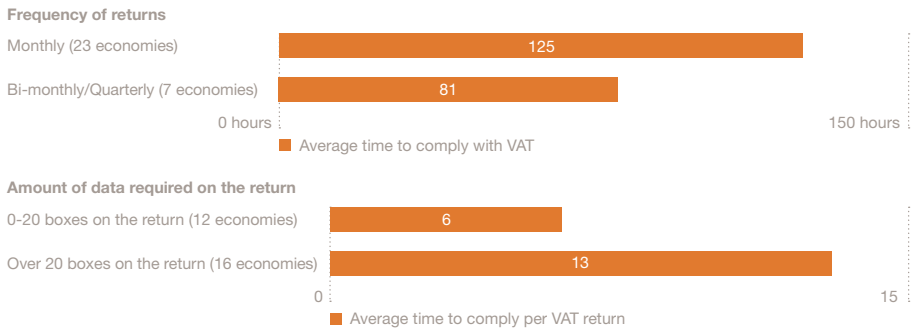
However, he says that in order for the system to be effective, it also has to be user-friendly and secure; "Rolling out an electronic filing and payment system and educating taxpayers in its use are not easy tasks for a government. The necessary infrastructure must be put into place, especially where not all citizens have broadband access."

The Paying Taxes study shows that by 2010, 66 economies had implemented electronic filing systems. Twenty of them adopted the system in the seven years. Ten member states of the Organisation for Economic Co-operation and Development (OECD) have made electronic filing and payment mandatory. De Wet says that this trend is likely to continue into the future.

The Paying Taxes project also shows that, on average, it takes less time to comply in countries where VAT is administered by the same tax authority as corporate income tax. Furthermore, the frequency at which VAT returns are required affects the time to comply.

De Wet says: "Tax authorities need to streamline the tax process in order to reduce the compliance and administrative burden on businesses to bring about an efficient and workable VAT system."

The frequency at which VAT returns are required and the amount of data required impacts the time to comply.

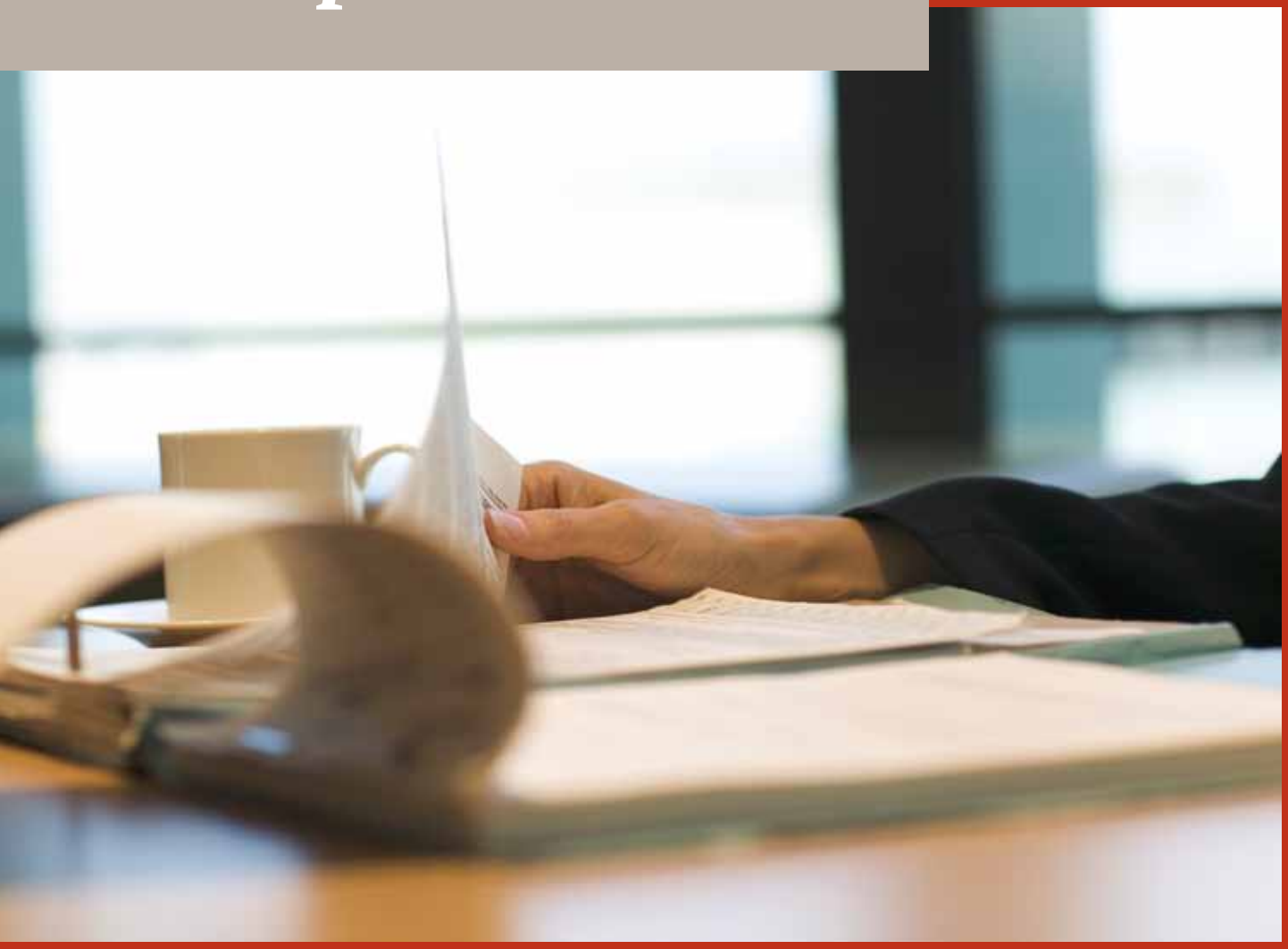


Note: The chart shows (1) the average time needed to comply depending on whether VAT returns are required to be made monthly or less frequently and (2) the average time per VAT return where more or less than 20 boxes have to be completed, both for a sample group of 30 economies with VAT.
Source: PwC analysis, *The impact of VAT compliance on business*, September 2010

Source: Paying Taxes 2012 - The global picture

PwC Reporter, South Africa

Indirect VAT in long-term insurance sector needs a revamp



By Matthew Besanko, PwC Senior Manager – Indirect Tax

Matthew Besanko
PwC Senior Manager – Indirect Tax

The concept of insurance refers to the elimination or spreading of risk that an event will occur. What is now known commonly as 'life insurance' originated in ancient Rome where a system was devised to assist families of injured or ill members, and to assist those in need of financial assistance to pay for the burial of their loved ones. Life insurance continued to grow through so-called benevolent societies and friendly societies during the 17th century where people donated amounts of money to a general pool which would be used for various forms of emergencies.

While early forms of life insurance were directed towards protecting against death or illness, in the modern context, the life insurance industry has grown to include product offerings geared towards retirement and other savings related products; such as savings bonds, endowments and annuities. Where once life insurers and banks operated in separate markets and offering distinct services, both industries have since grown to encompass and compete in the wealth management arena in terms of their product and service offerings.

In the South African context, long-term life insurance premiums represented 22% of household savings for the period 1999 to 2010, while retirement fund contributions, which often incorporate some element of life insurance, represented a further 35%. [1]Internationally, the coverage of the life insurance industry in South Africa is very high, and contribution rates are also high as the system seeks to provide millions of South Africans and their dependants with risk benefits in the case of premature death, and income during retirement. According to a report issued by National Treasury, 'total assets under management make South Africa's retirement funds industry one of the world's largest relative to gross domestic product.'

One reason for the growth and success of the industry in South Africa is, in part, due to substantial income tax incentives afforded to retirement savings, and the ease at which workers are able to participate in the system. While National Treasury launches further review into the industry to determine ways to further promote retirement savings through reducing retirement funding costs, and which will no doubt result in further amendments in the income tax treatment of life insurance and retirement savings products, little emphasis has been placed on the VAT implications for the sector and the role this plays in ensuring broader social security for South Africans. While the life insurance and retirement savings industry has indeed changed over the past 21 years, the Value-Added Tax (VAT) treatment has, in general terms, remained relatively unchanged.

The basis of a value-added type of indirect tax system is to impose a tax or charge on the value added to any product or service at each level of a supply chain, thereby resulting in a tax on value-added in each transaction. A credit is then allowed to the next supplier in the chain for its inputs used to add value, until the good or service is supplied to the final user, who is then not entitled to a credit and whereby the tax cost is ultimately borne on the entire value of the good or service provided.

[1] *Strengthening Retirement Savings – An overview of proposals announced in the 2012 Budget. South African National Treasury, 14 May 2012*

Notwithstanding, the VAT treatment of financial products, including life insurance and retirement annuities, is problematic on the basis that it is difficult to determine the margin or the 'value-added' during the supply-chain. As a result, no tax is charged on the supply of such financial products, and similarly, no credit is allowed for inputs, meaning that a financial services provider such as a life insurer or bank becomes the final consumer and bares the VAT cost. While this treatment is common amongst most VAT systems across the world, one difference that does distinguish the South African VAT from other jurisdictions are the amendments introduced in 1996 and 1999[2] which impose VAT on fees, commissions and other services directly associated with the provision of certain financial products. While at the time such changes represented a departure from the norms of the value-added taxation of financial products commonly known and applied in the European context, little further in this regard has progressed, particularly as the industry has grown and diversified, and as National Treasury once again focuses on ways to reduce the cost of life insurance and retirement savings products for all South Africans.

While the taxation of life insurance and indeed financial products is problematic, one way to ultimately reduce the cost of retirement and other life insurance products for South Africans through the VAT system is to reduce the VAT burden borne by financial and life insurance providers thereby reducing the extent to which such costs are built into product pricing. This approach has been adopted by other jurisdictions, for example Australia, where the government implemented indirect taxation policies aimed at promoting the country as a financial services center.

In Australia, for example, the A New Tax System (Goods and Services) Tax Act, 1999 (GST Act), provides for a reduced input credit of 75% of the Goods and Services Tax (GST) incurred on certain qualifying expenditure borne by financial services providers, including life insurers. Examples of qualifying expenditure include back office data processing, payment system, processing and clearing costs, statement processing, archives and data storage, and most relevant to the life insurance industry, portfolio management services and brokerage costs associated with selling insurance and retirement policies.

In the South African context, no such reduced input credit, such as that in Australia, exists for services acquired by a life insurer, and indeed bias exists where functions are in-sourced (thereby paying only a salary cost on which there is no VAT), and those who outsource.

