eJournal of Tax Research (2018) vol. 16, no. 1, pp. 175-200

Developing place of activity rules for the South African value-added tax: a comparative research approach

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Abstract

The globalisation of the world economy has led to a rapid increase in cross-border trade. The jurisdiction having taxing rights to a cross-border supply for Value-Added Tax (VAT) purposes is, however, not always clear. The South African VAT Act does not contain a standalone place of activity section, which many other countries do have. This could result in cross-border supplies involving South Africa being subject to either double taxation or double non-taxation. A standalone place of activity section was developed by the authors for the South African VAT Act by following a consultative process in terms of which South African VAT experts critiqued and commented on the proposed section, adding value to come up with a final proposed place of activity section for the South African VAT Act.

Key words: value-added tax, cross-border supplies, place of activity, OECD International VAT/GST Guidelines

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1. INTRODUCTION

> … [C]oming to grips with the concept of the place of consumption is, to steal a phrase used in a different context, 'like trying to get your hands around a piece of jelly' (Millar, 2004).

The globalisation of the world economy has led to a rapid increase in cross-border trade and hence in the interaction among the 164 value-added tax (VAT) systems in the world (Organisation for Economic Co-operation and Development (OECD), 2014). Without the proper coordination of these VAT systems through generally accepted place of supply rules, especially for intangible services, there is a risk that cross-border trade could lead to double taxation or double non-taxation (Davis Tax Committee (DTC), 2014). This could be curtailed if jurisdictions make use of generally accepted place of supply rules (Terra, 1998). This will benefit both the consumers and the tax collectors.

The place of supply rules in the South African *Value-Added Tax Act 89 of 1991* (VAT Act) are not explicitly listed in a separate section, but are indirectly woven into the different sections of the VAT Act. This is, however, only true for a limited number of specific transactions. Literature related to VAT suggests that numerous ambiguities exist with regard to the application of the different indirect place of supply rules in the VAT Act for both taxpayers and tax authorities when determining whether cross-border supplies should be subject to VAT in South Africa (Millar, 2008a; OECD, 2017; Schneider, 2000). The literature also suggests that it is not clear when an enterprise or activity is conducted 'in the Republic [of South Africa] or partly in the Republic', as required by the definition of 'enterprise' in section 1(1) of the Act[4] (Janse van Rensburg, 2011). It is also not clear when a service would be 'utilised or consumed in the Republic' for purposes of the definition of 'imported services' in section 1(1) (Botha, 2015). This is where the proverbial jelly slips through the fingers: trying to establish in whose jurisdiction the VAT is due. The ambiguity associated with the place of supply rules in the VAT Act suggests the need for clarity and consolidation.

Owing to South Africa's positive features, such as its sizeable economy and extensive tax treaty network, it is regarded as a holding company gateway into Africa (National Treasury, 2010). However, double taxation and unclear tax rules deter foreign investment (OECD, 2006). In order to remain lucrative as a holding company gateway into Africa and not fall behind other competing African countries, such as Mauritius, it is important that cross-border supplies involving South Africa are not subject to double taxation. Preventing double taxation can be achieved by inserting clearly defined place of supply rules in line with the OECD International VAT/GST (Goods and Services Tax) Guidelines (OECD Guidelines) into the VAT Act, as South Africa has observer status in the OECD.

The main objective of this article is therefore to develop a standalone place of activity section for the VAT Act to align South Africa's place of supply rules with those of other jurisdictions (DTC, 2014). This proposed legislative provision should adhere to the OECD Guidelines to increase certainty and to minimise the potential for cross-border supplies involving South Africa to be subject to double taxation or unintended double non-taxation.

[4] All references to sections are to the sections in the South African VAT Act, unless stated otherwise.

The article is organised as follows: section 2 considers the VAT system in South Africa in order to provide the appropriate context. This is followed (also in section 2) by an analysis of the place of supply rules as they apply in South Africa, Australia and New Zealand.[5] Like South Africa, Australia and New Zealand operate 'modern' or New World VAT systems, in contrast to the more traditional or Old World European systems.[6] Section 2 concludes with an initial proposed place of activity section, which was discussed with five South African VAT experts. Section 3 examines the results of the consultative process, making use of a thematic analysis of the open-ended questions. The final section (section 4) concludes with a refined legislative provision that could be used by National Treasury to introduce place of activity rules into the VAT Act as a standalone provision, in addition to the other provisions that have already been implemented.

