THE ZERO-RATING OF CERTAIN PROFESSIONAL SERVICES IN TERMS OF THE VALUE-ADDED TAX ACT.

by

TANYA ROBERTS

Submitted in partial fulfilment of the requirements for the degree of

MAGISTER COMMERCII (TAXATION)

in the

FACULTY OF BUSINESS AND ECONOMIC SCIENCES

at the

NELSON MANDELA METROPOLITAN UNIVERSITY

Port Elizabeth

December 2013

Supervisor: Professor A J N Brettenny

ACKNOWLEDGEMENTS

- To God for His never ending grace and favour.

- To my parents Deon and Lenet and sister Nadia for their support and understanding.

- To my best friend Ruaan for his constant words of encouragement.

- To my supervisor, Professor Alex Brettenny, for his guidance, patience and availability.

- To Jenny du Preez, who proof-read my project within the limited time available to her and who provided useful comments and suggestions.

My sincere appreciation and thanks.

DECLARATION

This project is an original piece of work which is made available for photocopying and for inter-library loans.

Signed: _____

Date: _____

CONTENTS

ACKNOWLEDGEMENTS **i**

DECLARATION **ii**

TABLE OF CASES **vi**

SUMMARY **vii**

CHAPTER 1: INTRODUCTION **1**

1.1 Overview of the South African VAT system 1

1.2 Research objective and problem statement 6

1.3 Research approach and procedure 9

CHAPTER 2: SECTION 11(2)(*l*) **11**

2.1 Introduction 11

2.2 The development of section 11(2) (*l)* 12

2.3 'the services are supplied to' 16

2.4 'a person who is not a resident of the Republic' 18

CHAPTER 3: PROFESSIONAL SERVICES **21**

3.1 Overview 21

3.2 Risks of incorrectly applying the zero rate 22

3.3 Professional services identified in research 24

3.4	Audit – External	25
3.5	Audit – Internal	27
3.6	Taxation – Value-Added Tax	28
3.7	Taxation – Transfer Pricing	30
3.8	Taxation – Individuals	31
3.9	Taxation – International Tax	33
3.10	Taxation – Corporate Tax	34
3.11	Actuarial Sciences	35

CHAPTER 4: PLACE OF SUPPLY **36**

4.1	Introduction	36
4.2	New Zealand GST – Background	38
4.3	GST Act	38
4.4	‘Consumption’	41

CHAPTER 5: APPLICATION **48**

5.1	Audit – External	49
5.2	Audit – Internal	52
5.3	Taxation – VAT	53
5.4	Taxation – Transfer Pricing	55
5.5	Taxation – Individuals	56

5.6 Taxation – International Tax 57

5.7 Taxation – Corporate Tax 58

5.8 Actuarial Sciences 58

CHAPTER 6: CONCLUSION 59

6.1 Recommendations for professional services firms 60

6.2 Recommendations for future research 61

TABLE OF REFERENCES 62

TABLE OF CASES

C:SARS v De Beers Consolidated Mines Limited [2012] 3 All SA 367 (SCA), 74 SATC 330.

SIR v Raubenheimer [1969] 4 SA 314 (A) 322, 31 SATC 209.

SUMMARY

Value-Added Tax ("VAT") is a tax levied in terms of section 7(1) of the VAT Act on the supply of goods and services. Where consumption takes place within the Republic, the supply is subject to VAT at the standard rate.

The supply of services to a person who is not a resident of the Republic is subject to the zero rate of VAT in terms of section 11(2)(*l*) of the VAT Act.

Research has shown that there is no guidance contained in the legislation to provide clarity when professional services are supplied to the non-resident or, when in fact, it is supplied locally to a resident entity.

The term 'consumption' is introduced to aid the above lack of clarity. This term provides a means to determine when the service is supplied to a non-resident and when the service can thus potentially be supplied at the zero rate of VAT. It is deduced that in order for section 11(2)(*l*) to be correctly applied, consumption needs to take place outside the Republic and the benefit of the service is received or consumed by the non-resident.

Where professional services are ultimately supplied to a local entity, although the professional services firm has engaged with a non-resident entity, the service should be supplied at the standard rate of VAT in terms of section 7(1)(*a*).

Where an SA entity receives an ancillary benefit as a result of the service supplied to the non-resident entity, it is not clear whether this ancillary benefit enjoyed by the local entity is sufficient for the service as a whole to be supplied at the standard rate of VAT.

Keywords

Section 11(2)(*l*), supply, place of supply, consumption, services

CHAPTER 1

INTRODUCTION

1.1 Overview of the South African VAT system

The final Value-Added Tax ("VAT") Act was adopted by Parliament and promulgated in South Africa on 12 June 1991[1]. VAT, replacing General Sales Tax ("GST"), was introduced at a single rate of 12% and shortly thereafter reduced to 10%. The rate at which VAT is charged was subsequently increased to 14% during 1993 and has remained unchanged since.

VAT is a consumption tax levied on the supply of goods and services in terms of section 7 (1) of the VAT Act, specifically subsections (*a*), (*b*) and (*c*). These subsections are briefly discussed below.

Section 7(1)(*a*) of the VAT Act levies VAT on the

> 'supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him'.

[1] Act No. 89 of 1991 (the VAT Act)

This levy is referred to as output tax and is defined in section 1 of the VAT Act as follows:

> 'in relation to any vendor, means the tax charged under section 7(1)(*a*) in respect of the supply of goods and services by that vendor'.

Furthermore, subsection (*b*) levies VAT on

> 'the importation of any goods into the Republic by any person on or after the commencement date'.

'Goods' is defined in section 1 and means:

> 'corporeal movable things, fixed property, any real right in any such thing or fixed property, and electricity'.

This definition excludes money, any right under a mortgage bond or pledge of any such thing or fixed property and any stamp, form or card which has a money value and has been sold or issued by the State for the payment of any tax or duty levied under any Act of Parliament.

Finally, section 7(1)(*c*) imposes VAT

> ‘on the supply of any imported services by any person on or after the commencement date’.

Both ‘supply’ and ‘imported services’ are defined in section 1 of the VAT Act. ‘Supply’ includes:

> ‘performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and any derivative of “supply” shall be construed accordingly’

and ‘imported services’ means

> ‘a supply of services that is made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that such services are utilized or consumed in the Republic otherwise than for the purpose of making taxable supplies’.

‘Imported services’ are thus services where the resident uses such services to make either non-taxable supplies or supplies not subject to VAT at all (exempt supplies). For example, persons supplying financial services as set out in section 2 of the VAT Act will be required to levy and declare VAT on the ‘imported services’ utilized by them to make such exempt supplies.

Input tax can generally be claimed by vendors on the purchases of goods and services provided that:

- The goods and services were subject to VAT at 14% in terms of section 7(1); and
- the vendor acquired the goods and services wholly or partly for the purpose of consumption, use or supply in the course of making taxable supplies[2].

Where, however, vendors acquire goods and services partly for making taxable supplies and partly for another use, input tax can only be claimed on the portion of goods and services acquired for making such taxable supplies. Section 17(1) of the VAT Act provides for apportionment rules to be applied when the vendor makes both taxable and non-taxable supplies.

The South African Revenue Service ("SARS") issued a guide[3] for vendors which, inter alia, provides guidance on such apportionment. Binding General Ruling No.16 also provides rules on the application of the 'standard apportionment method' whereby turnover, distinguished between taxable, exempt and other supplies, is used to calculate the apportionment ratio or percentage.