Another way to reduce the cost of retirement and life insurance products through the VAT system is to increase the rate at which the life insurer is able to recover VAT incurred. The VAT Act provides that input VAT may be recovered to the extent that it is incurred for the purpose of making taxable (being either zero or standard rated) supplies. While life insurance and other financial products are usually exempt from VAT in South Africa, changes in the Act recognise that the service and administration aspects associated with superannuation schemes are taxable.

In Australia the New Tax System provides for a reduced input credit of 75% of the Goods and Services Tax (GST) incurred on certain qualifying expenditure borne by financial services providers.

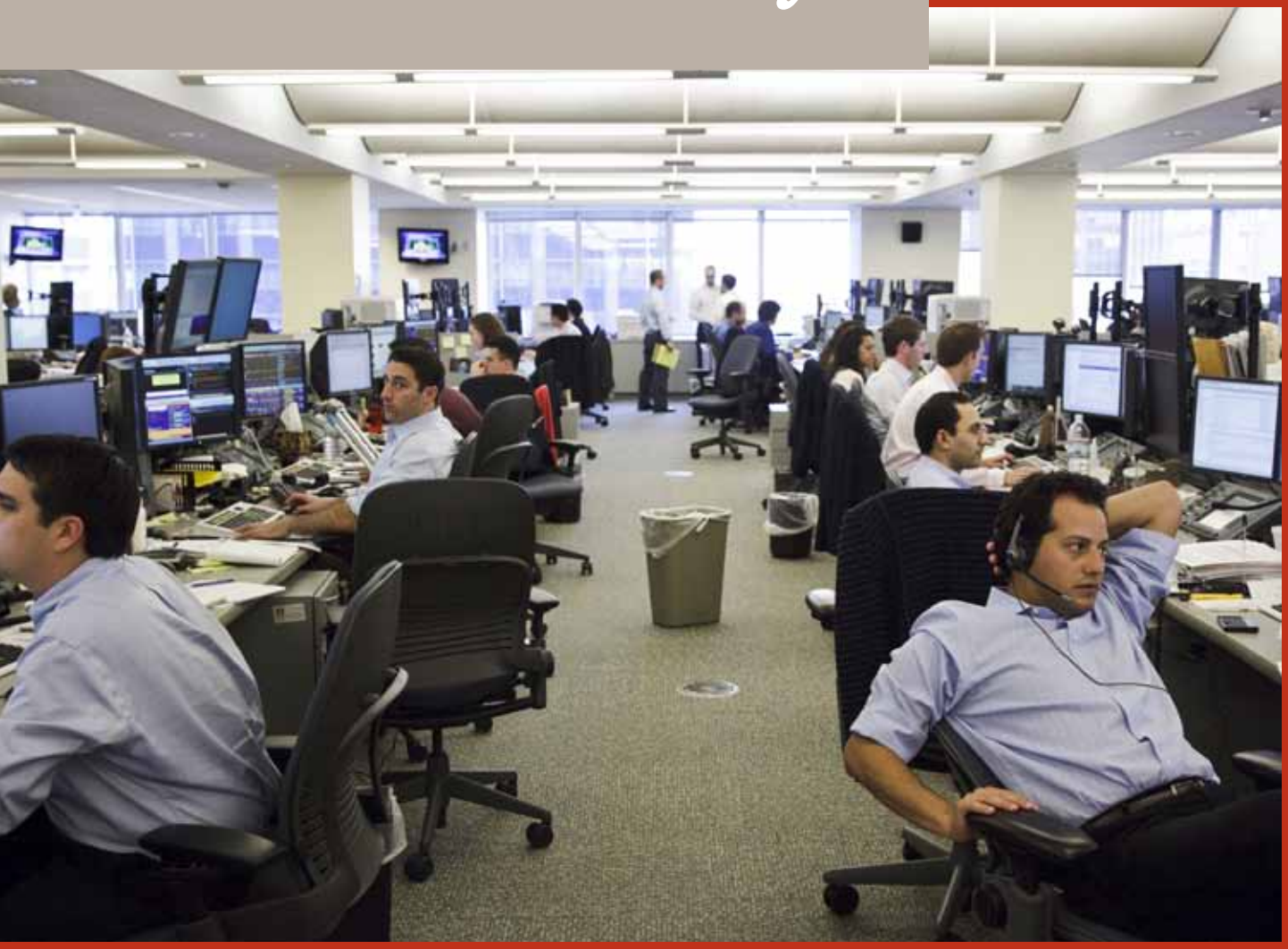
[2] One noticeable exception is the New Zealand Goods and Services Tax (on which the South African VAT is based) whereby since 1 January 2005, supplies of financial services to GST-registered persons whose taxable supplies equal or exceed 75% of their total supplies may be zero-rated, when the financial services provider elects to do so. The amendment seeks to prevent the cascading of tax in a business to business environment.

[3] In 1996, the proviso to section 2(1) of the VAT Act was introduced to standard-rate fees and commissions associated with financial products. Furthermore, in 1999, a proviso was added to section 2(1)(i) to remove the management of a superannuation scheme from the ambit of the exemption for long-term insurance and section 10(22A) was introduced to provide a valuation rule for the standard-rated supply of the management of a superannuation scheme.

In line with its current objective, National Treasury would be advised to set the VAT on such a component at the zero-rate, in line with other so-called 'merit-supplies' such as certain foods, which recognises the importance of these products within society. Zero-rating is the most beneficial VAT treatment whereby no additional VAT cost is borne, and the insurer receives a lower VAT cost base through additional input VAT recovery, savings which can then be passed on to policy holders, and the public at large.

There is no doubt that the life insurance and retirement industry in South Africa is significant, not only in terms of its size, but also from the perspective of offering many South Africans some level of social security. Given the changes in the industry over the years, and indeed National Treasury's focus on further reducing the cost of life insurance and retirement savings products for all South Africans, emphasis should now be directed towards how the VAT system can most appropriately be modernised to achieve these goals.

VAT accounting challenges facing the short- term insurance industry



By Dorwin Nyaga, PwC Senior Manager – Indirect Tax

Dorwin Nyaga
PwC Senior Manager – Indirect Tax

The South African Revenue Service (SARS) recently promulgated a five-year strategic plan for the financial years 2012 - 2017. In essence, the plan outlines four core desired outcomes, namely: increasing customs compliance, increasing tax compliance, increasing the ease and fairness of doing business with SARS and increasing cost effectiveness and internal efficiency.

National Treasury released the Tax Administration Act, 2011 within a few weeks following the promulgation of the SARS strategic plan. It appears that SARS will use on the Tax Administration Act to drive the implementation of some issues raised in the strategic plan.

SARS has stated that businesses are increasingly using sophisticated and complex financial schemes to evade tax obligations and minimise the effect of slow economic recovery on profitability. Examples identified by SARS include businesses utilising domestic loopholes to evade tax and take advantage of cross-border structuring and transfer pricing. SARS has also indicated that VAT processes will be under pressure as businesses deal with the slow economic recovery. This is likely to lead to increased incidences of VAT fraud that is the over-claiming of input VAT to protect the profitability of the business.

The above matters have huge implications on how businesses, including short-term insurers conduct their VAT affairs. For example, any transfer pricing adjustments as a result of SARS attacking the transfer price charged between related entities could lead to adjustments to the VAT and customs duty declaration. Such adjustments could result in interest and penalties being imposed – but the effect of transfer pricing adjustments on VAT accounting is a debate for another time.

The question arises as to what is the effect of the legislative changes and SARS' plan to the short-term insurance industry?

In an attempt to increase VAT compliance and promote uniformity of the tax treatment in the short-term insurance industry, SARS recently issued a draft short-term insurance guide and is in the process of finalising a class ruling relating to the short-term insurance industry. Based on these draft publications, SARS has provided clarity on the VAT accounting relating to certain transactions, including premiums collected by intermediaries on behalf of an insurer. In this regard, SARS is of the view that where a premium is collected by the intermediary on behalf of the insurer, the insurer must account for VAT in the tax period when the premium is received from the intermediary. Typically, under the Short-Term Insurance Act, the premiums are payable to the insurer within 15 days after the end of each month. Therefore, the fact that the premiums are received through the intermediary should not delay VAT accounting by the insurer.

Due to increased competition, existing insurers and new entrants into the market are introducing new insurance products; such as no-claim bonus and cash payments to the insured as an incentive to perform certain acts. These new products come with a share of VAT implications. For instance, where a cash payment is made to the insured as an incentive to perform certain acts related to the better management of the risk, consideration should be had as to whether the insurer is entitled to input tax deduction on such payments. Where input tax is not deductible, the full payment under these circumstances would be a cost to the insurer.

On this matter, SARS has taken the view that where an incentive payment is made to the insured; such payments constitute consideration for the services rendered or to be rendered by the insured. It would appear that where the insured is a vendor, it would be required to issue a tax invoice to the insurer and the insurer would claim input tax based on the tax invoice received. Should the insured not be a vendor, the insurer cannot make an input tax deduction as the service rendered by the insured would be taxable. In this regard, insurers should analyse the various products they offer to their clients to ensure that the VAT treatment is correct.

An area that requires attention is the effect of investment income earned by insurers on the VAT accounting. There is a misconception that because short-term insurers earn taxable premium income, there is no need to perform an apportionment calculation in respect of input tax deduction as is the case with long-term insurers and other financial institutions. This view is incorrect. Because of the significant amount of exempt investment income earned by short-term insurers, the requirement to apportion input tax may be necessary. Usually, an input tax apportionment calculation is not necessary where the ratio of exempt income to the total income is less than 5%. For the purposes of determining the 5% threshold, investment income entails proceeds on the disposal of equities, debt securities, interest income and all other exempt income streams. SARS has also stated that all income which is accrued which is not taxable, such as dividend income should be included in the apportionment ratio calculation. Effectively, the inclusion of proceeds from the disposal of investments and other non taxable income would increase the ratio of exempt income to the total income and this consequently reduces the input tax recoverable. It is recommended that short-term insurers review their income streams to determine the effect on apportionment based on the broad interpretation of income which should form part of the apportionment calculation. For example, a determination should be made on whether recoveries from foreign reinsurers should form part of the apportionment ratio calculation, as such income is neither exempt nor taxable at the standard rate or zero rate. An insurer can apply to SARS for approval of a suitable method of apportionment which provides a fair reflection of input tax incurred for the purposes of making taxable supplies. The application for approval of the suitable apportionment method should request guidance on inclusion or exclusion of certain income streams from the apportionment ratio calculation.