2. BACKGROUND AND CONTEXT

In order to set the backdrop for this study, this section explains how the South African VAT system operates and the place of supply and place of activity rules which are included in New Zealand's and Australia's GST systems. The OECD Guidelines for a 'good' VAT system are also considered.

2.1 Background to the South African VAT system

VAT was initially introduced in South Africa in 1991 at a standard rate of 10% and was subsequently increased to 14% in 1993 (Go, Kearney, Robinson & Thierfelder, 2005). The VAT Act is largely based on New Zealand's *Goods and Services Tax Act 1985* (New Zealand GST Act), although critically it does not contain a standalone place of activity section. Although there are specific place of supply rules regarding some types of supplies, there is no general place of activity section (DTC, 2014). Schneider (2000) believes that the lack of place of activity rules in the VAT Act can be attributed to the Republic's isolation from the world economy as a result of the sanctions imposed on it by other countries during to the apartheid regime. The lifting of these sanctions after 1994 has led to an increase in the openness of the Republic's economy and therefore in its involvement in cross-border trade (Du Plessis & Smit, 2006).

VAT is a general consumption tax that is collected through a staged collection process where a portion of the VAT is collected on the value added by a taxable person at each stage of the production or distribution chain (OECD, 2014). The value added is the difference between the value of the goods and services sold by a 'VAT registered supplier' and the value of the goods and services used as inputs in producing such goods and services. This process ensures that the economic burden of VAT rests on the final consumer of the goods and services.

South Africa's VAT system is a destination-based VAT system, meaning that exports are zero-rated and imports and domestic consumption are subject to the standard rate of VAT (Millar, 2009). This ensures that the VAT revenue is collected in the jurisdiction where the goods and services are *consumed*. This places all firms competing in a given jurisdiction on an even footing, enhancing neutrality in international trade (OECD, 2017). The purpose of internationally aligned place of taxation rules (including place of

[5] The data was collected during May 2016, and therefore the review of legislation of New Zealand and Australia (except where otherwise expressly stated) included legislation as it was up until 30 April 2016.
[6] The VAT is also known as Goods and Services Tax (GST) in other countries.

supply rules) is to avoid double taxation or double non-taxation owing to colliding taxing jurisdictions (Ecker, 2013).

The application of the destination principle to a cross-border supply of tangible goods is relatively simple as such a supply is required to pass through border controls where the destination of the goods can be verified. However, since the supply of cross-border services and intangibles cannot be subject to border controls in the same manner as tangible goods, difficulties are encountered in determining the place of taxation of these supplies and therefore also with implementing the destination principle (OECD, 2017).

Place of taxation rules refer to the collective rules used by a jurisdiction to establish whether it has the substantive right to tax a particular cross-border supply. Under a New World VAT system, place of taxation rules include a jurisdiction's place of activity, import VAT and zero-rating rules (Millar, 2009).

Section 7(1)(a) of the VAT Act determines that VAT must be levied at the standard rate '… on the supply by any vendor of goods or services supplied by him … in the course or furtherance of any enterprise carried on by him …'. The limited place of supply rules woven into various sections of the VAT Act are based on the modern VAT system on the basis that place of taxation is determined through the collective workings of the definition of 'enterprise' in section 1(1), the import VAT rules in sections 7(1)(b) and (c) and the zero-rating rules in section 11 (De Swardt & Oberholzer, 2006). The VAT Act does not differentiate between business-to-business and business-to-consumer supplies as do the VAT systems of many other countries (DTC, 2014). Other countries also have more prominent place of supply sections included in their VAT legislation. Place of supply rules are discussed next.