[2] As per the definition of 'input tax' in section 1 of the Value-Added Tax Act 89 of 1991

[3] 'Value-Added Tax Guide for Vendors' (VAT404) (12 March 2012)

The input tax is also defined in section 1 and reads partially as follows:

> 'in relation to a vendor, means-
>
> (a) tax charged under section 7 and payable in terms of that section by-
>
> (i) a supplier on the supply of goods or services made by that supplier to the vendor…'

Input tax can thus only be claimed by the vendor if it was levied:

- by the supplier (of the goods and services) under section 7(1)(*a*);
- on the importation of any goods into the Republic under subsection (*b*) ; or
- on the supply of any imported services under subsection (*c*).

The treatment of the input tax by the vendor, i.e. whether it can be claimed or not, follows the 'type' of supply – whether the goods or services are supplied at 14%, the standard rate of VAT, or whether non-taxable supplies are made.

The Act provides for the supply of taxable and non-taxable supplies. Taxable supplies are either made at the 14% or the 0% of VAT whereas non-taxable supplies are not subject to VAT at all.

Firstly, section 11 lists goods and services which are subject to the zero rate of VAT, provided that the goods or services would have been charged with VAT at 14% in terms

of section 7(1), had it not been for section 11. Documentary proof is required in terms of section 11(3) in order to apply the zero rate. The documentary proof required by the Commissioner for the zero rating of goods and services is set out in Interpretation Notes 30 and 31. Vendors supplying goods or services at the zero rate of VAT are entitled to claim the input tax on the goods or services acquired to make these supplies.

Secondly, supplies that are not subject to the VAT imposed under section 7(1)(*a*) are called exempt supplies and are listed in section 12 of the VAT Act. Entities making exempt supplies cannot claim input tax on the purchases of goods and services. However, as previously discussed; where both exempt and taxable supplies are made the vendor should apply an apportionment ratio to the input tax claimed.

1.2 Research objective and problem statement

The focus of this research project is a critical analysis of section 11(2)(*l*), which deals with the zero rating of services supplied to a non-resident of the Republic and reads as follows:

> ‘(2) Where, but for this section, a supply of services would be charged with tax at the rate referred to in section 7 (1), such supply of services shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent where—

(*a*) – (*k*) …

(*l*) the services are supplied to a person who is not a resident of the Republic, not being services which are supplied directly—

(i) in connection with land or any improvement thereto situated inside the Republic; or

(ii) in connection with movable property (excluding debt securities, equity securities or participatory securities) situated inside the Republic at the time the services are rendered, except movable property which—

(*aa*) is exported to the said person subsequent to the supply of such services; or

(*bb*) forms part of a supply by the said person to a registered vendor and such services are supplied to the said person for purposes of such supply to the registered vendor; or

(iii) to the said person or any other person, other than in circumstances contemplated in subparagraph (ii) (*bb*), if the said person or such other person is in the Republic at the time the services are rendered,

and not being services which are the acceptance by any person of an obligation to refrain from carrying on any enterprise, to the extent that the carrying on of that enterprise would have occurred within the Republic…' (emphasis added)

Section 11(2)(*l)* does not contain any guidance as to which criteria have to be met or which circumstances have to be considered in order to warrant that the supply is in fact

made to the person who is not a resident of the Republic[4], i.e. that such person is the ultimate recipient or beneficiary of the services. In order for the zero rate to be applied to the supply of the services, the recipient needs to be a non-resident.

General practice has shown that often, prior to further investigation, the non-resident who is party to a contractual agreement with the service provider is considered to be the automatic recipient of the services. It can easily, and incorrectly, be assumed that the services are received outside of the Republic by such a person. Consideration is not given to who receives the services and consequently consumes them.

In terms of proviso (iii) to section 11(2)(*l*), services, that are supplied directly to the non-resident or 'any other person' if the non-resident or 'such other person' is in the Republic at the time the services are rendered, cannot be supplied at the zero rate of VAT. It is unclear what the legislature's intension was with the term 'any other person' and who this could possibly refer to. It is, however, further considered throughout the remainder of the treatise.

Based on the findings of extensive practical research conducted, multinational entities with head offices or holding companies outside of the Republic, and subsidiaries inside of the Republic, often engage with professional service firms in South Africa to render services for consumption by either the offshore entity or the local entity.

[4] 'Person who is not a resident of the Republic' is hereafter also referred to as a 'non-resident'.

The aim, or objective, of this treatise is to determine when the link between the services rendered and the non-resident is close enough for the services to be supplied to the non-resident and not some other person in the Republic at the time the services are rendered. This therefore aids in determining whether the zero rate of VAT can be applied to such services. These guidelines are applied to the respective services to provide a clearer interpretation of whether section 11(2)(*l)* applies to the said services.

1.3 Research approach and procedure

Extensive practical research and investigations have been performed within a professional services firm to identify which supplies of professional services are subject to possible zero rating in terms of section 11(2)(*l).*

Within the treatise, the detailed nature of these services are examined in relation to local and foreign legislation as well as case law and other sources of information. New Zealand's legislation and interpretations are included to provide an additional perspective and to substantiate the conclusions which are presented. This country's Goods and Services Tax (GST) principles are similar to those of South Africa's VAT legislation. Brief comparisons are made between the two countries' legislations and interpretations to substantiate the assumption of similarities.

A detailed analysis of section 11(2)(*l*) is presented in Chapter 2. This identifies terms that can result in anomalies or lead to the incorrect application of this section. Chapter 3 follows with a detailed discussion around the specific professional services considered in this research project. Local and foreign legislation and other sources of information are considered and analysed in Chapter 4.

In Chapter 5 the research and outcomes in the previous chapters are applied to the specific professional services in order to provide guidelines for the application of section 11 (2)(*l*). Chapter 6 concludes the treatise and suggests further possible remedies that could be introduced by either SARS or the legislature to address the problem statement.

CHAPTER 2

AN ANALYSIS OF SECTION 11(2)(*l*)

2.1 Introduction

'Services' in terms of the VAT Act mean

> 'anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods, money or any stamp, form or card contemplated in paragraph (c) of the definition of "goods"'.

In the above definition, 'anything…to be done' implies that the person who will be performing the services has certain obligations[5]. Professional services firms enter into agreements with their clients to perform certain services. They perform these services in the terms of engagement letters signed by both parties and these agreements or contracts place obligations on both parties. These agreements

- create an obligation for the firm to render or supply certain services with a defined scope to the client; and
- they also create an obligation for the client to provide the necessary information to the firm and compensate the firm for the services rendered.

[5] Hereafter, for purposes of this treatise, the person who performs the services is referred to as the 'professional services firm' or 'the firm'.

The services offered and supplied by professional services firms thus clearly fall within the definition of 'services' for VAT purposes.

2.2 The development of section 11(2) (*l)*

Prior to section 11(2)(*l*) of the VAT Act being substituted in 1998[6], it read as follows:

> '(2) Where, but for this section, a supply of services would be charged with tax at the rate referred to in section 7(1), such supply of services shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent where—
>
> (*l)* the services are supplied <u>for the benefit of and contractually</u> to a person who is not a resident of the Republic <u>and who is outside the Republic at the time the services are rendered</u>, not being services which are supplied directly in connection with…' (emphasis added)

The first emphasised phrase, 'for the benefit of and contractually', is no longer included in the current legislation. Clause 89 of the Explanatory Memorandum[7] sets out the potential problem caused by the phrase quoted above:

---

[6] Para (*l*) of the VAT Act was substituted by s. 13(*l)* of Act 20 of 1994, amended by s. 28(*d)* of Act 27 of 1997 and substituted by s89 of Act 30 of 1998.

[7] Explanatory Memorandum on the Taxation Laws Amendment Bill (1998) ("Explanatory Memorandum")

> 'Where services are contractually supplied to a person who is outside the Republic, but physically rendered to a person who is in the Republic at the time the services are rendered for the benefit of both the person outside the Republic and the person inside the Republic, some doubt exists as to whether the zero rate of VAT may be applied or not'.