The above matters, coupled with the recently introduced Supplementary Declaration (IT14SD) returns, require short-term insurers to be vigilant with respect to VAT accounting. The IT14SD is intended to reconcile financial information across PAYE, Income Tax, VAT and Customs tax types. The form requires the reconciliation to be accurate to within R100, and it has to be completed within 21 days. For short-term insurers, completion of this return will be onerous because of reconciliation difficulties that arise as a result of timing differences with respect to VAT accounting and financial accounting. Furthermore, the VAT implications of the different transactions undertaken by short-term insurers add another dimension to the difficulties in reconciling financial information to the various taxes.

In the light of the emphasis by SARS on tax compliance, short-term insurers cannot afford to be complacent. It appears as though the promulgation of the Tax Administration Act will reward those taxpayers that voluntarily disclose tax liabilities and non-compliant taxpayers will be punished. It is worth noting that the Tax Administration Act stipulates that a taxpayer will be required to pay, in addition to the tax payable, an understatement penalty which is calculated based on the behaviour of a taxpayer. The behaviour of taxpayers is classified into five categories, namely: substantial understatement, reasonable care not taken when completing a return, no reasonable grounds for 'tax position' taken, gross negligence and intentional tax evasion. Substantial understatement means liability of tax which is more than five per cent of the tax properly payable or refundable or R1 million. The behaviours set out above are not defined, which could lead to subjective interpretation.

Where the understatement of tax is substantial, the taxpayer may be required to pay a penalty of 25% of the understated tax. However, should the taxpayer voluntarily disclose the understatement to SARS prior to notification of an audit, the authorities will waive the full amount of understatement penalty. The understatement penalty could increase to 150% of the tax due where there is gross negligence and up to 200% in the case of intentional tax evasion. Unlike in the past, SARS will not waive interest levied as a result of the understatement of tax.

It appears that SARS is encouraging taxpayers to voluntarily disclose any tax liabilities. However, where SARS identifies the liability as a result of an audit, the taxpayer will pay a hefty price.

If short-term insurers are to avoid VAT costs as a result of the Tax Administration Act, compliance with the VAT Act cannot be ignored. Due to complexities of VAT accounting in the short-term insurance industry, the new requirement to reconcile all taxes, and SARS' stated objective to increase tax compliance, insurers need to relook their VAT accounting processes.

Higher VAT costs on the cards for banks

By Perushka Moodley, PwC Manager – Indirect Tax

Perushka Moodley
PwC Manager – Indirect Tax

With the collapse of the US investment bank Lehman Brothers, the global financial system suffered its worst shock in September 2008. As market players withdrew from the financial system, credit dried up and world trade collapsed.

However, three-and-half years later, with the enforcement of tighter regulation, an overhang of debt in the west and the immense growth in the power of banks in emerging economies, the financial services sector show signs of some emergence from global disaster.

South Africa's banking sector was one of the three, along with India and Australia. that withstood the financial crisis. The main driver of such growth has undoubtedly been the containment of costs, which will continue to remain a priority for banks going forward. The banks will continue to focus on operational effectiveness by streamlining processes, including geographical hubbing and infrastructure sharing.

With all this talk of cost containment, as a consultant you can't help but think of a bank's Value-Added Tax (VAT) costs. Owing to the large amount of interest earned by a bank, a large portion of the financial institution's VAT on expenditure incurred is a straightforward cost to the bottom line and has a direct effect on the profitability of its business.

The VAT cost is closely monitored by most banks' in-house tax teams. Through recent interaction and communication with the South African Revenue Service (SARS), we may find this cost soon on the uprise, prompting outbursts from various key stakeholders in the company.

Banks have always faced challenges with SARS when it comes to the principles of direct attribution and apportionment. Many old rulings granted by SARS in respect of direct attribution have now come under close scrutiny, creating an unsettling feeling amongst banks that suggests original decisions may be rescinded. The age old debate of principles of 'direct and immediate link' or the 'look through' principle will resurface. It may well exist that an expense previously linked to the making of taxable supplies may now be linked to the making of both taxable and exempt supplies resulting in an apportionment of tax as opposed to a previous full input tax deduction.

SARS is also in the process of withdrawing the current Banking Council method of apportionment. Using such method, most banks claim input tax ranging between 45% to 55%. It is uncertain as to why SARS wants to withdraw this method. However, looking at the larger banking industries of the world, most banks claim a much lower percentage than South African Banks. Therefore, it was only a matter of time before SARS investigated this inconsistency. A lower apportionment rate would result in higher VAT costs for South African banks.

Another shocker came through during the recent February 2012 Budget Speech when National Treasury announced its proposal to eliminate the zero-rating of interest earned on loans to non-residents. The movement from zero-rated to exempt supplies would yield a double blow to the banks. A larger denominator to be used in the apportionment calculation would result in a lower input tax recovery rate, resulting in a larger VAT cost being expensed. Furthermore, banks would no longer be entitled to claim input tax on expenditure incurred in relation to such provision of loans to non-residents, as the expenditure would now be linked to the making of exempt supplies.

With all these changes on the cards, an increase in VAT costs and the negative effect it will have on the bottom line is likely. However, this falls foul of the banks very need to contain costs. Needless to say, the banks will push hard against certain decisions to be taken by SARS. A battle between the banking giants and SARS seems on course. The question arises as to who will be the winner.

And if you were not concerned with this before, you should be. An increase in costs may find banks looking towards increasing their revenue lines to balance the scale of profitability. This could mean higher pricing of products which will in turn hurt the consumer's back pocket.

Municipalities need to ensure they have the correct systems and processes in place

By Mornay Schafer, PwC Associate Director – Indirect Tax

Since the introduction of Value-Added Tax (VAT) in 1991, municipalities have had to register for the tax and special rules were applied in respect of supplies made by municipalities. The main difficulty with these rules was that municipalities collect property rates and this was not taxable. Furthermore, municipalities had the breakeven test to apply to certain activities to determine whether or not the supplies were taxable.

Mornay Schafer
PwC Associate Director – Indirect Tax

These rules led to many complications for municipalities, particularly causing much uncertainty when it came to claiming input VAT and carrying out apportionment calculations. Municipalities were unique because their types of income differed as some have income from abattoirs, the letting of property or caravan parks, which others don't. All of these scenarios need to be tested under the breakeven test before it can determined if income is taxable or not. Only then can the apportionment calculation be carried out.

Property development was an example where the breakeven test had to be applied. Should the development not be able to breakeven, then the municipality could not claim any input VAT relating to the expenses.

Municipalities had to apply for rulings from the South African Revenue Service (SARS) due to all these challenges and uncertainties.

After numerous submissions, the Finance Minister proposed some changes to the VAT treatment of municipalities in his February Budget Speech in 2006. The major change was the zero-rating of property rates. This change increased the taxable supplies of municipalities substantially. These changes further allowed the municipalities to claim input tax on previously non-taxable or 'out of scope' supplies.

These changes to the legislation came into effect on 1 July 2006. Prior to this change, SARS also confirmed that Grant Payments which are made under the Division of Revenue Act are subject to VAT at the zero-rate to the extent that it is used to make a taxable supply. This change came into effect on 1 April 2005. With a number of supplies becoming taxable with the 2006 change to legislation, the grants received also became taxable at the zero-rate and input VAT can now be claimed on these projects.

SARS has in recent years also released a guide to assist municipalities with VAT. It has also issued binding general rulings for the calculation of apportionment percentages.

Despite all of these changes and SARS simplifying VAT within municipalities, they are still not getting it right. One only need review the Auditor General's reports and find that municipalities have not claimed the input VAT on expenses. The VAT account does not reconcile with the VAT returns submitted to SARS. Furthermore, municipalities are claiming input VAT on suppliers that are not registered for VAT and tax invoices that do not comply with the requirements of the VAT Act.

Municipalities need to understand that SARS has changed its approach and that compliance with the VAT Act is becoming increasingly difficult. They need to ensure that they have systems in place to comply with the changes. In recent months it has also been noticed that once the vendor submits its VAT 201 per e-filing, a request to submit supporting documents can be received. The problem that municipalities are facing is that they are uncertain as to how the information from their system can be obtained and then how to upload the information to e-filing.

This industry still has a long way to go in ensuring that it gets the full benefit from all the changes to the VAT Act in the past 21 years. They will benefit from the positive contributions to the growth of the South African public and infrastructure.

However, it is to be seen whether this sector and the VAT Act will be able to adapt to the ever changing landscape.

Tax authorities focus their attention on State Owned Entities

By Thavendran Perumal, PwC Senior Manager – Indirect Tax

Thavendran Perumal
PwC Senior Manager – Indirect Tax

To date not much time and effort has been put into determining the VAT compliance levels at State Owned Entities (SOEs). Historically, from a funding model perspective, VAT in the public sector was not seen as significant to the South African Revenue Service (SARS). This view is likely to change in the near future considering the Government's New Growth Path strategy and SARS' strategic plan in driving tax compliance levels. While the Government looks at growing the economy and improving the lives of all citizens, SARS aims to ensure that all spheres of the economy contribute to the country's growth through compliance programmes. The objectives of both the Government and SARS bring us to a junction on how important compliance is in the public sector regarding tax legislation and the consequence of non-compliance by such entities.

According to SARS, VAT compliance refers to the degree to which taxpayers meet their obligations in terms of the legislation administered by SARS. VAT compliance is brought about by ensuring that we all are aware of our legal obligations, that it is reasonably easy to meet these obligations and the consequences for those who seek to avoid the law.

Historical factors such as the past political environment fostered a legacy of widespread non-compliance with the tax laws.

The application of VAT in SOEs is one of the most problematic aspects of any VAT system. The inherent problems of applying VAT to public entities are universal according to Michel Aujean, former Director of Indirect Taxation, European Commission. Special rules are adopted from the functioning of the VAT system, particularly activities carried out by public entities and also those carried out in the public's interest. Most of these services are seen as provided by such entities which are not subject to competition.

The South African Government's New Growth Path strategy entails 12 outcomes that the initiative seeks to achieve. Creating employment is one of the key outcomes. This requires major growth and changes in the public sector environment. One way that the Government can achieve this outcome is by establishing more SOEs and increasing capacity at current entities. These SOEs would, to a large extent, be in direct competition with the private sector. By doing this, one of the major underlying consequences would be the possible VAT registration liability for these SOEs. The SOEs are referred to as designated entities from a VAT perspective in that they carry out work which would otherwise be done by the Government, but also compete with other vendors in the economy. The funding that these entities receive is treated on the same basis as the consideration received by other vendors for making the same or similar taxable supplies. Payments to designated entities are therefore taxable at the standard rate of VAT (14%).

This would assist in creating more jobs, but with this comes more administrative requirements that the Government institutions are normally exposed to. Engaging the correct forums or specialists is vital to ensuring that the SOEs' tax administrative burdens are managed before they get out of control.

Corporate governance has become entrenched in the responsibility of public officers. Compliance with the Public Finance and Management Act (PFMA) is compulsory with certain disclosure requirements in the financial statements for non-adherence to the Act.