2.2 An introduction to place of supply rules

Place of supply rules can be based either on a pure consumption test that determines where the actual consumption of a supply takes place, or on a proxy (also referred to as a 'marker') that approximates where the actual consumption of a supply is likely to take place. This approximation is based on the features of the supply that are known to the supplier at the time of the supply (OECD, 2017). The use of proxies is necessitated by the fact that VAT must be levied by the supplier on consumption expenditure at the time the expenditure is incurred. This will either be before consumption or at the time that consumption takes place (Millar, 2008a). Should a supply not be consumed at the time and place the consumption expenditure is incurred, the supplier would have no or limited information as to when and where the supply would eventually be consumed (Millar, 2004). Proxies are therefore required to assist suppliers in predicting where the supply is likely to be consumed by identifying a connection between the supply and a particular jurisdiction (Millar, 2004). Jurisdictions primarily rely on proxies and only occasionally resort to pure consumption tests (Millar, 2004; Ecker, 2013).

Where a supply of goods is made, the place of supply usually follows the delivery of the goods. This is, however, not that easy with the supply of intangible services. For business-to-business supplies, it is preferred general practice to use the customer's location as the place of supply. There are, however, various deviations from this rule to ensure that a supply of a service is not zero-rated if it is consumed in the jurisdiction of the supplier. Administrative difficulties could be encountered where the actual consumption test is applied. For this reason, proxies are sometimes used to determine

the place of taxation. The reverse charge mechanism can also be applied to solve this burden (Ecker, 2013).

For business-to-consumer supplies, the place of consumption is deemed to be in the jurisdiction in which the customer has his/her usual place of residence. If the customer has more than one country of residence, the place of consumption would be deemed to be in the jurisdiction in which the customer spends most of his/her time (OECD, 2001).

Since VAT systems do not have any bilateral or multilateral treaties to prevent double taxation, a taxable person whose supply is subject to double taxation due to inter-jurisdictional conflicts would not be entitled to relief (Schenk, 2009). In this regard, Schenk (2009) argues that there is a growing need for bilateral or multilateral VAT treaties to assign taxing rights to cross-border transactions.

The OECD advocates a different approach to prevent double taxation in terms of which all member states are encouraged to follow the neutrality and place of supply guidelines advocated in the OECD Guidelines (OECD, 2017).

2.3 OECD International VAT/GST Guidelines

The OECD's mission is to assist in the 'economic and social well-being of people around the world' by, amongst other things, assisting in drafting international standards to harmonise tax.[7] The International VAT/GST Guidelines are aimed at increasing certainty and reducing the occurrence of double taxation and unintended non-taxation. This is achieved by promoting an internationally accepted understanding of the place of supply rules used to implement the destination principle on the most common cross-border supplies of services and intangibles. The purpose of the Guidelines is therefore to promote the consistent application of similar place of supply proxies by different jurisdictions (OECD, 2017).

The Guidelines advocate eight place of supply rules for purposes of implementing the destination principle. Guideline 3.1 determines that: 'For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption'. It advocates the implementation of the destination principle and forms the overarching objective of the place of supply rules for both business-to-business and business-to-consumer supplies (OECD, 2017). Guideline 3.2 sets out the general place of supply rule for business-to-business supplies that must be interpreted in conjunction with Guidelines 3.3 and 3.4. Guidelines 3.5 and 3.6 provide the general place of supply rules for business-to-consumer supplies. Guidelines 3.7 and 3.8 provide the instances in which it may be appropriate to base place of supply rules on proxies other than those advocated by the general rules for business-to-business and business-to-consumer supplies (OECD, 2017). Under both the general rule for business-to-business supplies in Guideline 3.2 and Guidelines 3.5 and 3.6 for business-to-consumer supplies, the place of supply rules are based on the location of the customer (OECD, 2017).

2.4 Place of supply rules in the VAT Act

The OECD released the Guidelines briefly discussed above, advocating a set of generally accepted place of supply rules for cross-border supplies of services and

[7] See OECD, 'About the OECD' and 'What we do and how', http://www.oecd.org/about/.

intangibles. Although South Africa has observer status to the OECD, it is one of the few countries that does not have clearly defined place of supply rules that are explicitly listed in a separate section. The rules are merely captured into different sections of the VAT Act such as definitions of 'enterprise' and 'imported services' and in some paragraphs of the zero-rating section of the VAT Act (Millar, 2008a).

The place of supply rules currently contained in the VAT Act are discussed below, including the potential problems encountered.