Prior to the amendment, it would have been relatively uncomplicated to show that the party (the non-resident) with whom the professional services firm engaged with received the benefit of the services. The firm would have supplied the services to the non-resident under an obligation in terms of a contract and it is, thus, incorrectly implied that the same person would receive the benefit. It was necessary for the legislature to remove this term as it could possibly have led to abuse of the zero rate afforded under section 11(2)(*l).* The purpose of this section is to allow for services to be supplied at the zero rate of VAT where they are supplied to a person who is not a resident of the Republic[8]. Incorrect application of this section would unfairly benefit the vendor in the event that he provides a service and it is consumed within the Republic.

The legislature, correctly, removed this phrase, because it made it 'easier' for the vendor to apply the zero rate. The vendor could use the contractual agreement with the non-

[8] As per section 1 of the VAT Act, "Republic", in the geographical sense, means the territory of the Republic of South Africa and includes the territorial waters, the contiguous zone and the continental shelf referred to respectively in sections 4, 5 and 8 of the Maritime Zones Act Act 15 of 1994.

resident as a pillar to rely on for applying the zero rate. However, the phrase was not replaced with guidance as to when the zero rate applies when services are supplied to a non-resident. This lack of clarification creates a gap in the legislation which vendors can exploit in order to more freely supply services at the zero rate.

This lack of guidance in the legislation could potentially be to SARS' detriment should a dispute end up in court. *Income Tax in South Africa*[9] states the following:

> 'Should a taxing statute reveal an ambiguity, the *contra fiscum* principle must be applied, that is, the ambiguous provision must be interpreted in favour of the taxpayer. In other words, where a section of the Act is reasonably capable of two constructions, the court will place the construction upon it that imposes the smaller burden on the taxpayer.

This rule was formulated by Steyn CJ in *SIR v Raubenheimer*[10] as follows:

> 'Dit wil my bygevolg voorkom dat, hoewel die voorskrif in par (*e*) vatbaar is vir 'n engere betekenis, 'n wyere nie uitgesluit kan word nie. Dit is gemene saak dat by meer as een moontlike betekenis, die uitleg teen dis fiscus moet gaan'.

[9] D Clegg and R Stretch *Income Tax in South Africa* SI 42 (2013) LexisNexis

[10] [1969] 4 SA 314 (A) 322, 31 SATC 209.

The Explanatory Memorandum further sets out in clause 89 that the aim of the amendment of section 11(2)(*l)* is to eliminate

> 'any doubt as to the scope of this subsection. The supply of the services must be made to a recipient who is not a resident, and neither the recipient nor any other person to whom the services are rendered may be in the Republic at the time the services are rendered, for the zero rate of VAT to apply'.

The above sets out the objective of section 11(2)(*l*), which is applying the zero rate to services consumed outside of SA. It does not, however, provide further guidance as to when services are specifically consumed outside of SA.

Interpretation Note No. 31[11] provides for certain documents to be obtained and retained for purposes of compliance with section 11(3), one of which is the recipient's order or the contract between the recipient and the vendor. This requirement still does not cater for the instances where the recipient of the service and the person who consumes the services are two different persons, residing in two different countries. Where the latter resides within the Republic, the service is consumed there and the zero rate cannot be applied. In such cases, the existence of the contract between the recipient and the vendor does not aid at all with the correct application of section 11(2)(*l).*

Furthermore, the requirement to comply with section 11(3) is easily overlooked when the main focus is on section 11(2)(*l*). The taxpayer tends to look for a relationship of

[11] Issue 3, 22 March 2013.

any kind with the non-resident party, whether it is by means of the engagement letter or the invoicing process. In any event, the person who ultimately consumes the benefit of the service supplied cannot be determined in any other way than by scrutinizing the nature of the service and all the parties thereto, and arriving at a conclusion that can be supported and that is evidenced by actual events and audit trails.

The second emphasised phrase, 'and who is outside the Republic at the time the services are rendered', was removed from its original location in section 11(2)(*l)* and inserted in a new subsection (iii) to the quoted section. This has the effect of disallowing the zero rating of services where they are supplied directly to the non-resident or any other person if the said person or such other person is in the Republic at the time the services are rendered.

2.3 'the services are supplied to'

'Supply', as defined in section 1 of the VAT Act, includes

> 'performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and any derivative of "supply" shall be construed accordingly…'

Professional services rendered by a firm are, as previously discussed, carried out in terms of engagements with clients as formulated by signed engagement letters. These services fall within the definition of ‘supply’ as the services are compulsory once an agreement has been reached between the firm and the client. The parties to the agreement are required to perform certain acts and one party could enforce legal action upon the other party should one party not carry out its obligations in terms of the contract.

In terms of the definition of ‘supply’ in section 1, the ‘recipient’, in relation to any supply of goods or services, means the person to whom the supply is made.

Thus, there is an apparent connection between a supply (of services) and the recipient thereof. As the title (recipient) indicates, a person to whom the supply is made receives the supply.

However, the following questions arise:

- Who is the true recipient of the services? It is often assumed that the supply is given to the party that engages with the professional services firm and that this party is, consequently, the recipient. In the chapters that follow, it is demonstrated that this is more often than not an incorrect application of the legislation.

- Where is the supply of the services effected? VAT is a tax on the consumption of services and, if services are consumed in South Africa, they are generally subject to VAT at the standard rate in terms of section 7(1)(*a*). No exemptions from VAT would generally be available in these circumstances. For the zero rate of VAT to be applied, the service needs to be supplied to a person who is not a resident of the Republic.

  This question is applied to the professional services that are dealt with in Chapter 3 to provide clarification as to where the services are consumed and thus where the place of supply is.

By formulating answers to these questions, clear interpretations and guidelines can be provided regarding the correct application of the zero rate of VAT to certain professional services.

2.4 'a person who is not a resident of the Republic'

'Person' is defined in section 1 and includes any public authority, municipality, company, body of persons (corporate or unincorporated), trust fund, foreign donor funded project and the estate of any deceased or insolvent person.

'Resident of the Republic' is defined in the VAT Act and, firstly, refers to the definition in the Income Tax Act[12], but then widens the definition for purposes of the VAT Act by adding to it a deeming provision as follows:

> 'any other person or any other company shall be deemed to be a resident of the Republic to the extent that such person or company carries on in the Republic any enterprise or other activity and has a fixed or permanent place in the Republic relating to such enterprise or other activity…'

For a person to not be a resident of the Republic they must be a non-resident in terms of the Income Tax Act[13] and must neither carry on an enterprise[14] or activity nor have a fixed or permanent place relating to that enterprise or activity.

'Permanent place' is not a defined term, but a derivative thereof, 'permanent establishment', is often used in practice. This term is also not defined in the VAT Act, but the meaning as per the Income Tax Act has been adopted, which further refers to the definition in Article 5 of the Articles of the OECD Model Tax Convention on Income

[12] Income Tax Act 58 of 1962

[13] The definition of 'resident' in section 1 of the Income Tax Act 58 of 1962 includes meanings for natural persons and persons other than natural persons. It has proven to be troublesome to determine residency of the latter due to the 'place of effective management' phrase in the definition. Guidance is given on this in Interpretation Note 6 (26 March 2002).

[14] As defined in section 1 of the VAT Act.

and Capital[15]. For purposes of this research project, emphasis is placed on sections 1 and 2 of the Article which reads:

> ‘1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
>
> 2. The term "permanent establishment" includes especially:
>
> *a*) a place of management;
>
> *b*) a branch;
>
> *c*) an office;
>
> *d*) a factory;
>
> *e*) a workshop, and
>
> *f*) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.’

This forms an integral part of the process of arriving at a conclusion about whether a person is a resident of the Republic. There are no general rules to be applied and each situation needs to be analysed individually.

[15] As they read on 22 July 2010.