The PFMA's requirement of disclosure of fruitless and wasteful expenditure is one way to ensure that compliance with tax legislation is adhered to in the public sector. Holding the public officers accountable for the expenditure is one mechanism included in the PFMA to curb money being rotated in the system instead of being used for the purpose intended, which is to enhance the lives of all South Africans. Squandered funds means delays in investing in projects that would develop South Africa and its economy, a key reason that this occurs is primarily because of non-compliance with VAT and other tax laws.

A significant portion of the fruitless and wasteful expenditure contained in the Auditor-General's Report relates to interest and penalties incurred on taxes, including VAT. It would be interesting to determine how much of the total amount of fruitless and wasteful expenditure relates to non-compliance with VAT legislation. SARS has started with its modernisation programs, such as simplifying eFiling and payment processes, and streamlining refund procedures which will assist in making the administration task easier. However, this does not have an effect on the VAT compliance level in SOEs. SARS has also put forward its formal business and compliance strategies for the next few years. SARS is now focusing on different industries which currently have low levels of tax compliance. Undoubtedly, it won't be long before public officers become fully accountable for such fruitless and wasteful expenditure to the extent of disciplinary action or even dismissal.

Often the CEO or CFO of a SOE does not see VAT in the income statement, due to it either being claimed from SARS or as part of the expense – only the net amount for the single month appears. The fact of the matter is that VAT has an influence on nearly every transaction by a VAT vendor and discrepancies can and will have a material effect for the SOE. The more silent VAT is in a SOE's financial environment, the higher the chance that risk management is neglected. This is only identified if SARS finds errors with past transactions or more commonly when auditors raise queries on the entity's VAT accounting. Timing differences and changes in recent VAT legislation regarding SOEs not managing VAT risk continuously could result in qualified audited financial statements and direct accountability by management.

With the introduction of the IT 14SD form, SARS has indicated its intention to increase the level of compliance by asking companies to reconcile their financial statements to the amount reflected in the VAT returns. This is a formal legal declaration. Many SOEs will be caught unaware by this development. Decisive action needs to be taken by SOEs to ensure that the Enterprise Resource Planning (ERP) system will be able to cope with the demand for tax information.

The modernisation of the South African VAT system has led to improvements in the quality and integrity of data. SARS is able to use such technology to sharpen their analytical capabilities which puts additional pressure on the entity to ensure that its ERP system is designed to provide the information required by SARS.

Much of the fruitless and wasteful expenditure contained in the Auditor-General's Report relates to interest and penalties incurred on taxes, including VAT.

As SARS continues to raise its game, it will be the simple things that will catch taxpayers out, such as inadequate documentation, the inability to reconcile VAT payments, non-existent data trails and other VAT treatment issues that one thought had long since been resolved.

The provisions of the VAT Act are far more complex and technical than is generally perceived. There are a number of factors that management needs to consider when assessing VAT risk. SOEs should acknowledge or identify their VAT risk to ensure that informed decisions are made. Where uncertainties exist that result in a possible VAT risk, this must be actively managed to minimise potential future VAT liability and exposures. Public officers involved in the VAT function must be properly trained and have access to the correct tax specialists who can accurately address the issues at hand.

The Tax Administration Bill is set to provide more fairness with regards to taxpayers' rights to just administration action. However, many critics feel that it has the opposite effect. An onerous burden seems to be placed on taxpayers in terms of ensuring that their administrative affairs are in order and significant controls are in place to ensure compliance. Taxpayers have no additional avenue but to ensure that the VAT function is effectively monitored and all risks are kept to a minimum or accordingly planned and managed continuously and regularly. The VAT function needs to be documented in a procedural guide and adhered to by all public officers involved with the tax.

Taking into consideration the Government's position to increase the capacity and scope of SOEs to reach its strategic objective, it is now more necessary than ever that SOEs include VAT compliance in their strategic planning activities and where necessary, be prepared to defend business and VAT decisions from overzealous tax officials.

VAT is keeping pace with technology

By Sigmund Rohrer, PwC Manager – Indirect Tax

Sigmund Rohrer
PwC Manager – Indirect Tax

In the past 21 years, technology has progressed at a staggering pace and in many ways has completely transformed not only the way we live and interact with one another and society, but also the way in which we conduct business.

As a reminder to just how far we have advanced in the last 21 years, let's go back in time to 30 September 1991.

Personal computers were just starting to make in-roads into business and your average workstation operated with a 5 1/4 ″ floppy drive and the new high tech 3 ½″ stiffy drive (720 kilobyte) was just starting to make inroads into the data storage arena. Hard drives, as we now know them, were small, mostly around 20 megabytes in capacity, expensive and rare. Today your average workstation has a 500 megabyte drive and 2 terabyte (2,000,000,000 kilobytes) drives are relatively inexpensive and common place.

Similarly, the internet and electronic data communications have totally transformed the business and economic landscapes in which we operate. Interestingly, also in 1991, South Africa first joined the internet when a connection was made between Rhodes University's computing centre and Portland Oregon in the US. By November 1991, most South African universities were connected to the internet through UNINET and commercial internet access for businesses and private use began in late 1993.

Today the internet is integral to our daily lives and vital to most forms of communication. Within the last few years three new submarine optical cables have landed in South Africa and more are planned for the near future. These optical cables are connecting Africa to massive international data pipelines and are essential for the future economic growth of this continent. The largest submarine cable ever to grace our shores, the 14,000km long WACS cable has a minimum design speed of 3.84 Terabits per second and this capacity is almost triple to any other cable before it.

As with computer hardware and the advancements in the internet, computer software has also made large strides and now carries out many tasks that would previously have been performed by putting pen to paper in a leather bound ledger. Most organisations these days use computer software in almost every facet of their operations, including accounting and reporting functions. These advances have not only allowed substantially larger numbers of transactions to be processed at significantly fast speeds, but computer software is assisting with reporting, auditing and risk assessment functions. Data integration and data mining software is beginning to take on a more important role as the number of transactions processed become larger and more difficult for easy human comprehension.

Compliance

The single biggest change with respect to VAT compliance will have been the move from paper-based VAT201 return submissions to an electronic system introduced by the South African Revenue Service (SARS) which it named, eFiling.

Electronic filing has brought with it many benefits for taxpayers and SARS alike. The electronic submission of VAT returns has several benefits, the most beneficial being that a VAT return can no longer be 'lost' in the post and this results in a saving of interest and penalties that would have otherwise been levied by SARS for the late or non-submission of returns.

Initially, as an incentive to encourage the uptake of eFiling by taxpayers, SARS extended the due date for submission of VAT returns, together with the payment thereof, from the 25th of the following month to the last day of the following month and this resulted in a few days worth of cash-flow advantage accruing to the taxpayer.

Over the years, SARS has been adding new features to, and improving on, eFiling. Some of the current features include the ability to amend a VAT return subsequent to its submission, the requesting of a statement of account, VAT vendor search, requesting of a tax clearance certificate, payment of Custom's duty and VAT, obtaining a history of eFiling return submissions and payments, various payment options including credit push, debit pull and ad-hoc payments and the ability to allocate and re-allocate payments to different tax periods.

One of the most recent changes has been the ability for taxpayers to upload to eFiling supporting documentation required by SARS for their audit queries. This has time saving advantages for both SARS and the taxpayer. However, the downside of this has resulted in a break in personal contact as this more impersonal method of communication is resulting in the taxpayer not being able to build a relationship with SARS.

Presently, the eFiling upload of supporting documentation has a size limit of 2 megabytes per file. Should the supporting documentation be larger than this, then the taxpayer is requested to hand this documentation in at their local SARS office and from here the documentation is sent to a bulk scanning and document uploading centre. Unfortunately, this can cause some time delays and taxpayers are advised to include a copy of the original eFiling request for information as the first page of their submission. This will help to ensure that SARS knows to which audit query to upload the documentation.

A more recent and useful eFiling feature to be added is the payment allocation and re-allocation function whereby the taxpayer will be able to: (a) allocate an unallocated portion of a payment, (b) request the reallocation of a payment as already been allocated, and (c) trace and report missing payments.

There are two important technological milestones on SARS' radar, the first of which they are calling 'SARS Direct Data Flow Channel'. The idea is that the new Direct Data Flow channel will be used for processing large volumes of data. This new channel will reduce the overall administrative burden for large volumes by speeding data transfer and shortening data processing cycle times.

SARS envisaged that this channel will be used by vendors making use of the software provided by independent software vendors for their accounting activities. This channel allows the extraction of the relevant supporting data from the accounting package and submitting the supporting data in a prescribed format directly to SARS' systems. The vendor will be able to log into eFiling to view a synopsis of the supporting data submitted and then authorise the submission of the data.

Over the years, SARS has been adding new features to, and improving on, eFiling.

A second channel for submitting VAT supporting data and documentation to SARS and which is better suited for small to medium enterprises is the e@syFile™ VAT channel. This method allows vendors to create an export file from their accounting system and to upload this file into e@syFile™ VAT for submission to SARS.

Although this technology has some advantages, the disadvantage is that there are still many people and organisations which do not have these technological tools at their disposal. SARS has been promoting eFiling and in doing so has also made many of the older systems less attractive and more difficult to comply with. For example, previously SARS would accept a photocopied or faxed VAT201 return. Now SARS will only accept the original, which needs to be requested either from a call centre or by visiting a branch office. Facsimiles and photocopies are no longer accepted.

Data integration

Indirect tax often represents one of the largest throughputs in a business. Despite this, and in our experience, we have found that only a minority of organisations have specific VAT goals, objectives and policies and that there is minimal internal knowledge of VAT throughput within many organisations. Furthermore, we have found that VAT policies, processes and procedures are seldom documented.

As a result, many organisations are failing to identify areas of opportunity and risk with regard to their VAT accounting and compliance.

PwC utilises electronic data interrogation and data mining tools that can assist organisations with their VAT and further help to prevent the embarrassment and expense of things going wrong when the tax authorities carry out a VAT inspection.

At PwC we use the power of modern computing technology to:

- improve cash flow and identify outright cash saving opportunities
- identify and quantify VAT contained in business' expenditure data
- improve VAT processes and reduce VAT compliance and accounting costs
- manage VAT risk and provide a level of comfort and confidence in the accuracy and reliability of data
- electronically review VAT systems down to a transaction level, and
- test and verify VAT numbers.

Using our technical tax expertise in combination with our electronic interrogation tools, we can offer a systematic, technology-based review to maximise the recovery of VAT and to identify non-compliant transactions.