First, paragraph (a) of the definition of 'enterprise' in section 1(1) refers to any enterprise or activity that is carried on 'in the Republic or partly in the Republic'. The VAT Act does not provide guidance as to when an activity is regarded as being carried on 'in the Republic or partly in the Republic'. This lack of guidance leads to uncertainty when determining whether an enterprise is carried on for South African VAT purposes (Millar, 2008a). Guidance on this topic is referred to as 'place of activity rules'.

Paragraph (b)(iv) was inserted into the VAT Act in 1997 with effect from a date still to be proclaimed. It includes within the ambit of an 'enterprise' '… the activities of any person who continuously or regularly supplies telecommunication services to any person who utilises such services in the Republic'. Such proclamation date has, however, never been announced. Further, 'telecommunication services' are not defined in section 1(1) so as to differentiate between telecommunication services and electronic services. This creates uncertainty as some telecommunication services could potentially fall within the ambit of 'electronic services' as defined in section 1(1) (Meiring, 2014).

Paragraph (b)(vi) of the definition of 'enterprise' in section 1(1) deals with the supply of electronic services: the definition of 'enterprise' in section 1(1) and the compulsory registration requirements in section 23 were amended by the *Taxation Laws Amendment Act 31 of 2013* to require foreign suppliers of electronic services to South African customers to register as vendors at the end of the month in which the total value of taxable supplies made by such suppliers exceeded ZAR 50,000. This amendment has the effect that such foreign suppliers would be liable to levy output VAT on their electronic services supplied to South African customers in terms of the general charging provision in section 7(1)(a) (Meiring, 2014).

Proviso (ii) to the definition of 'enterprise' in section 1(1) and section 8(9), deal with branches or main businesses of enterprises permanently situated at premises outside the Republic. Section 8(9) specifically deems supplies made by the vendor to its branch or main business so excluded from the definition of enterprise to be made in the course or furtherance of the vendor's enterprise. This allows the vendor to zero-rate such supplies if the requirements of section 11(2)(o) are met, to ensure that neutrality is maintained (Botes, 2018).

Proviso (vi) to the definition of 'enterprise' in section 1(1) deals with the conclusion of insurance contracts by Underwriting Members of Lloyd's of London in the Republic. With effect from 1 January 2001, the activity of underwriting insurance business by Underwriting Members of Lloyd's of London is deemed to constitute the carrying on of an 'enterprise' to the extent that such insurance contracts are concluded in the Republic.[8] The place of conclusion of such contracts is therefore used as proxy. Schneider (2000)

[8] Explanatory memorandum on the Revenue Laws Amendment Bill, 1999.

expresses concern about the fact that this provision is open to manipulation as Underwriting Members can simply decide to conclude all contracts outside of the Republic in order to avoid carrying on an enterprise in the Republic.

Section 7(1)(b) of the VAT Act levies VAT on imported goods. Goods imported into the Republic are subject to import VAT at 14% in accordance with the destination principle. The location of the goods therefore serves as proxy for purposes of section 7(1)(b).

The definition of 'imported services' in section 1(1) of the VAT Act refers to services 'utilised or consumed in the Republic'. This definition therefore makes use of a pure consumption test, rather than a proxy (Janse van Rensburg, 2011). Numerous previous studies have concluded that the application of this phrase is not clear (Van Zyl, 2013a; Van Zyl, 2013b; Olivier & Honiball, 2011; Silver & Beneke, 2016).

Section 11(1) zero-rates the export of goods. The place of taxation of exported goods is determined by the destination of the goods (Millar, 2008a).

Section 11(2) zero-rates the export of services. The zero-rating provisions for exported services in the VAT Act differentiate between services provided to immovable property, movable property and intellectual property. The provisions also contain specific rules for services supplied to non-residents.

Section 11(2)(f) zero-rates services that are '… supplied directly in connection with land, or any improvement thereto, situated in any export country'. Section 11(2)(f) does not find application to the supply of the use of, or right to use immovable property under a rental agreement, since section 8(11) would deem such a supply to be a supply of goods rather than a supply of services (Olivier & Honiball, 2011). The location of the land therefore serves as proxy for section 11(2)(f) (Millar, 2008a).