CHAPTER 3

PROFESSIONAL SERVICES

3.1 Overview

'Services' is defined in section 1 of the VAT Act as

> 'anything done or to be done'.

Professional services firms enter into agreements with their clients to perform certain services. They perform these services in terms of engagement letters signed by both parties. The engagement letters set out the scope of the services to be performed, or 'to be done', and the obligations both persons party to the agreement must meet.

The Big Four audit firms[16] offer services such as audit, assurance, actuarial, advisory, consulting, corporate finance and tax. Within these service lines, different types of services are offered and, in certain instances, agreements are entered into between the firm[17] and a non-resident[18]. Consideration has to be given as to whether the supply of

[16] The Big Four commonly refers to Deloitte, PricewaterhouseCoopers, KPMG and Ernst & Young.

[17] Hereafter, both 'firm' and 'professional services firm' refer to a professional services firm resident in the Republic, unless otherwise stated.

[18] 'Non-resident' hereafter refers to a person who is not a resident of the Republic and is a client of the professional services firm.

these services is made at the zero rate of VAT in terms of section 11(2)(*l)* or whether it needs to be invoiced at the standard rate of VAT in terms of section 7(1)(*a*).

In order to determine the VAT treatment of these supplies, the scope, and further details, of the respective services need to be analysed to identify the true recipient of the services.

3.2 Risks of incorrectly applying the zero rate

Professional services firms provide clients in industry with, inter alia, advice around taxation matters. Should the firm incorrectly supply services at the zero rate, and be exposed for it, they would face a reputational risk as they are trusted to provide accurate advice and deliverables to their clients.

Furthermore, in order to comply with section 11(3) firms need to obtain and retain the supporting documents required in terms of Interpretation Note 31. Should the South African Revenue Service ("SARS") conduct an audit or request the supporting documents relating to the firm's zero rated supplies and adequate support cannot be provided, the firm faces the risk of having an adjustment made to these supplies and having to supply them at the standard rate of VAT in terms of section 7(1)(*a).* SARS

has the powers to issue an additional assessment in terms of section 92 of the Tax Administration Act[19] ("TAA") if

> 'SARS is satisfied that an assessment does not reflect the correct application of a tax Act to the prejudice of SARS or the *fiscus*'.

Such an assessment can be made up to five years after the date of the original assessment in terms of section 99 of the TAA.

Practically, this results in the firm having to issue a credit note in terms of section 21 of the VAT Act to cancel the previously zero rated invoice and issue a new invoice by either

- adding VAT at the standard rate of 14% to the original charge; or
- calculating 14% of the original charge to the client.

The first option is the most advantageous to the firm as no income is lost in the process, i.e. if the original charge to the client was, for example, R100, the firm would issue an invoice for R114 and still receive a net amount of R100 after accounting for output tax of R14. The client might, however, not agree to pay the additional R14, specifically where the invoice is issued to a non-resident who is not registered for VAT in SA. Only registered vendors can claim an input tax deduction.

[19] Tax Administration Act 28 of 2011.

Using the same example as above, the second scenario puts the firm in a position where they 'lose' R12.28 of the original charge of R100, as the R100 is deemed to include VAT. The firm is left with a net income of R87.72. This is more favourable with regard to client relationships as the client still pays the firm the original charge of R100, compared to R114 in the first scenario. This treatment is also in line with section 64 of the VAT Act whereby

> 'any price charged by any vendor in respect of any taxable supply of goods or services shall…be deemed to include any tax payable in terms of section 7(1) (*a*)…whether or not the vendor has included tax in such price'.

3.3 Professional services identified in research

The service lines considered for the purposes of this research are: audit, taxation and actuarial sciences. Different scopes of the services within these service lines, where the complications of zero rating could arise when raising invoices, are discussed in detail. The facts given for each are considered relevant in determining the VAT treatment.

3.4 Audit – External

A non-resident firm[20] has engaged with a non-resident holding company in respect of an external audit on a South African ("SA") resident[21] subsidiary or branch. The non-resident firm subcontracts the resident member firm to render the service inside the Republic in terms of a SA statutory audit. The firm addresses the invoice to the non-resident firm as the agreement has been entered into between these parties.

3.4.1 The firm has been engaged by a non-resident firm to assist with an external audit on a foreign company or branch. The services rendered are not in terms of a SA statutory audit and are rendered physically inside the Republic. A member of the non-resident company or branch is in the Republic at the time the services are rendered and the deliverable is presented to the non-resident at this time. The invoice is once again addressed to the non-resident firm.

3.4.2 The firm has been engaged by an SA resident client, which is the holding company or head office in a group of multinational companies, in respect

[20] 'Non-resident firm' hereafter refers to a professional services firm that is not a resident of the Republic and is a member firm of the resident professional services firm.

[21] 'Resident' refers to a 'resident of the Republic' as defined in section 1 of the VAT Act.

of an external audit on a foreign company resident in SA or branch in terms of an SA statutory audit. An SA group audit opinion is required and certain procedures need to be performed by the firm on the foreign resident company or branch for purposes of the SA statutory audit report. The service is rendered within the Republic and the audit report will be signed in terms of SA statutory audit requirements.

3.4.3 The firm has been engaged by a non-resident firm to provide secondment staff to assist a non-resident firm. The agreement does not specify which clients the staff members will be rendering services to and the services will be rendered within the Republic. The services are thus rendered to the non-resident firm in terms of the agreement entered into between the member firms.

3.4.4 The firm has been engaged by a non-resident to perform audit work on an SA entity. The work performed will be used to contribute to the non-resident group audit opinion. However, no additional work is performed to support the non-resident group audit opinion. The audit work is performed physically in SA and the audit work performed on the SA company is in terms of an SA statutory audit. A situation can also arise where the firm performs audit work on the SA entity, but the service rendered constitutes procedures solely to support the non-resident group

audit opinion. Specific procedures are performed and these are not in terms of an SA statutory audit.

3.4.5 The firm has been engaged by a non-resident to prepare financial statements for either the same entity or its SA subsidiary or branch. No audit services are rendered in this scenario and the deliverable is a complete set of financial statements handed over to either the non-resident or the resident subsidiary or branch.

3.4.6 The firm has been engaged by a non-resident firm to perform quality reviews. These reviews are usually performed on high risk and larger engagements to determine whether the non-resident firm has applied the international professional services firm's methodology and policies appropriately. Audit files of other offices are reviewed under certain standards and the services are rendered within the Republic.

3.5 Audit – Internal

The firm has been engaged by a non-resident firm in respect of an internal Sarbanes Oxley ("SOX") audit on a SA resident company or branch. The service is rendered physically within the Republic in terms of a statutory audit under the SOX Act, which is an US statutory requirement. There is no SA statutory requirement to perform this audit.

3.5.1 The firm has been engaged by a non-resident firm in respect of an internal SOX audit on a non-resident company or branch and the service is rendered physically inside the Republic. Again, there is no SA statutory requirement to perform this audit.

3.6 Taxation – Value-Added Tax ("VAT")

The following types of engagements generally arise:

3.6.1 The firm has been engaged by a non-resident in respect of an opinion on whether or not it has an enterprise[22] in SA. The service is rendered inside SA and the deliverable is a report containing an opinion on the above matter. The deliverable is presented to either the SA company or the non-resident company.

3.6.2 The firm has been engaged by a non-resident to register it for VAT in SA. The service is rendered physically inside the Republic.

[22] 'Enterprise' is defined in section 1 of the VAT Act.

3.6.3 The firm has been engaged by a non-resident company to calculate the VAT liability of its SA registered VAT branch. The service is rendered physically in SA and two situations could arise:

3.6.3.1 the information prepared is used to complete and file VAT returns in SA; or

3.6.3.2 the information prepared is not used to complete and file VAT returns and is used by the non-resident holding company for its own financial reporting or planning purposes.