As tax compliance and tax legislation becomes more complex and onerous together with the tax authorities display of a more zero-tolerance attitude, it is becoming more relevant for businesses to be certain of the robustness and accuracy of their VAT systems and to further ensure that they are maximising claiming the VAT due to them.

No VAT invoice on learning

By Verena Jessnitz, PwC Senior Consultant – Indirect Tax

Verena Jessnitz
PwC Senior Consultant – Indirect Tax

Educational services supplied in terms of Section 12(h) of the Value-Added Tax (VAT) Act are exempt from the tax imposed under Section 7(1)(a). The supply of educational services by the following entities is exempt from VAT:

- by the State or a school registered under the South African Schools Act, 1996 (Act No. 84 of 1996)
- by a public college or private college established, declared or registered as such under the Further Education and Training Colleges Act, 2006 (Act No. 16 of 2006)
- by an institution that provides higher education on a full time, part-time or distance basis and which is established or deemed to be established as a public higher education institution under the Higher Education Act, 1997 (Act No. 101 of 1997), or is declared as a public higher education institution under that Act, or is registered or conditionally registered as a private higher education institution under that Act
- by any public benefit organisation as contemplated in paragraph (a) of the definition of a 'public benefit organisation' contained in section 30 (1) of the Income Tax Act that has been approved by the Commissioner in terms of section 30 (3) of that Act and which has been formed for—
  - adult basic education and training including literacy and numeracy education, registered under the Adult Basic Education and Training Act, 2000 (Act No. 52 of 2000), vocational training or technical education;
  - education and training of religious or social workers;
  - training or education of persons with a permanent physical or mental impairment;
  - provision of bridging courses to enable indigent persons to enter a higher education institution as envisaged in subparagraph (bb), or
- by the Joint Matriculation Board referred to in section 15 of the Universities Act, 1955 (Act No. 61 of 1955).

Educational services are not defined. Subsection (ii) includes the supply by a school, university, technikon or college solely or mainly for the benefit of its learners or students of goods or services (including domestic goods and services) necessary for and subordinate and incidental to the supply of services above if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging. Therefore, where additional goods and services are not supplied as part of the consideration for and payment of the tuition fees, school fees or fees or payment for board and lodging, they will fall outside this category; they will be subject to VAT.

Educational institutions also usually provide accommodation for participants at workshops or sporting events. The VAT position relating to this accommodation was discussed in official rulings issued in August 1992, but these rulings were subsequently withdrawn in 2009.

Vocational or technical training provided by an employer to his employees and employees of an employer who is a connected person in relation to that employer does not constitute the supply of an educational service.

Before 1 March 2002, crèches and after-school care centres were treated as exempt educational institutions, and therefore exempt from VAT registration. However, from 1 March 2002 crèches and after-school care centres are specifically exempt from VAT in terms of section 12(j) of the VAT Act.

Educational institutions making taxable supplies of more than R1 million per annum are obliged to register and account for output tax on their taxable supplies.

Usually, organisations making exempt supplies do not charge VAT on their supplies and cannot claim input tax credits on their purchases or only a portion is recoverable through the application of an apportionment methodology.

The details of the exemption are complex and the mixture of supplies that are rendered by these institutions creates even more difficulties.

In an effort to resolve some of the industry challenges, the South African Revenue Service (SARS) has been involved in an ongoing discussion with the Voice of Higher Education Leadership in South Africa, Higher Education South Africa (HESA), regarding the finalisation of a VAT class ruling applicable to the members of HESA. SARS issued a Draft Binding Class Ruling on 20 January 2012 and a VAT Class Ruling was issued on 1 August 2012. The VAT Class Ruling applies to HESA members and prescribes the apportionment method to be used to calculate the VAT to be allowed as input tax incurred for mixed supply purposes.

Universities' supplies consist primarily of exempt educational services. However, to obtain funding from other sources, universities have expanded their range of services and now apply their resources to supply additional services, such as research services, to corporate entities and the Government.

The ruling specifically addresses these research activities and defines 'applied research', 'basic research' and 'research grants' and in addition, outlines the input tax treatment of these specific research types.

The ruling provides that only 'basic research' would not be regarded as a VAT enterprise activity. Where the research is conducted with no student involvement, a full input tax deduction would (in principle) be allowed for contract research. However, where the 'applied and contract research' requires any form of student involvement, the research is regarded as being a mixed supply and full input tax may not be deducted.

SARS has also capped the overhead recovery rate at 12.5%. Therefore, should the apportionment recovery rate exceed 12.5%, it is limited to 12.5%. However, if the apportionment recovery rate is calculated to be less than 12.5%, the lesser percentage should be applied.

The following apportionment formula is detailed for purposes of calculating deductible input tax in respect of mixed applied research:

$$y = \frac{A}{a + b)} \times \frac{100}{1}$$

Where:	
"y" =	the apportionment percentage;
"a" =	The VAT incurred wholly for the purpose of making taxable supplies made during the period: • 100% of all VAT incurred in relation to contract research funding where there is no student involvement • 50% of all VAT incurred in relation to 'applied research' funded by sources other than contract research • VAT incurred wholly in the course of making of taxable supplies other than research.
"b" =	VAT incurred wholly for the purposes of making all exempt and non-supplies during the period (excluding mixed use): • VAT incurred on 'applied research' activities which is not deductible as input tax as a result of the ruling in respect of research activities.

Furthermore, the ruling requires that universities will have to code their zero-rated and exempt funding correctly. SARS has given the universities until 31 December 2012 to adjust their accounting systems so that other apportionment methodologies can be considered.

While it was always contemplated that it would be necessary to perform two apportionment calculations for 2012, it appears that one calculation is done based on the information for the full year (the old method), while the second calculation (the new method) is carried out based on information for period from 1 April 2012 to 31 December 2012.

The ruling is valid until 31 December 2012.

Challenges facing VAT in the mining industry

By Juan Swanepoel, PwC Senior Manager – Indirect Tax

Juan Swanepoel
PwC Senior Manager – Indirect Tax

Since the introduction of the Value-Added Tax Act No. 89 in 1991 and even in the good old General Sales Tax days, the mining industry was a major contributor to the economic growth of South Africa. The African continent is well known for its mineral opulence with South Africa in the forefront, not just from a diversity of minerals perspective but also its enticement towards foreign investors.

The mining industry has had its ups and downs in the last two decades, which is expected since commodity prices are linked to the international economic environment as well as politics. The South African Value-Added Tax (VAT) Act, on the other hand, was relatively unchanged, apart from amendments being introduced to clamp down VAT leakages and fraudulent transactions. Few amendments or concessions were effected to assist the mining industry in its ever changing environment. In fact, the majority of the amendments and concessions were rather directed to enforce a more stringent VAT environment as opposed to a supporting one, especially if one compares the VAT Act with the Income Tax Act.

The dawning of a new South Africa brought with it numerous challenges and legislation which affected all businesses, particularly the mining industry. The BEE abbreviation, and the likes, had and still have a significant effect on the business models of mining houses as well as medium to small scale miners, so to speak. The introduction of the Mineral and Petroleum Resources Development Act 28 of 2002 brought with it the old order mining right conversions and new mining right applications which are another enforcement that contributes to uncertainties in the mining environment. Add to this the numerous strikes and the regular power outages in recent years, life as a mining company is not as extravagant as perceived by the public.

The South African VAT Act is believed to be comprehensive, particularly when comparing it to other VAT jurisdictions on the African continent. However, the Act is written for the general commercial public with little reference to specific industries such as the banking and capital investment industry. Furthermore, the legislation rarely deals with transactions specific to the mining industry.

Although the manufacturing and production provisions in the VAT Act provide concessions pertaining to beneficiation of minerals in South Africa, it was only in recent years and months that the Act was aligned with the Customs and Excise Act No. 91 of 1964 specifically in relation to the importation and beneficiation of minerals and the exportation of the finished product.

Conversely, amended provisions and a new regulation were introduced to clamp down on fraudulent export transactions. Although it is understandable, considering the fraudulent export transactions undertaken by the general commerce, the mining industry, again, is herded by the general commerce's non-compliance to the provisions of the VAT Act.

International commerce has in recent years introduced new ways of trading with commodities, with transactions like drop shipments, flash title arrangements, and so forth, entering the international market. Many revenue authorities of eastern and western countries have adapted to the new transaction arrangements resulting in VAT regulatory amendments. This is one area where the South African Revenue Service (SARS) is lacking, that is adapting swiftly to the international commerce arrangements.

However, not all is gloom for SARS and its approach towards VAT transactions relating to mining companies; it has been open for discussions and has regularly issued directives appropriate to the current international market trends, bearing in mind the economic climate of the mining industry and South Africa. It has also introduced the diesel refund incentive scheme whereby mining companies are allowed to claim a refund on the amount of diesel bought and used in the production of primary mining activities. That said, the diesel refund incentive scheme is governed by the Customs and Excise Act No. 91of 1964 and not the VAT Act. There is also room for improvement, particularly in determining who qualifies for the diesel refund incentive scheme.

The past 21 years were indeed a time of trial and error for the VAT Act, with positive contributions to the growth of the South African public and infrastructure. The VAT Act has also been written to cover South African commerce in all aspects and the adaptability of the VAT Act is amongst one of the best in the world and on the African continent. However, it is to be seen whether the VAT Act will adapt swiftly to the ever changing commercial environment, particularly the challenges facing the mining industry.

No VAT on supply of digitised products

By Thinus Carstens, PwC Senior Manager – Indirect Tax

The Telecommunications industry is most likely one of the fastest growing industries worldwide. In 2010, the number of mobile subscribers equalled 77% of the world's total population. The industry has progressed at a staggering rate and yet there is no end in sight to the possibilities, applications and growth within the sector bringing access to the world to the tip of your finger with a handheld device as small as your business card.

Thinus Carstens
PwC Senior Manager – Indirect Tax

Over the last few years, e-commerce, including telecommunication services, has grown into what has become the biggest challenge for modern tax systems to date. The digitisation of commerce specifically affects consumption taxes, such as Value-Added Tax (VAT) and Sales Tax. This is due to the fact that consumption taxes were developed under the premise of the physical presence of a product within a specific taxation jurisdiction. However, with e-commerce, such a physical presence is no longer necessary.

The International Telecommunication Union (ITU) was founded in Paris in 1865 as the International Telegraph Union. It took its present name in 1934, and became a specialised agency of the United Nations for information and communication technologies (ICTs) in 1947. They allocate global radio spectrum and satellite orbits, develop the technical standards that ensure networks and technologies seamlessly interconnect, and strive to improve access to ITCs to communities worldwide.