Section 11(2)(g)(i) zero-rates services that are '… supplied directly in respect of … movable property situated in any export country at the time the services are rendered'. The location of the goods therefore serves as proxy for section 11(2)(g)(i) (Millar, 2008a). Silver and Beneke (2016) contend that the phrase 'directly in respect of' should be given a narrow interpretation.

Section 11(2)(m) applies to intellectual property and provides a zero-rating if the service comprises:

> (i) the filing, prosecution, granting, maintenance, transfer, assignment, licensing or enforcement, including the incidental supply by the supplier of such services of any other services which are necessary for the supply of such services, of intellectual property rights, including patents, designs, trade marks, copyrights, know-how, confidential information, trade secrets or similar rights; or
>
> (ii) the acceptance by any person of an obligation to refrain from pursuing or exercising in whole or in part any such rights,
>
> where and to the extent that those rights are for use outside of the Republic.

Given the fact that the zero-rating applies only insofar as the rights are for use outside the Republic, an apportionment of the service would have to be made in terms of section 8(15) if the intellectual property rights are used both within and outside the Republic

(Botes, 2018). The portion of the service that relates to the use of the right in the export country would be zero-rated under section 11(2)(m)(i), while the South African portion of the service would be subject to VAT at the standard rate in terms of section 7(1)(a). Section 11(2)(m) therefore uses the place of effective use or enjoyment of intellectual property as proxy (Millar, 2008a).

Section 11(2)(k) provides for a zero-rating for services physically rendered outside the Republic. The place of performance of the services is therefore used as proxy (Millar, 2008a). As from 1 April 2015, section 11(2)(k) no longer applies to electronic services supplied by offshore suppliers that fall within paragraph (b)(vi) of the definition of 'enterprise' in section 1(1).[9]

Millar (2008a) notes that section 11(2)(k) has a wider application than its counterpart contained in section 11A(1)(j), read together with section 11A(1B) in the New Zealand GST Act. Section 11A(1B) would only allow the section 11A(1)(j) zero-rating if the nature of the services is such that they can only be received at the time and place where they are physically performed. Millar contends that the wide ambit of section 11(2)(k) could lead to the non-taxation of services that are in fact consumed in the Republic. This is because section 11(2)(k) of the VAT Act will zero-rate services performed from outside of the Republic, irrespective of whether such services are intangible services or on-the-spot supplies. If such services are supplied by a registered vendor from outside of the Republic to a recipient in the Republic who consumes such services in the Republic but who is not a 'resident of the Republic' then such services would qualify for the zero-rating in section 11(2)(k) of the VAT Act while simultaneously not constituting 'imported services' as defined in section 1(1) of the VAT Act. This will only be the case for services which do not constitute 'on-the-spot supplies' as on-the-spot supplies that are consumed from within the Republic require the supplier to be physically present in the Republic when such services are performed.

Section 11(2)(l) provides a zero-rating for the following services if supplied to a person who is not a resident of the Republic:

> … services … not being services which are supplied directly-
> (i) in connection with land or any improvements thereto situated inside the Republic; or
> (ii) in connection with movable property … 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,

[9] Explanatory memorandum on the Taxation Laws Amendment Bill, 2014.

> 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...

In order for a service supplied to a non-resident to be zero-rated in terms of section 11(2)(l), it must pass all three of the exclusions listed in section 11(2)(l)(i) to (iii).[10] The so-called 'round-tripping rule' that provides an exclusion from the zero-rating in section 11(2)(l)(iii) in instances where a non-resident or any other person is in the Republic at the time the services are rendered, is aimed at ensuring that any consumption or use of the service in the Republic is not zero-rated (Botes, 2018). The only instance in which the zero-rating would be allowed if the non-resident or any other person is present in the Republic, would be if the circumstances of section 11(2)(l)(ii)(bb) are met.[11] The proxies used by section 11(2)(l) are the residency status of the recipient, the location of the land or goods and the place of effective use or enjoyment of the service (Millar, 2008a).