3.6.4 The firm has been engaged by a non-resident, which is a holding company of a multinational company, to provide it with general information pertaining to the VAT principles and filing of VAT returns in SA. The service is rendered physically inside the Republic and the deliverable is a report setting out the above required information.

3.6.5 The firm has been engaged by a non-resident to provide it with VAT advice relating to proposed SA activities. The service is rendered physically inside the Republic and at the time of the supply of the service consideration is given as to whether an SA entity has been established or not.

3.7 Taxation – Transfer Pricing

These services are rendered inside the Republic and not under a statutory obligation or requirement. The services are carried out in accordance with section 31 of the Income Tax Act[23] and related guidance provided in a Draft Interpretation Note[24] issued by SARS.

3.7.1 The firm has been engaged by a non-resident in respect of a transfer pricing policy between it and its SA registered VAT branch or SA resident company or branch. Two situations can arise:

3.7.1.1 The resident firm reviews an existing group transfer pricing policy for SA considerations. The firm does not develop the transfer pricing policy, but merely reviews the existing policy from an SA transfer pricing perspective. The SA portion of the policy forms part of the group transfer pricing policy. The resident firm can either have interaction with the SA company or branch and present the deliverable to them; or have no interaction with the SA company or branch and present the deliverable to the non-resident company.

[23] Income Tax Act 58 of 1962.

[24] Draft Interpretation Note on section 31 (2013).

3.7.1.2 The firm develops a transfer pricing policy for the SA company or branch. The service is physically rendered inside the Republic and the firm interacts with the SA company or branch during the course of rendering the service. The deliverable is a transfer pricing policy and is presented to either the local company or the non-resident holding company.

3.7.2 The firm has been engaged by a non-resident in respect of the preparation of an opinion for transfer pricing purposes. The deliverable is a report setting out the opinion as requested. The opinion is either given with reference to the non-resident company's proposed SA activities or its established SA subsidiary or branch.

3.8 Taxation – Individuals

3.8.1 The firm has been engaged by a non-resident company in respect of the tax filing obligation of an expatriate in SA. Two situations could arise:

3.8.1.1 The expatriate is working in SA for the local company on an assignment and will return to his home country on completion of the assignment. The firm invoices the non-resident company.

3.8.1.2 The expatriate is an SA resident and is working on assignment outside the Republic. He will remain an SA resident throughout the assignment period and will return to SA on completion of his assignment.

3.8.2 The firm has been engaged by a non-resident in respect of Pay-As-You-Earn ("PAYE") implications. Two situations could arise:

3.8.2.1 Advice is required in respect of the non-resident's SA subsidiary or branch either already registered for PAYE or not yet registered for PAYE. The deliverable is presented to either the non-resident company or the SA subsidiary or branch, where one exists.

3.8.2.2 Advice is required in respect of a proposed SA subsidiary or branch. The deliverable is presented to the non-resident company as there is no SA company or branch to receive the advice. It is considered to be a shareholder activity.

3.8.3 The firm has been engaged by a non-resident in respect of the SA income tax implications of a global employee share plan. This engagement arises when a non-resident employer implements a global employee share

incentive plan internationally. The non-resident firm or employer engages with the resident firm (and professional services firms from other jurisdictions) to provide the income tax implications for employees of these share schemes across different countries. Two instances arise:

3.8.3.1 The advice is provided to the SA company or subsidiary directly; or

3.8.3.2 the advice is provided to a non-resident and is used as part of a larger project where advice has been obtained from all countries where the share scheme has been implemented.

3.9 Taxation – International Tax

These services are rendered inside the Republic and not under a statutory obligation or requirement.

3.9.1 The firm has been engaged by a non-resident company in respect of tax advice for proposed SA activities. The need for this service arises when the non-resident company requires the SA tax implications of establishing an entity in SA. The deliverable is a report setting out the various local tax implications.

3.9.2 The firm has been engaged by a non-resident company in respect of tax advice for its SA subsidiary or branch. The non-resident company requests that the firm advise it on the SA tax implications of the already established SA company or branch. The deliverable is presented to the non-resident.

3.10 Taxation – Corporate Tax

These services are rendered physically inside the Republic.

3.10.1 The firm has been engaged by a non-resident company to calculate the income tax liability of its SA subsidiary or branch. Two situations could arise:

3.10.1.1 The tax liability calculation is used by the SA entity to complete their SA income tax return ("ITR14"); or

3.10.1.2 the tax liability calculation is used by the non-resident company for its own purposes and not to comply with an SA statutory obligation or requirement.

3.11 Actuarial Sciences

The firm has been engaged by a non-resident to perform a statutory actuarial service for the non-resident. This service is physically rendered inside SA in terms of a statutory obligation or requirement of the non-resident's country. The deliverable is a report issued in terms of the statutory requirements, setting out the findings of the procedures performed.

These professional services are addressed in Chapter 5 where research and interpretations are applied to the services. This is not an exhaustive list of services professional services firms offer, but rather the most common services where there is the potential of the zero rating of supplies.

CHAPTER 4

PLACE OF SUPPLY

4.1 Introduction

As discussed in Chapter 1, one of the causes of the incorrect application of section 11(2)(*l*) is the lack of guidance around who ultimately consumes the service or receives the benefit of the service supplied. Following from this problem is the issue of where the ultimate place of supply is.

Subsection (iii) of section 11(2)(*l)* excludes the zero rating of services rendered where the services are rendered to a non-resident or to 'any other person' if the non-resident or 'other person' is in South Africa at the time the services are rendered. The *Deloitte VAT Handbook*[25]explains that the intention behind this subsection is to

> 'ensure that services are standard-rated, where the person "consuming" the service is physically in South Africa when the service is rendered…irrespective of the location of the contracting parties'.

This, once again, emphasises the need to determine precisely who consumes the service as well as the place where consumption takes place. Furthermore, it highlights that the parties to the engagement should be disregarded since the person who engages with the

[25] C Beneke Deloitte *VAT Handbook* 8 ed (2012)

resident professional services firm is not necessarily the same person consuming the services and thus isn't a non-resident by default. The incorrect application of the zero rate can easily occur when the non-resident party to the engagement is assumed, without consideration, to be the person who consumes the service.

This chapter analyses alternative legislation and sources of information in an attempt to address the lack of clarification in the legislation around who consumes a specific professional service and where the supply is consumed.

Along with other resources, New Zealand's legislation around GST is briefly examined in order to identify similarities and distinguishing factors between it and South Africa's VAT system. A conclusion is reached about whether New Zealand's GST legislation is similar to that of South Africa's VAT system. A further analysis of the relevant sections dealing with the zero rating of services attempts to ascertain whether the foreign legislation can be useful in finding a solution to the problem statement.

Furthermore, articles and case law are considered and criticized to identify possible guidance and interpretations with regard to the issue at hand.

4.2 New Zealand GST – Background

GST was introduced in New Zealand on 1 October 1986 at a rate of 10% and was subsequently increased to 12.5% and 15%, as it currently stands, during 1989 and 2010 respectively. As per *VAT in South Africa*[26], New Zealand's GST replaced a wholesale tax. The initial draft GST Bill was based on United Kingdom legislation[27], but after several changes were made to it it 'deviated substantially' from the United Kingdom VAT Act. New Zealand's GST is a value-added tax, rather than a retail sales tax, and is levied in terms of the Goods and Services Tax Act[28] (GST Act). Both New Zealand and South Africa make use of a value-added tax system which makes these legislations comparable.

4.3 GST Act

GST is levied on the supply of goods and services in New Zealand, at the rate of 15%, in terms of section 8(1):

> 'Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1

[26] AP de Koker and D Kruger *VAT in South Africa* SI 14 (2013) LexisNexis.

[27] United Kingdom VAT Act of 1983.

[28] Goods and Services Tax Act 141 of 1985.