The organisation is based on public-private partnership since its inception. ITU currently has membership of 193 countries (including South Africa) and 700 private sector entities and academic institutions. An international telecommunication regulation (ITR) was signed in 1989 by all member states of the ITU. A section of this regulation is devoted to the taxation and the place of taxation of international telecommunication services. Article 6.1.3 of the regulation determines that where, in accordance with the national law of a country, a fiscal tax is levied on collection charges for international telecommunication services billed to customers in that country, unless other arrangements are made to meet special circumstances. In other words, no fiscal taxes can be levied by the member countries for international telecommunication services which are billed to customers in another country.

Article 2.2 of the regulation defines an international telecommunication services to be the offering of a telecommunication capability between telecommunication offices or stations of any nature that are in or belong to different countries.

South Africa was a member of the ITU before 1981, but its membership was revoked due to its political policies and was re-admitted to the ITU in 1991. In September 2010, a Telecommunications conference was held in Sri-Lanka and South Africa became a signatory to the ITRs of the ITU once again.

Currently, member countries of the ITU, such as Australia, India, New Zealand and all European countries follow the tax treatment of international telecommunications services as stipulated by the ITU.

During the 1990s, the Organisation for Economic Co-operation and Development (OECD) initiated a study project on the tax consequences of electronic commerce. The OECD was soon recognised as an international leader and catalyst in advancing the debate on international tax aspects of e-commerce. During 1998, the OECD agreed on a number of generally accepted tax principles, referred to as the Taxation Framework Conditions that should apply to the taxation of e-commerce. Since then, the OECD has focused on the practical implementation of the principles that should apply to the imposition of consumption tax on e-commerce. The rationale for these frameworks is to eliminate conflict in, distortions and disincentives to international trade. Although South Africa is not a member country of the OECD and is not bound by the OECD's consumption tax principles on e-commerce, it is prudent to consider these principles when evaluating current South African VAT legislation.

VAT was introduced in South Africa during 1991, replacing General Sales Tax. To date, no amendments have been made to the South African VAT Act, to ensure that it specifically provides for imposing VAT on the supply of digitised products. The question to be considered is whether the VAT Act in its current form in fact provides for the imposition of VAT on the supply of digitised products and whether imposing VAT is consistent with the principles formulated by the OECD.

Taxation in the jurisdiction where consumption takes place.

The general consensus on consumption taxes around the world is that the rules for levying consumption tax on the cross-border supply of digitised products should result in taxation in the jurisdiction where consumption takes place. The question that arises with regards to the place of consumption is; what are the circumstances under which supplies are held to be consumed within a specific jurisdiction?

The OECD defines the place of consumption for cross-border supplies of services and intangible property that are capable of direct delivery from a remote location for business-to-business (B2B) transactions as the place where the recipient has located its business presence and for business-to-consumer (B2C) transactions as the jurisdiction where the consumer has his or her usual place of residence. In terms of B2C transactions the recipient's presence is not an effective proxy for determining the place of consumption but it is the OECD's opinion that, although this approach is not a theoretically pure definition of the place of consumption and may not always result in taxation in the actual place of consumption, it is at present the most practical option in the industry.

The South African VAT system is a destination-based system, which implies that goods and services are taxed where the consumer is situated. An unusual feature of the South African VAT system is that it does not use specific place of supply rules to determine whether a supply is subject to VAT in South Africa, unlike other VAT jurisdictions. The definition of an 'enterprise' in terms of section 1 of the VAT Act, together with the VAT import and export rules, attempts to regulate the determination of consumption of services considered to have taken place in South Africa and consequently subject to South African VAT.

It is evident, that there is great uncertainty regarding whether a foreign supplier that supplies digitised products to persons located in South Africa is carrying on an enterprise, as defined, in the country. In cases where it is regarded or concluded that a foreign supplier is carrying on an enterprise in South Africa and is subsequently liable to register for VAT in the country, the supply of digitised products to non-resident persons, may be zero-rated in terms of section 11(2)(l) of the VAT Act, which in itself is a complex section of the Act and from a practical perspective, difficult to administer and interpret in many instances.

Where it is regarded that a foreign supplier of digitised products is not an 'enterprise' for South African VAT purposes, the local VAT system provides for VAT on imported services and the consumer is obliged to self-assess the amount of VAT due to the South African Revenue Service (SARS), provided the 'service' is utilised for purposes other than the making of taxable supplies.

In conclusion, the South African VAT system is a self-assessment system, as in most other jurisdictions. This being the case, challenges of understanding complex industries, such as the telecommunications and e-commerce industries and aligning it with local and international VAT principles, will contribute to the creation of a fiscal climate in South African, in which these industries can reach its full potential and contribute to securing the South African VAT base.

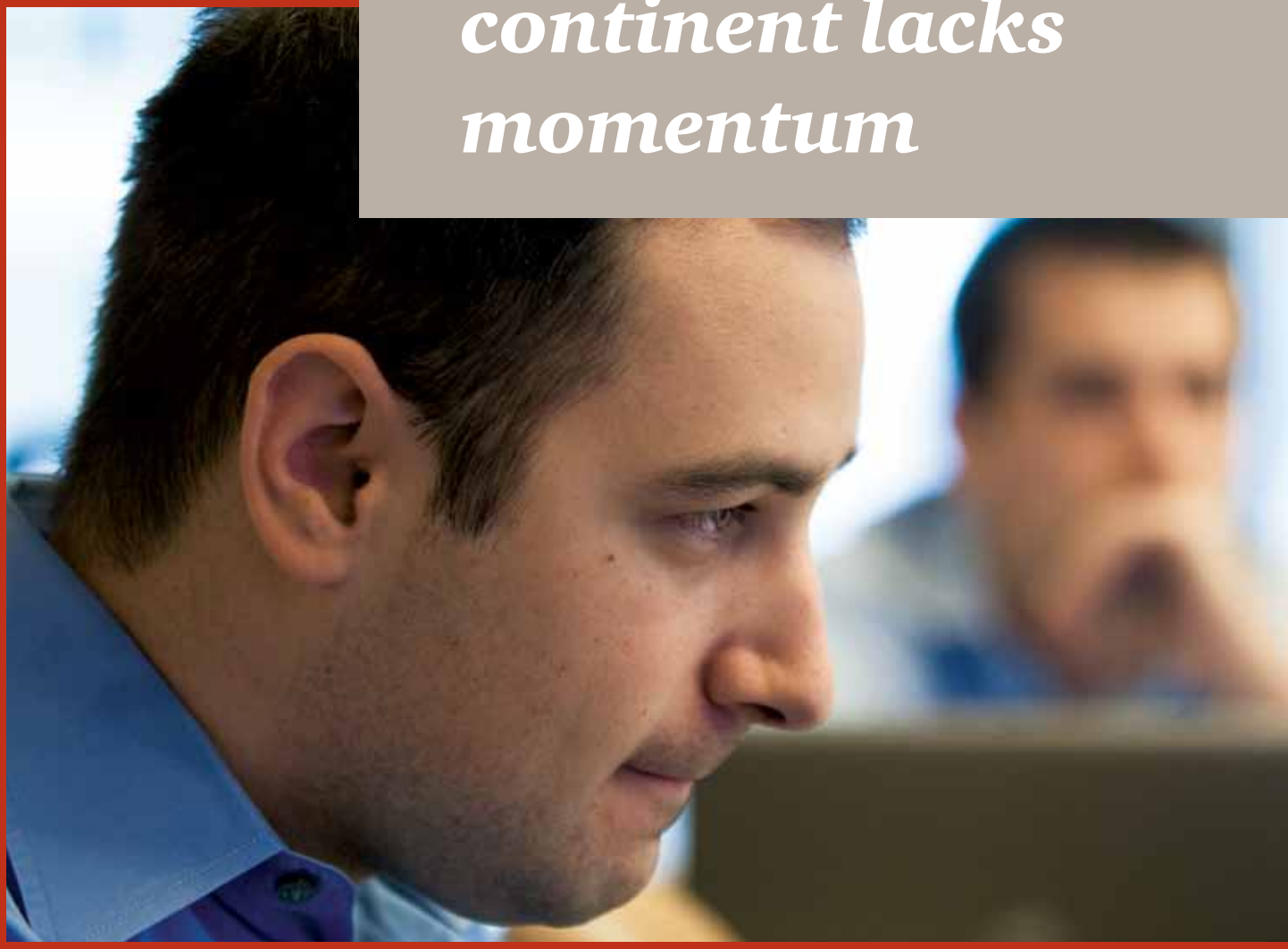
It is recommended by various VAT specialists in South Africa, that in order to overcome many of these challenges, SARS should legislate 'place of supply rules' within the South African VAT Act.

There is great uncertainty regarding whether a foreign supplier that supplies digitised products to persons located in South Africa is carrying on an enterprise, as defined, in the country

Bibliography

1. *RD de Swardt & R Oberholzer, Meditari Accountancy Research Vol. 14 No. 1 2006: 15-28*

Intraregional trade on African continent lacks momentum



By Johan van Niekerk, PwC Manager – Indirect Tax

'One Zambia, One Nation' was the refrain initiated by Dr. Kenneth Kaunda shortly after Zambia gained independence in 1964. This was aimed at uniting a diverse nation above tribal interests. Similarly, President Julius Nyerere mandated Kiswahili to be the only national language of Tanzania shortly after independence, with the goal of galvanising a new national identity. These political initiatives although in response to often ill-defined colonial political boundaries and decades of division between people groups, set off a wider process of economic and trade integration on a regional basis.

Johan van Niekerk
PwC Manager – Indirect Tax

In the international trade environment the themes of harmonisation and integration follow these early political drives beyond national borders. Not only does Africa boast the oldest customs union[1] in the world, but it has a rich history of growing trade block to the mutual advantage of member states. The advantages of economic integration into trade blocks are numerous. These include, amongst others, larger markets to attract foreign direct investments and to create economies of scale.

Across the African continent a number of preferential trade arrangements are in place. The agreements differ in nature and are at varying degrees of implementation.

Trade blocs can be categorised by the degree of economic integrations achieved:

1. ***Preferential Trade Area*** – preferential access is given to participants for certain products, usually through reduced tariffs. The Generalized System of Preference (GSP) which lowers tariffs for least developed countries, while not extending the benefit to rich countries falls within this description. [2]The unilateral United States Africa Growth and Opportunity Act (AGOA) creates a GSP related dispensation.

2. ***Free Trade Area*** – member countries eliminate tariffs, quotas and preferences on most goods and services traded between them. The members, however, have no common external policies to non-member countries. The Common Market for East and Southern Africa (COMESA) and Southern African Development Community (SADC) fall within this category.

3. ***Customs Union*** – this comprises a free trade area with a common external tariff. Often a common external trade policy is established, with some variations on quota requirements. The Southern African Customs Union (SACU) and the East African Community (EAC) are examples of such arrangements.