Section 11(2)(g)(ii) provides a zero-rating for services supplied directly in connection with '… goods temporarily admitted into the Republic from an export country that are exempt from tax on importation under Items 470 and 480 of paragraph 8 of Schedule 1' of the VAT Act. These goods are exempt from import VAT in terms of section 13(3). Item 470 applies to goods temporarily admitted for processing, repair, cleaning, reconditioning or for the manufacture of goods exclusively for export. Item 480 applies to other goods that are temporarily admitted into the Republic for specific purposes after which the goods must be exported. Examples of items to which Item 480 applies include goods for display at exhibitions, meetings, fairs and similar events, and containers used for packing purposes. The proxy used in section 11(2)(g)(ii) is therefore the location of the goods (Millar, 2008a).

As is evident from the above discussion, the place of supply rules in the VAT Act make use of various proxies, including the location of movable and immovable property; the location of the consumer or quasi-consumer; the place of performance of services; and the residency status of the recipient. The definition of 'imported services' in section 1(1) and section 11(2)(m) make use of a pure consumption test.

There is uncertainty, however, when determining whether an activity is carried on 'in the Republic or partly in the Republic' for purposes of paragraph (a) of the definition of 'enterprise' in section 1(1) and whether a service is 'utilised or consumed in the Republic' for purposes of the definition of 'imported services' in section 1(1). A place of activity section would thus assist in determining when an activity is carried on 'in the Republic or partly in the Republic'.

2.5 Place of supply sections applied in New Zealand and Australia[12]

South Africa's place of supply rules consist of: (i) the definition of 'imported services' in section 1(1) read together with section 7(1)(c) which operate the reverse charge

[10] South African Revenue Service (SARS), 'The Master Currency case and the zero-rating of supplies made to non-residents', Interpretation Note No. 85, 2015.
[11] Ibid.
[12] As stated in n 5 above, the data was collected during May 2016, and therefore the review of legislation of New Zealand and Australia (except where otherwise expressly stated) included legislation as it was up until 30 April 2016.

mechanism; (ii) the definition of 'enterprise' in section 1(1), and (iii) South Africa's zero-rating rules in section 11. All three categories of rules operate together to ensure that the South African VAT Act effectively implements the destination principle.

The primary purpose of this article is to develop a place of activity section applying to activities carried on by an entity in South Africa, thus for category (ii) above. In order to develop the proposed place of activity section, it is necessary to consider the zero-rating provisions for exported services of other New World VAT systems such as Australia and New Zealand. Such a consideration also aids in determining whether South Africa's zero-rating provisions for services use place of supply proxies similar to those used by other New World VAT systems.

In general, section 8(1) of the New Zealand GST Act determines that GST must be levied at 15% on '… the supply (but not including an exempt supply) in New Zealand of goods and services … by a registered person in the course or furtherance of a taxable activity carried on by that person …'. The residency of the supplier is used as proxy for purposes of determining whether a supply is made in New Zealand (Millar, 2004).

The out-in-out-in analysis of the New Zealand GST Act works as follows. The default position under the GST Act is to deem the place of supply for supplies made by a non-resident to be outside New Zealand. Should the goods supplied by the non-resident be in New Zealand at the time of the supply, or if the supply consists of services that are physically performed by a person who is in New Zealand at the time the services are performed, such a supply would be deemed to be made in New Zealand in terms of section 8(3). However, if the goods or services are supplied by the non-resident to a registered person who would use such goods or services for purposes of carrying on its taxable activity, section 8(4) would deem such goods or services to be supplied by the non-resident outside New Zealand, unless the supplier and the recipient agree out of this provision (Millar, 2008a; McKenzie, 2012). If the supplier and consumer agree out of the provision, then the supply of the goods that are physically located in New Zealand at the time of the supply or on-the-spot services performed in New Zealand would be deemed to be made in New Zealand in terms of its place of supply rules.

Section 5B, read together with section 8(4B), operate New Zealand's reverse charge mechanism. The reverse charge mechanism relies on a consumption-based proxy (DTC, 2014). It finds application to services supplied by a non-resident that are treated as being made outside New Zealand by the out-in-out-in analysis if the services are supplied to a resident who utilises them for less than 95% taxable purposes and if that supply would have been a taxable supply if it had been supplied by a registered person in the course or furtherance of a taxable activity in New Zealand (McKenzie, 2012). With the exception of fine metals, all goods imported into New Zealand are subject to import GST in accordance with section 12 (McKenzie, 2012).