October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply'.

Section 8 sets out certain deeming provisions and exceptions not dealt with in detail in this research project.

Section 11A(1)(*k*) states the following:

'(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

(a) – (j) ...

(k) subject to subsection (2), the services are supplied to a person who is a non-resident and who is outside New Zealand at the time the services are performed, not being services which are—

(i) supplied directly in connection with—

(A) land situated in New Zealand or any improvement to the land; or

(B) moveable personal property, other than choses in action or goods to which paragraph (*h*) or (*i*) applies, situated in New Zealand at the time the services are performed; or

(ii) the acceptance of an obligation to refrain from carrying on a taxable activity, to the extent that the activity would have occurred within New Zealand; or…'

Section 5, headed 'Meaning of term supply', widely defines supply in subsection (1) as including 'all forms of supply' and further addresses specific circumstances either included or excluded from the term 'supply'. However, none of these are relevant to the

nature of the services considered for the purposes of this research and are not discussed further.

The term ‘services’ means ‘anything which is not goods or money’ as per section 2. This meaning or interpretation can be distinguished from the South African meaning, as discussed in Chapter 2, as follows:

- The GST Act’s meaning is very wide as it does not list what is included under the term services, but rather lifts the limitation by stating that it includes ‘anything’, provided that it does not constitute goods or money. ‘Goods’ and ‘money’ are defined terms in section 2.

- In Chapter 2 ‘services’ was defined in the VAT Act to mean ‘anything done or to be done’ with certain exclusions.

Professional services, the subject of the research, falls within the term ‘services’ for purposes of the New Zealand GST legislation and the South African VAT legislation.

New Zealand’s GST Act, similarly to South Africa’s VAT Act, does not provide any guidance or rules about the place of supply and when a supply is consumed inside or outside the respective country. The potential zero rating of services, however, depends on where consumption takes place.

The *New Zealand Master Tax Guide*[29] outlines the potential difficulties in applying the zero rate to services rendered or supplied to a non-resident under section 11A(1)(*k*). These include

- failing to ensure the non-resident is outside New Zealand when the services are performed; or

- failing to reasonably ascertain whether any person in New Zealand will receive the services for domestic consumption.

The latter links with the problem statement as it is problematic to determine where services are consumed. It is, however, a critical factor in assessing whether the zero rate of VAT can be applied. The guide acknowledges what could lead to difficulties in applying section 11A(1)(*k*), but provides no further guidance about determining who consumes the service and where it is consumed.

4.4 'Consumption'

From the above it can be concluded that New Zealand's GST legislation does not offer any more guidance about the application of the zero rate of VAT in terms of the supply of services than South African legislation does.

[29] *New Zealand Master Tax Guide* (2013) CCH New Zealand Ltd.

In an attempt to obtain a clear understanding of when the services 'are supplied to a person who is not a resident of the Republic', the term 'consumption' is introduced as an alternative solution to the quoted phrase.

All references to legislation hereafter are references to sections of South Africa's Value-Added Tax Act No. 89 of 1991, unless otherwise specified.

In an online *Ensight* article,[30] Gerhard Badenhorst speaks about how section 11(2)(*l)* has been subject to much debate since the implementation of VAT in South Africa. The introduction to the article furthermore states that

> 'VAT is an indirect tax based on consumption in the economy and is a destination-based tax and its aim is to tax the consumption of goods or services in South Africa' (emphasis added).

Attention is drawn to the word 'consumption' in the above quotation from the article. Section 11(2)(*l)* contains no reference to this word, but it is used as a practical means of determining whether the zero rate should or should not be applied to the supply of services. In broad terms, it implies that if consumption of services takes place in South Africa the services should be supplied at the standard rate of VAT in terms of section

[30] G Badenhorst 'Recent judgement on VAT zero rating of services supplied to non-residents' (2011) *Ensight.*

7(1)(*a*). In contrast, if the services are consumed outside of South Africa the services should, subject to further analysis, be supplied at the zero rate of VAT under section 11(2)(*l*).

The article further refers to the

> 'absence of place of supply rules in the VAT Act'

and that the lack of such rules makes it problematic to determine where services are consumed.

SARS has issued an Interpretation Note[31] note on the supply of goods and/or services by the travel and tourism industry. It states that the aim of VAT is to

> 'tax final consumption that takes place in the Republic'

and furthermore that

> 'supplies of goods or services consumed in the Republic, regardless of to whom the services are supplied'

[31] Interpretation Note No 42 (2 April 2007).

shall be subject to VAT at the standard rate. This provides further support that it needs to be determined where the service is ultimately consumed and only

> 'where consumption of the goods or services supplied will occur outside the Republic, provision is made for such supplies to be zero-rated'.

This interpretation note offers no further guidance which proves useful with respect to the supply of professional services.

The above problem emphasises the need for an in depth analysis into the practical application of this section; and hence the problem statement of this research arose.
Since neither the VAT Act nor the Income Tax Act[32] contain an interpretation or meaning of the word 'consumption' the ordinary dictionary meaning has been considered. The online *Oxford Dictionaries*[33] define 'consumption' as

> 'the using up of a resource'

and, more specifically with regards to goods and services, as

> 'the purchase and use of... services by the public'.

[32] Income Tax Act 58 of 1962.

[33] The definition of 'consumption' as at https://www.oxforddictionaries.com.

In this definition, it is not a clear requirement that the purchaser of the services and the person who consumes them need to be one and the same person. This situation can arise in practice if a foreign holding company engages with a resident professional services firm to supply services to its resident subsidiary or branch. In this situation, the foreign holding company in effect ‘purchase’ the services as the invoice would be issued and addressed to the same company. However, the resident subsidiary or branch would ‘use’ the services, as they are supplied to the resident. Thus, in this instance, consumption or use takes place in South Africa.

It is, however, often complex to determine who consumes the service and, furthermore, where consumption takes place. A single rule cannot be applied to all types of services to determine who consumes the service and where it is consumed. The nature and terms of each engagement need to be scrutinised to determine, inter alia, the following:

- The parties to the agreement and whether the resident firm will be interacting with any resident.

- The nature of the services and whether the services will be performed in terms of any South African statutory obligation.

- Where the services are physically rendered.

In a 2012 article[34] dealing with the two most recent VAT cases at that time, a discussion around the *C: SARS v De Beers Consolidated Mines Limited*[35] ("De Beers") judgement is held with regards to where the particular services were consumed and, thus, whether it was subject to zero rating in terms of section 11(2)(*l*). De Beers engaged the services of an offshore independent financial advisor to

> 'satisfy a statutory obligation of De Beers towards its unit holders'.

The Supreme Court of Appeal's practical approach resulted in its judgement that

> 'these services were consumed where the DBCM board finally met to receive and approve the recommendations made, and where the transactions were implemented',

which was outside South Africa.

Furthermore, the article speculates about whether SARS will adopt this approach going forward. That is, if it will

> 'accept that advice provided by a South African service supplier to a foreign recipient who receives the advice and approves the recommendations outside South Africa is

[34] R Rad, G Badenhorst and J Strauss 'South Africa: The Supreme Court of Appeal casts light on VAT debate' (2012) *Mondaq.*

[35] [2012] 3 All SA 367 (SCA), 74 SATC 330.

> consumed outside South Africa, and that the zero rate to such services will apply, notwithstanding the fact that a representative of the foreign entity may have been present in South Africa when the advice was given or recommendations made'.

To date, no further guidance or interpretations have been issued by SARS regarding the place of consumption. Thus, no conclusion on this matter can be reached through consideration of local and foreign legislation, case law and published material. There is thus no alternative but to analyse each type of service and derive a basis from which to identify who consumes the services and where they are consumed.

