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Draft Regulation: Non-residents supplying services electronically liable to register and account for VAT with little exceptions

The VAT rate increase to 15% on 1 April this year was possibly the amendment which most significantly impacted the entire business community and end consumers over the last 25 years. It is envisaged that the new Regulation on electronic services will potentially be the single largest disruption for non-residents supplying services to residents by way of electronic means.

Following the first Draft Regulation dealing with the expansion of the ambit of electronic services, National Treasury has now published a second amended Draft Regulation (the Draft Regulation). The most significant difference between the current Regulation (effective since 1 June 2014) and the Draft Regulation, is that the latter does not list electronic services which are subject to VAT, but rather provides for all services which are supplied by electronic means, except specific exclusions as stated in the Draft Regulation. We summarise below the provisions of the Draft Regulation, and the potential impact.

- Business-to-Business (B2B) and Business-to-Consumer (B2C) transactions: As is the case with the current Regulation the Draft Regulation does not distinguish between B2B and B2C transactions.
- Definition of electronic services: The intention is that the definition should be as wide as possible in order to cater for the fast-moving changes in the industry. Therefore, as mentioned, unlike the current Regulation that lists the types of electronic services included in the electronic services definition, the Draft Regulation defines the term “electronic services” as meaning services supplied by means of any electronic agent, electronic communication or the internet for a consideration, with only three types of services being specifically excluded in the Draft Regulation (refer excluded services below). Although not covered in the Regulation, the Explanatory Memorandum provides that the policy intention is to subject services to VAT that are provided using

minimal human intervention. In this regard the Explanatory Memorandum uses the example of consultancy or legal advice etc. supplied from abroad "by means of" e-mail which would not fall within the definition of electronic services. The concept of limited human intervention and to what extent the intervention would be 'minimum' is not included in the Draft Regulation, and no further guidance is provided in the Explanatory Memorandum. It is however a concept used in other jurisdictions (EU specifically), and is specifically included in the EU VAT legislation. However, for now, given the absence of definitive legislation in the Draft Regulation, the concept of limited human intervention remains open to interpretation. Thus, even if one assumes that SARS will adopt similar principles as the EU with regards to the concept of minimal human intervention, these are by no means clear and it is envisaged that numerous non-resident suppliers will have to apply for rulings to SARS to obtain clarity. In summary, all services supplied by electronic means, unless specifically excluded, as detailed below, will constitute electronic services, subject to the comments above.

- Excluded Services:
  - **Educational services** supplied from an export country which are regulated by an educational authority in terms of the laws of that country.
  - **Telecommunication services**, as defined (i.e. services *inter alia* relating to the transmission, emission or reception of signals, writing, images, sounds or information of any kind by a telecommunication system, excluding the content of telecommunications).
  - **Inter-group supplies** from a place in an export country by a person who is not a South African resident to a company that is a South African resident, if both companies form part of the same group of companies as defined (i.e. a controlling company in a group of companies which holds 100% of the shares directly or indirectly through other companies in the group) and the foreign supplier itself supplies those services to the South African resident group entity. Therefore, typical global contracts where a non-resident group entity enters into an agreement with a third party supplier to supply services electronically (e.g. business process software) contractually to it, but for the benefit of group companies, the non-resident group company will still be required to register for VAT in South Africa.
    In this regard it is stated in the Explanatory Memorandum that the policy intention is that this approach is an anti-avoidance measure.
  - **Exempt services**, although not explicitly provided for in the Draft Regulation, the Explanatory Memorandum states that services that are exempt from VAT in South Africa will not be subject to VAT if supplied by a non-resident by way of electronic means (e.g. exempt financial services).
- Imported services: Before the introduction of the electronic service provisions in 2014, a recipient of electronic services would have been liable to account for VAT on such a supply received from a foreign supplier to the extent that those services were not used for taxable purposes. Currently the legislation does not impose an imported services liability on the recipient of the electronic services where the foreign supplier is required, but fails to register and account for the VAT on such supplies. National Treasury and SARS did not amend the legislation in this regard. However, it is stated in the Explanatory Memorandum that where the supplier is not required to register, or is required to register and levy VAT but fails to do so, the recipient may still be liable to declare VAT on imported services, i.e. where they recipient acquires the services for non-taxable purposes. In this regard it is our view that in the absence of a relevant amendment to the VAT legislation there is no legal basis for the aforementioned.
- Registration threshold: The threshold has been increased from ZAR 50 000 to ZAR 1 million per annum, in line with the registration threshold for all other businesses.
- Intermediaries and Platforms: A foreign electronic service provider will not be required to register for VAT where it engages an intermediary (as defined) to supply the electronic services on its behalf subject to the following criteria:
  - 'Intermediary' means a person who facilitates the supply of electronic services supplied by the electronic services supplier and who is responsible for issuing the invoices and collecting payment for the supply.

- There must be an agreement between the intermediary and the foreign electronic service provider (the principal) that the intermediary will act on behalf of the principal.
- The intermediary must be a South African VAT vendor.
- The principal is not a South African resident and not a VAT registered vendor.
- The electronic services are supplied or to be supplied by the principal to a person in South Africa.

If the above criteria are met, the intermediary will be deemed to supply the electronic services and it will be liable to charge and account for the VAT on these services in its VAT returns. As a result the foreign service provider would then not be required to register for VAT in South Africa. The VAT registration threshold of ZAR 1 million per annum should apply to the aggregate of supplies made by the intermediary.

A few practical points to consider:

- The intermediary will not be limited to act for only one principal electronic service provider.
- There is no definition of 'facilitation' but reference should be made to the wording that follows, i.e. at a minimum the intermediary should be responsible for the invoices and collecting payment for the supplies. In addition, the Explanatory Memorandum states that this would apply where suppliers provide electronic services firstly by using the electronic platform of another person (i.e. the intermediary), and the intermediary is responsible for at least the issuing of the invoices and the collection of payment. It was stated further that this would therefore exclude those intermediaries that are only facilitating payment (i.e. pure payment platforms).

Although the legislation in relation to intermediaries still needs to be promulgated, it is proposed that the amendments envisaged in the Draft Regulation and the amendments relating to intermediaries become effective on 1 April 2019.

To date we have not received any notice of a further public consultation process or workshop to be held to discuss the proposals.

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