4. ***Common Market*** – this trade bloc is a free trade area for goods, while allowing a degree of free movement of capital, labour, enterprises and services. The European Free Trade Association (EFTA) operates a common market, and in some instances, a single market, which is essentially an advanced or freer version of a common market.

5. ***Economic and Monetary Union*** – this advanced trade bloc combines a common market, customs union and monetary union. The Economic and Monetary Union of the European Union creates the most integrated form of trade bloc.

[1] *SACU – the Southern African Customs Union, comprising of South Africa, Botswana, Lesotho, Namibia and Swaziland was established in 1910.*
[2] *This is a departure from the World Trade Organisation (WTO) requirement of treating all members according to the most favoured nation (MFN) principle.*

The main trade agreements in Sub-Saharan Africa include the:

1. Southern African Customs Union (SACU) consisting of South Africa, Botswana, Lesotho, Namibia and Swaziland. SACU, as a customs union, has entered into a free trade agreement with the European Free Trade Association (EFTA)[3] in 2006.

2. Southern African Development Community (SADC) comprising of Angola, Botswana, Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe. This free trade area is governed by the SADC Trade Protocol.[4]

3. East African Community (EAC) includes Kenya, Uganda, Tanzania, Rwanda and Burundi. This community is a customs union. Steps have been taken to move the EAC to a level of further integration (common market) by initiating the first phases of free movement of capital, labour and enterprises.

4. Economic Community of West African States (ECOWAS) includes Benin, Burkina Faso, Cabo Verde, Cote D'Ivoire, Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo. Although plans have been drafted to create a customs union and monetary integration, in practice there is only a preferential trade arrangement between certain members governed by the ECOWAS Trade Liberalisation Scheme (ETLS).

In Eastern and Southern Africa, the process of integration has gone a step further with the adoption of the Draft Tripartite Vision and Strategy in 2008. The aim is to create a COMESA-EAC-SADC Tripartite Free Trade Area which will establish a larger market for Eastern and Southern Africa to improve trade performances and competitiveness.

One of the main drivers of regional integration is the need to boot intra-African trade, which is currently at low levels of about 10%. Intra-regional trade in Europe is close to 70% of total trade. Poor regional transport infrastructure is mainly to blame for this state of affairs, resulting in disproportionate transport costs compared to other regions. Within the Tripartite Free Trade Area the focus is on attracting private investment through public-private partnerships targeted at energy, information and communication and transport infrastructure.

Although monetary integration is a declared intention of the African Union (AU), the lessons recently learned from the Eurozone warrant extreme caution. In Europe the levels of adherence to the fundamental building blocks of successful monetary integration, such as macro-economic convergence, far exceed those present in most African trade blocks, which would support the calls for caution.

[3] *EFTA members states are the Republic of Iceland, the Principality of Liechtenstein, the Kingdom of Norway and the Swiss Confederation.*
[4] *Although members of the SADC, Angola, the DRC and the Seychelles have not yet signed the Trade Protocol.*

Supply chains of multi-national corporations face a daunting task to navigate the maze of trade compliance requirement and optimisation of trade benefits across trading blocks. Processes to harmonise and simplify the movement of goods and services across the continent would be welcomed.

The notion of a United States of Africa was advanced by the former Libyan leader Colonel Muammar al-Gaddafi at various forums of the African Union (AU) as the only mechanism to provide wealth and prosperity on a pan-Africa scale. Although not practical, the benefits of harmonisation regulations, common markets, free movements of goods and services across the African continent cannot be denied. The themes of integration were initially bilateral (country to country agreements), then regional into trade blocs, and increasingly regional trade blocks are merging on a multi-lateral basis.

Who knows, maybe we should not deride too much the widely held American idea that Africa is one country.

Diversity of VAT laws makes compliance difficult for multinational companies

By Charles de Wet, National Indirect Tax Leader for Southern Africa

The multiplicity of Value Added Tax (VAT) systems across Africa exposes multinational companies to tax risk, errors and inconsistencies in the application of the law. Most of Africa's 54 countries have VAT systems in place which foreign investors and businesses cannot afford to be ignorant about, according to PwC's report entitled an 'Overview of VAT, 2011'.

Charles de Wet
National Indirect Tax Leader for Southern Africa

A potentially lucrative deal in Africa can easily turn sour if the parties do not take into account the potential liability for VAT registration or the basic structure of VAT in the relevant country.

The fourth edition of 'Overview of VAT in Africa" guide has been compiled by PwC VAT specialists in the following African countries: Botswana, Cameroon, Cape –Verde, Chad, Congo, Côte d'Ivoire, Equatorial, Guinea, Gabon, Ghana, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Morocco, Mozambique, Namibia, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Tunisia, Uganda, Zambia and Zimbabwe. The guide, which is based on the law in effect as at 31 July 2011, outlines the VAT principles, regarding VAT rates, the registration of VAT, output tax, exemptions, zero-rating, input tax, international trade, VAT accounting, record keeping, as well as the basic principles relating to other indirect taxes in each of these countries.

Many multinational companies encounter two major hurdles when entering into transactions in Africa. Firstly, the VAT laws tend to be complex in most countries. Secondly, they have to deal with different rules across a multiplicity of jurisdictions. The VAT systems in Africa are not aligned, which has a major effect on a company's operating and financial systems. The tax authorities expect compliance with the laws in their respective jurisdictions. As a result the compliance burden on companies may be onerous.

Compliance with the VAT laws is more difficult for multinational companies due to the diversity of laws in different tax administrations. Companies are expected to comply with the tax legislation in their own countries, regardless of the VAT laws in other jurisdictions in which they are operating.

Furthermore, many companies are unable to claim VAT refunds as a result of unsophisticated tax systems and changes in legislation, and unreasonable deadlines for submitting claims. Companies with cross-border transactions are also unable to track their VAT payments due to the complexities in the legislation. South Africa uses a screening process to determine whether a VAT refund is to be audited or whether the amount may be paid. Other countries, such as Kenya require an audit before an amount may be released. The VAT compliance burden for companies is also high. For instance, it takes far longer for companies to comply with the VAT rules than corporate income tax. Africa is also known for its stringent penalty regimes. For example, in Kenya penalties of up to US$1170 are payable per month in the case of not filing a VAT return, plus interest on the outstanding balance. In South Africa, additional tax of up to 200% may be imposed for the evasion of tax, including criminal prosecution.

There is also uncertainty on the VAT rules applying to financial services and products across the continent. Many companies have had to resort to the courts on occasion. Tax administration needs to be clear and simple. South Africa has a well-administered VAT system that is in line with international norms. The VAT rate is lower than the global average rate of between 18% to 20%. For example, New Zealand has a VAT rate of 15% and the UK 20%. A significant number of African countries, including South Africa and Botswana, have a single rate system in place, which is easier to administer.

Other countries are looking into introducing VAT into their systems as a means of efficiently collecting revenue. For example, Swaziland recently implemented a VAT sustem on 1Aprl 2012. The Democratic Republic of Congo is also introducing a VAT system next year. There are considerable variations in the level of the VAT threshold across African countries. In 2009 South Africa increased its threshold from R300 000 to R1 million and a number of jurisdictions have also implemented special regimes for small and micro businesses. South Africa, Kenya, Zambia and Tanzania have introduced a tax based on the turnover of a business.

VAT may become a reality in the US

China has introduced new VAT reforms across 10 cities and provinces, including Beijing and Guangdong province on 1 September 2012. The reforms, which will be phased in over the next six months, follow in the wake of a VAT pilot programme started in January 2012. The initiative is intended to bolster the weak services sector, which currently pays a business tax of 3 – 20 % on sales.

Thomas Boniface
PwC US

South Africa has a Value-Added Tax (VAT) system in place – so does the UK, Canada, Australia and New Zealand. However, to some Americans, the prospect of a Value-Added Tax (VAT) may be an unknown concept. But it may soon become a reality as policymakers in Washington are considering introducing a VAT system in the US, in the wake of the recent economic uncertainty.

Although VAT is a common tax worldwide and has been introduced in almost every developed economy, it has never been given serious consideration in the US. While policymakers have not made any formal announcements on the adoption of VAT, the possibility of its introduction is beginning to become more widely discussed among politicians, legislators, tax analysts and other interested stakeholders, particularly in the wake of the widening gap of the US deficit.

In 2009 the US fiscal deficit reached $1.41 trillion and neared the $1trillion mark in July 2012.

A number of prominent stakeholders and politicians, such as former chair of the US Federal Reserve Alan Greenspan, have suggested that the introduction of a VAT may be the "least bad" option open to the US government as a means of raising revenue to combat the soaring deficit. However, there is strong political opposition to the introduction of VAT, with the Republicans rejecting the notion of an additional tax.

There is also growing consensus among economists, academics and tax analysts that VAT could be an effective way of raising revenue to reduce the deficit. Michael Graetz, a Professor of Law at Columbia University, has suggested combining a broad-based VAT at a rate of between 10% and 14% with a reduction in the top individual corporate rates and exclusion of taxpayers earning below $100,000 from the individual tax system, as well as additional tax changes.

The National Commission on Fiscal Responsibility and Reform was formed in 2010 with the aim of investigating a wide range of means to reduce the fiscal deficit. Although a number of Commissioners recommended a Federal consumption-based tax as a component of overall tax reform, aimed at increasing revenue. It was not included in the Commission's final report.

US President Barack Obama has put forward proposals to raise income taxes for high income earners and impose levies on businesses. However, indications are that these moves are not enough to generate the revenue required to, amongst other things, balance the country's budget and cover the cost of health care. Furthermore, these proposals have not been embraced by Congress.

Unfortunately, the proposals to introduce a VAT system in the US have been put on hold for 2012 in the wake of the presidential elections. "The issue is a hot potato for politicians and no one dare raise it at this point in time," says Thomas Boniface, PwC US Leader for Indirect Taxes.

Boniface points out that almost every developed country, apart from the US, has introduced a VAT system, with the notion continuing to spread across the world. The case for VAT in the US is also becoming much stronger, with the deficit widening by the hour. As VAT affects almost every transaction, the Congressional Research Service estimates that each 1% of VAT could raise $50 billion.

Boniface says that if VAT is implemented in the US, it can learn a lot from the other 156 countries that are already using the tax. "Tax reform is not easy", he says, "and if VAT is to be implemented in the US, it is likely to be based on the New Zealand model. The model New Zealand uses is simple, efficient and neutral. A federal VAT rate of about 10% has been proposed. The European Union (EU) model is considered far too technical and complex".

"Plans for a VAT system in our immediate future are not on the table, but they should not be discounted."