CHAPTER 5

APPLICATION

In Chapter 3 the specific professional services included in this research project are discussed in detail. The conclusion reached in Chapter 4 is that in order to determine who services are supplied to and where the services are supplied, it has to be determined who consumes the services and, ultimately, where the consumption takes place. In basic terms, should the consumption take place locally within the Republic, the zero rate of VAT in terms of section 11(2)(*l)* cannot be applied and VAT has to be levied on the supply.

This chapter applies these principles to the professional services outlined in Chapter 3 and provides guidelines to determining where consumption takes place with reference to these services.

Irrespective of who the contracting parties are, it needs to be determined which person consumes the service rendered. Where services are consumed outside of the Republic, and the supporting documents as per section 11(3) are obtained and retained, these services can be supplied at the zero rate of VAT under section 11(2)(*l*).

Where services are physically rendered outside the Republic, and provided that a resident entity does not receive the main benefit of the services, these services could

possibly be supplied at the zero rate of VAT in terms of section 11(2)(*k*). However, this section has not been considered further.

5.1 Audit – External

Where the firm has been engaged to render services in terms of a South African ("SA") statutory audit, the services can only be consumed in the Republic, as the audit is conducted in terms of SA audit and accounting standards. The deliverable, the audit report issued in terms of ISA 700,[36] will be addressed to the SA entity as the audit was conducted on the same entity. Irrespective of whether the professional services firm is engaged by the non-resident firm, non-resident client or resident client, the service rendered in terms of a statutory audit is consumed where the statutory obligation arose. The resident entity has to fulfil its obligation to have an audit performed on it and a non-resident person cannot consume such a service. However, the non-resident entity can indirectly benefit from this as its resident branch or subsidiary complies with local legislation and statutory obligations. The main benefit is, however, derived by the resident entity and consumption thus takes place locally in the Republic. Thus, it can be concluded that where services are rendered in terms of a statutory obligation, the person who has the obligation to comply will consume the services supplied, provided the services are physically rendered in the Republic.

[36] International Standard on Auditing (ISA) 700, 'The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements' (Revised and issued December 2001).

In contrast, where the firm has been engaged by a non-resident to perform specific audit procedures on a local entity in support of the non-resident group opinion, the local entity does not consume the benefit, as no audit report or deliverable is issued locally. A report of findings on the procedures conducted is issued or presented to the non-resident and these findings are incorporated into their group audit opinion. The group audit opinion is signed by the non-resident firm.

Should the firm be engaged to assist with an external audit on a foreign company or branch, it has to be determined where the services are physically rendered and whether any SA person receives any benefit of the service rendered, i.e. whether the service is wholly or partly consumed in the Republic. In the situation where the services are physically rendered within the Republic, it has to be determined whether the firm has any interaction with a local entity and whether any deliverables were presented to a local entity. If the firm interacted with the local entity, the extent of interaction should be analysed. Where the interaction merely involved the collection of information about the foreign entity or making use of the local entity's premises to render the service, it is not sufficient to conclude that the local entity consumes part of, or the entire, service. In the event that the deliverables are presented to the local entity, further investigation has to be conducted in order to determine whether the local entity uses the information contained in the deliverable for reporting purposes or to make business decisions. This is considered highly unlikely in instances where the local entity is merely a subsidiary or branch of the foreign holding company.

It can be concluded that the services are consumed outside of the Republic when it can be confirmed that no local entity receives any benefit from the services rendered.

In the situation where the resident firm is seconding staff to assist a non-resident firm, what needs to be considered is whether the services are physically rendered within the Republic. The level of interaction with any local entity needs to be analysed and, furthermore, it needs to be determined whether the main benefit is consumed by the local entity or the non-resident firm. Where all services are rendered to the non-resident firm and its non-resident clients, the services are clearly consumed outside the Republic and no local benefit is derived.

Where the firm has been engaged by a non-resident to prepare a set of financial statements for either itself or its SA subsidiary or branch, there is no statutory obligation being fulfilled and the entity receiving the deliverable consumes the service. Should the deliverable, being a set of financial statements for the local entity, be presented to the non-resident, it has to be established whether the service was rendered to the non-resident as such and for their reporting purposes only. In other words, it has to be determined whether the South African entity received a benefit from the services or merely an ancillary benefit. No guidance or precedence has been identified as to whether an ancillary benefit is sufficient to conclude that the services have been consumed locally and are thus required to be supplied at the standard rate of VAT in terms of section 7(1)(*a)*.

Services, in terms of quality reviews that are rendered physically within the Republic are consumed by the non-resident firm as the reviews are performed solely on non-resident entities. If, however, the reviews were performed on local entities, the reports on the reviews would still be presented to the non-resident firm. These firms receive the full benefit of the service as they need to comply with firm policies to have quality reviews performed. The client upon whom these reviews are performed does not receive any benefit from the service; in fact they would not be aware of the review being performed.

5.2 Audit - Internal

Where SOX audits are concerned, the deliverable is either presented to the local entity or the non-resident entity. More often than not, though, the deliverable is presented to the non-resident entity that has the obligation to have the SOX audit conducted; the deliverable being an audit report or report of findings on certain procedures performed. As discussed in Chapter 3, SOX audits are performed in terms of US statutory obligations. As with audits performed under SA statutory obligations, the entity located in the country under whose legislation the statutory audit is required, consumes the benefit of the services rendered. Thus, the non-resident entity will, in most situations, consume the services as they are rendered under a statutory obligation of a foreign country.

5.3 Taxation - VAT

The specific facts of the engagement and the scope thereof, as stated in the engagement letter, need to be analysed and interpreted. Where formal written opinions are concerned, the place of consumption will be where the opinion is presented and to whom it is presented. The purpose of the opinion is also an important consideration, i.e. who is using the information and advice.

In most instances, the non-resident holding company will use the advice on the resident entity for its own purposes and, as such, the opinion will be delivered to the foreign entity. The services are thus consumed outside the Republic. Where the opinion is presented to the local entity, careful consideration needs to be made as to whether this entity in fact consumes the service or merely passes it on to its foreign holding company for its use.

Where a local professional services firm is engaged to register a local entity for VAT in South Africa, only the local entity can consume such a service as the registration is directly linked to such an entity. Only the entity to be registered as a vendor can ‘enjoy’ the South African VAT system.

As per Chapter 3, South African VAT liability calculations can be used to either complete the VAT return for a local entity, or the calculations can be used by the non-

resident holding company for its own purposes. In the latter instance, the non-resident entity consumes the service, provided that it does not provide its local subsidiary or branch with the calculations. This has proven to be impractical to determine as the professional services firm has no control over what the non-resident entity does with the calculations after being provided with them. It is thus important that the firm obtain confirmation from the non-resident that the information will be used mainly for its own purposes.

In the situation where the calculations are used by the local entity to complete its VAT return, the service is consumed by the same entity as only a local entity can enjoy the benefit under a statutory obligation. It is the obligation of the local vendor to complete and submit a VAT return – its non-resident parent company cannot relieve it of this obligation.

Where a non-resident entity engages with a professional services firm to provide it with general South African VAT information, it needs to be determined what the purpose of the request is. Should the non-resident entity require the information for the consideration of whether or not to establish a South African subsidiary or branch, this type of service is considered to be a shareholder activity and the non-resident consequently consumes the service as there is no established SA entity to receive the service.

In the event that a local entity has already been established, the details of the information request need to be considered to determine whether the information will be used directly by the resident entity, in which case the service does not constitute a shareholder activity and consumption takes place inside the Republic.

5.4 Taxation – Transfer Pricing ("TP")

The distinguishing factors are whether the local firm compiles an entire TP policy for the resident entity, or whether it updates the information of an existing group TP policy for South African considerations. What is relevant to determining the place of consumption is whether the deliverable is presented to the non-resident holding company or to the local entity, and which entity will use the deliverable.

In most instances, where the local firm is required to update the group policy for relevant SA considerations and the firm's input forms part of a bigger report, the services are consumed by the non-resident holding company. An example would be where the report contains other countries' TP considerations for the entire group. The SA subsidiary or branch might receive an ancillary benefit in that the report will be made available to it as well. This is, once again, not within the control of the professional services firm and is impractical to establish.

Where a TP policy is compiled or updated for a local entity, such an entity consumes the service.

Where the resident firm has been engaged by the non-resident to provide an opinion for transfer pricing purposes, it is either in connection with the non-resident's proposed or existing SA activities. Where there are no established SA activities, the service is consumed by the non-resident. Where the non-resident has a SA subsidiary or branch it needs to be determined whether the information contained in the opinion is used by the local entity or whether it is used solely for the non-resident's purposes.

5.5 Taxation - Individuals

Where the resident professional services firm has been engaged by a non-resident employer to complete and submit an expatriate's South African income tax return, the filing obligation arose in South Africa and, hence, the service can only be consumed in South Africa. Even in the event that an outbound expatriate is outside the Republic at the time the service is rendered, the service is still consumed locally as the expatriate's statutory filing obligation is in South Africa.

PAYE advice provided to a non-resident in respect of proposed SA activities is consumed by the non-resident outside the Republic, as there is no local person who could consume the service. However, should advice be provided subsequently to

establishing a SA subsidiary or branch, it is likely that the service is consumed locally by the resident, as PAYE is an SA term and advice thereon could only benefit a local entity.

Where an opinion, or advice, is given in respect of a global employee share plan, it needs to be determined whether the resident professional services firm's advice forms part of a comprehensive report including opinions from various countries forming part of the share plan; or whether the advice on the SA tax implications is presented to the local entity. In the event of the advice being only a part of the full report, it can be argued that the advice is consumed outside the Republic by the non-resident, provided that the advice or opinion is presented to the non-resident. The resident entity arguably receives an ancillary benefit, and as previously stated, it is not clear whether an indirect or ancillary benefit is sufficient for the service to be considered to have been consumed in the Republic.

5.6 Taxation – International Tax

Tax advice in respect of international transactions is generally seen as a shareholder activity whereby the non-resident holding company requires advice on proposed or existing SA activities. Where advice in respect of international tax transactions is provided to a non-resident in respect of proposed SA activities prior to establishing a subsidiary or branch, the service is consumed outside the Republic. Where the advice is

given in respect of an already established SA subsidiary or branch, it needs to be determined who receives the deliverable and who uses it – the non-resident holding company or the local subsidiary or branch. Consumption takes place where the advice is used or applied.

5.7 Taxation – Corporate Tax

As with VAT liability calculations, the corporate tax calculations can either be used to complete the non-resident's local subsidiary or branch's income tax return ("ITR14") or it can be used for the non-resident's own purposes. The resident subsidiary or branch has a statutory filing obligation in SA and the service can, thus, only be consumed in the Republic as this is where the obligation arose. Where the non-resident uses the calculations for its own purposes, they are consumed outside the Republic by the non-resident. It is, however, not practical for the professional services firm to determine what the non-resident ultimately uses the calculations for.

5.8 Actuarial Sciences

Where services entail performing an actuarial audit under the non-resident country's statutory requirements, only the non-resident can consume this service, outside the Republic, as the statutory obligation arose in the non-resident's country.

CHAPTER 6

CONCLUSION

Section 11(2)(*l*) gives rise to problems which leads to the potential incorrect application of the zero rate in terms of this section as it does not provide clear guidance as to when the supply is in fact made to a person who is not a resident of the Republic.

The VAT Act does not offer a solution to the problem at hand and neither does the Income Tax Act. The principles relating to applying the zero rate to services contained in New Zealand's Goods and Services Tax Act are similar to that of South Africa's VAT Act and hence do not provide further clarity on the matter of place of supply. One of the potential difficulties identified in applying the zero rate to services in New Zealand is 'failing to reasonably ascertain whether any person in New Zealand will receive the services for domestic consumption', which introduces the term 'consumption' as an alternative. No solution is thus identified within legislation.

Articles and the *De Beers* case further make mention of 'consumption' but the insights are not sufficient to draw a conclusion on where the ultimate place of supply is for services.

What remains as a last resort is thus an interpretation of the section and applying what has been identified thus far to the professional services considered in the research. A

definition cannot be attributed to the place of supply and, ultimately, place of consumption and therefore no rule can be derived which can be applied to professional services. The scope and nature of each engagement and the persons involved in the assignment need to be identified and then upon further investigation and analyses, together with the guidance provided in Chapter 5, determine firstly, who consumes the service and secondly, where the person consumes the service.

To further aid the correct application of section 11(2)(*l*) SARS should consider issuing an Interpretation Note providing the guidance as discussed in Chapter 5 in an attempt to compensate for the lack of clarification in the legislation. As pointed out in Chapter 2, courts will most likely rule in favour of the taxpayer should the intention or interpretation of the legislation be unclear.

6.1 Recommendations for professional services firms

In the event where it is clear that an entity within the Republic will consume the service the resident firm should engage with the local entity. The firm can thus supply the service at the standard rate of VAT in terms of section 7(1)(*a)* and the local entity should be entitled to claim the input tax paid. This limits the exposure risk from the incorrect application of the zero rate.

6.2 Recommendations for future research

Throughout the research situations were identified where a local entity receives an ancillary benefit, in other words, the main benefit is consumed by the person who is not a resident of the Republic, but the report or deliverable is provided to the local entity for its use or consideration. In such an instance it is not clear, and no guidance or interpretations could be obtained, whether an ancillary benefit is sufficient to conclude that the service is consumed within the Republic.

TABLE OF REFERENCES

BOOKS

C Beneke *Deloitte VAT Handbook* 8 ed (2012) LexisNexis.

D Clegg and R Stretch *Income Tax in South Africa* SI 42 (2013) LexisNexis

AP de Koker and D Kruger *VAT in South Africa* SI 14 (2013) LexisNexis.

New Zealand Master Tax Guide (2013) CCH New Zealand Ltd.

ARTICLES

G Badenhorst 'Recent judgement on VAT zero rating of services supplied to non-residents' (2011) *Ensight*.

R Gad , G Badenhorst, and J Strauss 'South Africa: The Supreme Court of Appeal casts light on VAT debate' (2012) *Mondaq*.

WEBSITES

http://www.mondaq.com

http://www.oxforddictionaries.com

LexisNexis online at http://www.mylexisnexis.co.za

SARS online at http://www.sars.gov.za

LEGISLATION

South Africa

Income Tax Act 58 of 1962.

Taxation Laws Amendment Act 27 of 1997

Taxation Laws Amendment Act 30 of 1998

Tax Administration Act 28 of 2011.

Value-Added Tax Act 89 of 1991.

New Zealand

Goods and Services Tax Act 141 of 1985.

United Kingdom

United Kingdom VAT Act of 1983

PUBLICATIONS ISSUED BY GOVERNMENT

Explanatory Memorandum on the Taxation Laws Amendment Bill (1997) available at http://www.sars.gov.za

Explanatory Memorandum on the Taxation Laws Amendment Bill (1998) available at http://www.sars.gov.za

OTHER

International Standard on Auditing (ISA) 700, 'The Independent Auditor's Report on a

Complete Set of General Purpose Financial Statements'.

OECD Model Tax Convention on Income and Capital, as they read on 22 July 2010.

SARS Interpretation Note 6 (26 March 2002).

SARS Interpretation Note 30 (6 March 2006).

SARS Interpretation Note 31 (22 March 2013).

SARS Interpretation Note 42 (2 April 2007).

SARS Draft Interpretation Note on section 31 (2013).

SARS Value-Added Tax Guide for Vendors ("VAT 404") (12 March 2012).