Gerard Soverall, Leader of PwC Gauteng Indirect Practice, says that, worldwide, countries are in the process of adopting or reforming their VAT systems, particularly in the wake of the continuing global economic difficulties. The European Union (EU) has also embarked on a 'once in a lifetime' consultation of reform of the VAT system in order to develop recommendations for a simpler and easier to administer tax system.

"Worldwide the shift continues towards indirect taxes, rather than direct taxes as a means to raise government revenues," says Soverall. "This is why it is so important to get the VAT or GST model right. The ideal VAT system is one that is simple, efficient, creates legal certainty and neutrality both nationally and internationally, and promotes compliance among taxpayers."

A properly framed VAT system, possibly in conjunction with reduced personal income tax and corporate tax rates has the potential to make a tax system fairer overall, especially in a jurisdiction such as the US, he says. "The introduction of a VAT or GST system could materially reduce the US deficit. However, it would require the active support and energy of Congress."

Furthermore, countries that decide to implement a VAT system should ensure they take guidance and adopt best practice from other jurisdictions that have found the most effective solutions to the challenges that arise from design, implementation and administration of the tax, says Soverall. "No VAT system in the world is perfect. However, there are some good examples of indirect tax systems that are creating positive outcomes for governments, businesses and other stakeholders."

PwC Reporter South Africa

Source: Shifting the balance: from direct to indirect taxes (PwC)

The European Commission recently adopted a Communication on the future of Value-Added Tax (VAT), which is aimed at bringing about a more simple, efficient and robust system of taxation in the European Union (EU).

It is more than 40 years since the EU VAT system was first set up, and the Commission has stated that the time has arrived for an overhaul of the current system. The regime no longer fits with its service-driven, technology-based economy.

PwC South Africa goes face-to-face with Logan Wort, Executive Secretary for ATAF

By Sanchia Temkin, PwC In-house Journalist, South Africa

Worldwide, governments are increasingly looking to Value-Added Tax (VAT) to balance their books and make up the shortfall in the wake of the recent economic uncertainty.

Value-Added Tax (VAT), considered by many countries as one of the significant indirect taxes, accounts for about one-fifth of total tax revenue worldwide. The tax is increasingly gaining worldwide importance and recognition by revenue authorities and governments, as was recently seen when the African Tax Administration Forum (ATAF) launched its Indirect Taxes Working Group in Seychelles in May 2012.The conference was hosted by ATAF in collaboration with the European Commission and the Seychelles Revenue Commission. Member countries from ATAF gathered together to discuss trends in the administration of indirect taxes.

Logan Wort Executive Secretary for ATAF shares some of his insights and challenges going forward in an interview with Sanchia Temkin, In-house Journalist for PwC, South Africa.

Sanchia: What was the purpose of the recent ATAF conference held in Seychelles?

Logan: ATAF has added indirect taxes to its work plan in the light of a call by member countries at the first meeting of the ATAF General Assembly held in Mauritius in July 2011. The General Assembly resolved to 'task the Secretariat with immediate establishment of a Working Group on Indirect Taxes, and a review of the 2011-2013 ATAF Strategic Plan to incorporate Indirect Taxes'. This resolution informed the process the ATAF Secretariat used to commence work on indirect taxes.

Sanchia: Who attended the conference and what was resolved?

Logan: The conference provided both members of ATAF as well as other stakeholders with an important platform on what has been happening in their own countries in terms of the various indirect taxes. The conference included participants from Finance Ministries, VAT and Excise experts from African Tax Administrations across Africa who were able to contribute the policy elements of indirect taxes to the discussions.

The technical conference gave birth to the ATAF Indirect Taxes Working Group, which held its inaugural meeting on 31 May 2012. The Working Group, consisting of seven members, namely Ghana, Nigeria, Lesotho, Mauritius, Senegal, South Africa and Uganda, met to set out deliverables and timelines for indirect taxation products for ATAF member states.

Sanchia: What is the typical VAT rate in Africa?

Logan: Typical rates of VAT in Africa vary between 15-20%, which is considered high by international standards for developing countries. In most Asian countries, rates are around 10%, whereas in the Americas, the average is around 14%.

VAT 21
The African Tax Family

The African tax family consists of the African Tax Administration Forum (ATAF), the African Development Bank, the Tax Justice Network for Africa and the African Association of Tax Administrations.

ATAF was launched in November 2009 in Kampala, Uganda. Currently 34 African countries are members of ATAF. ATAF's objectives is to become a platform for articulating African tax priorities and building the institutional capacity of the continent's fiscal administrations through peer learning and the sharing of good practices. It is currently setting up an African Tax Centre to foster experience-sharing, benchmarking and peer-reviewing.

The African Development Bank is the strategic partner of ATAF. Together with ATAF and the Korean African Economic Cooperation Fund, the AFDB has established the East Africa Tax Initiatve, which focuses on sharing best practices in revenue governance in East Africa, including Burundi, Kenya, Rwanda, Tanzania and Uganda.

The Tax Justice Network for Africa is a pan-African initiative and part of the International Tax Justice network. Its aim is to mainstream tax justice in the economic discourse in Africa and promote socially just, democratic and progressive tax systems. It has made declarations on domestic taxation, revenues from natural resource extraction and international taxation.

The African Association of Tax Administrations is an African region of professional groups that aims to advance the cause of taxation through commitment to work for reforms in the areas for domestic and international taxation.

Source: ATAF

Sanchia: What type of VAT system is applied in Africa?

Logan: Most countries tend to apply a single tier system of VAT. If properly administered, VAT is better than the sales or turnover tax, as it leaves an audit trail. The ideal conditions for well-functioning VAT systems are sufficient capacity and a limited cash-based economy. The problem is that this is not the case in most African countries.

Sanchia: What are the difficulties regarding the application of VAT in Africa?

Logan: Different jurisdictions tend to apply different thresholds which range from 5-30%. One major problem with VAT in Africa is the numerous exemptions granted by governments. Usually, health care, education, financial and insurance services, small-scale agriculture, and housing are exempted from VAT.

In addition, there are also other VAT exemptions that contribute to eroding the tax base and distorting the economy. For instance, excisable goods such as fuels in Kenya and Uganda, the transporting of tourists in Kenya, locally produced tea and coffee in Tanzania, restaurant services in Kenya, postage stamps, which are common across Africa, building materials in Kenya, betting, which is common in many countries in Africa, and computers in Uganda.

Ending the VAT exemption is unlikely to raise significant amounts o f revenue. However, it serves three additional purposes: Firstly, it reduces compliance costs for many firms. Secondly, it prevents cascading and undue integration of firms. Lastly, it reduces administrative costs, allowing resources within the tax administration to be employed elsewhere.

With the advent of globalisation, the mobilisation of goods and the dropping of certain trade barriers, this is even more complicated when VAT is applied at the point of service. The question arises as to who is liable for collecting the tax.

Sanchia: How can the revenue authorities and governments in African make VAT systems less complicated?

Logan: The tax authorities need to create more benchmarks on how to apply the tax. They also need to share best practice and international norms on the administration of VAT. Importantly, taxpayer experience needs to be taken into account as well as simpler audit and more consistent enforcement measures applied.

For the past decade the International Monetary Fund (IMF) has strongly encouraged the introduction of VAT on the continent. This goes hand-in-hand with tax compliance and administration, but unfortunately it also opens the systems to corruption and fraud. While VAT may be relatively easier to collect compared to other taxes, one must be careful that it does not come at the expense of broadening the tax base, especially personal income tax.

Sanchia: Does VAT really broaden the tax base as revenue authorities worldwide seem to contend?

Logan: That is an interesting question and one which is open to much debate. Some revenue authorities create the impression that VAT brings in much sustainable revenue and widens the tax base considerably. In so doing, awareness around tax compliance is broadened and spending by governments.

However, if one has to actually analyse taxes carefully in some jurisdictions, it will be seen that VAT usually represents about one-third of total domestic income, particularly from industries. Governments generate most of their income from personal income taxes and corporate taxes. For the tax regime to be substantially fair, there has to be a good tax mix between personal, corporate and indirect taxes. In Africa especially, it is important to broaden the personal income tax base. Elites and politicians are not always taxed and this must change.

Sanchia: Multinational companies are finding that there are too many rules and barriers in carrying out business effectively on the continent. Could the harmonisation of VAT rules assist companies?

Logan: The issue of harmonised tax policies, in particular harmful tax competition, will form part of ATAF's agenda in the medium to long term.

The issue of harmonised tax policies, including VAT, will have to be addressed by the Budget Offices and Treasuries of African governments and revenue authorities will have to offer direction. ATAF has initiated some harmonised practices, including the adoption of a common approach to transfer pricing and the examination of tax treaties. Of course, tax policy is a sovereign matter. However African countries need to increasingly share policy outcomes and administration experience to improve revenue generation and to enhance the taxpayer experience including the ease of doing business. ATAF many technical seminars serve as a platform where many such exchanges take place.

The issues of harmonised tax policies, in particular harmful tax competition, will form part of ATAF's agenda in the medium to long term

Contacts

Gerard Soverall (BSc and CTA (UK)) is the leader of the Gauteng Indirect Tax practice and the deputy leader of the Tax Services division in Gauteng. Gerard joined the firm as a partner in December 2002 after having previously been a partner with another international accounting firm. He is an experienced tax practitioner specializing in VAT consulting. He worked initially for HM Customs & Excise in the UK for 3 years as a Tax Auditor before joining the profession.

gerard.soverall@za.pwc.com

Christine Eguchi, project co-ordinator, is a senior tax consultant in the indirect taxes division on secondment from PwC Kenya. Christine joined the South African practice in October 2011. She has assisted clients in a number of industries on VAT and Customs matters in Kenya and South Africa and on international tax matters. Christine has a Bachelor of Commerce degree from Kenyatta University. She is also a member of the Association of Chartered Certified Accountants (ACCA).

christine.x.eguchi@za.pwc.com

Charles de Wet is a director in the Tax Services practice and is the Country Leader responsible for Indirect Tax in Southern Africa and coordinating the African Indirect Tax Network. Charles is a qualified CA(SA) and holds a B Comm Honours degree in Taxation. Charles specialises in VAT consulting services and provides advice to a number of clients. Charles is also involved in tax research projects and specifically the Total Tax Contribution (TTC) Framework. He is also a frequent speaker at tax and budget seminars and also responsible for a number of articles that are published in the press.

charles.de.wet@za.pwc.com

Production and Editing

Sanchia Temkin: In-House Journalist, PwC, South Africa

Sonja Nel: Associate Director (Marketing & Communications, Business Development)

Ayanda Shangase: Communications Officer (Marketing & Communications, Business Development)

Veemal Daya: Senior Graphic Designer (Marketing & Communications, Business Development)