The following table provides a summary of the place of supply proxies for services in New Zealand.

Table 1: New Zealand Place of Supply Proxies for Services

Section	Rule	Proxy
s11A(1)(e)	Services supplied directly in connection with land situated outside New Zealand or any improvement thereto.	Location of land
s11A(1)(f)	Services supplied directly in connection with moveable personal property, other than choses in action, situated outside New Zealand when the services are performed.	Location of goods
s11A(1)(j) & s11A(1B)	Services physically performed outside New Zealand, provided that the services can only be physically received at the time and place of its performance.	Place of performance of services
s11A(1)(k), s11A(2), s11A(3) & s11A(3B)	Services supplied to a non-resident who is outside New Zealand at the time of performance if the services are neither directly in connection with land in New Zealand or goods in New Zealand at the time the services are performed, nor the acceptance of an obligation not to carry on a taxable activity in New Zealand.	Residence and location of recipient plus location of land plus location of goods plus place of use or enjoyment
s11A(1)(n) & s11A(4)	Services in relation to intellectual property rights that are for use outside New Zealand.	Character of supply and place of use or enjoyment

Source: NZ GST Act, Millar (2008a)

For Australia, section 9-25(1) to (3) determine that goods will be connected with Australia if they are delivered or made available to a recipient in Australia; the supply involves the goods being removed from Australia; or the supply involves goods being brought into Australia if the supplier either imports the goods into Australia or installs or assembles the goods in Australia (*A New Tax System (Goods and Services Tax) Act 1999*, 'Australian GST Act').

(Note that, as from 1 July 2017, all supplies other than supplies of goods or real property will be connected with Australia (relevantly defined as the 'indirect tax zone') if, amongst other possibilities, they are made to an 'Australian consumer'. An Australian consumer is an Australian resident who is not registered for GST or, if registered for GST, the supply is not to any extent acquired for purposes of the enterprise it carries on (section 9-25(7) of the Australian GST Act)).

According to sections 9-26(1) and (2) of the Australian GST Act, a supply by a non-resident is not connected with Australia if the supplier is a non-resident; the supply is not made through an enterprise in Australia; and the supply relates to an inbound intangible supply, intangible supply between non-residents or supply of leased goods between non-residents. The entity is an Australian business recipient if, subject to the other salient requirements of section 9-26, it is registered in Australia, it carries on an enterprise in Australia and the supply received is not solely for private or domestic purposes.

An enterprise is seen to be carried on in Australia when it is carried on by an individual in Australia either through a fixed place in Australia, or through one or more places in

Australia for more than 183 days in a 12 month period, or there is an intention of the individual to carry on an enterprise in Australia for more than 183 days in a 12 month period (section 9-27 of the Australian GST Act).

A supply of services that is not connected with Australia must be reverse charged in terms of section 84-5(1) in instances where a recipient acquires the services solely or partly for an enterprise carried on in Australia, but not solely for a creditable (taxable) purpose; the supply is for a consideration; the recipient is registered or is required to be registered; and the supply is not one otherwise of various supplies specified in the section.

The following Table provides a summary of the place of supply proxies for services in Australia.

Table 2: Australian Place of Supply Proxies for Services

Section	Rule	Proxy
Rule 1 in section 38-190	Services directly connected with real property situated outside Australia.	Location of real property
Rule 2 in section 38-190	Services directly connected with goods situated outside Australia.	Location of goods
Rule 3 Item 2(a) in section 38-190	Services supplied to a non-resident who is outside Australia at the time of performance if the supply is neither a supply of work physically performed on goods in Australia when the work is performed, nor directly connected with real property in Australia.	Location & residence of recipient plus location of land plus location of goods
Rule 4 Item 2(b) in section 38-190	Services supplied to a non-resident, who is outside Australia at the time of performance if the recipient acquires the services in carrying on its enterprise, but is neither registered nor required to be registered for GST.	Location & residence of recipient plus registration status of recipient
Rule 5 Item 3 in section 38-190	Services supplied to a recipient who is outside Australia at the time of performance if the effective use or enjoyment of the supply would be outside Australia, excluding supplies of work performed to goods situated in Australia at the time the services are performed and supplies directly in connection with real property in Australia.	Location of recipient plus effective use or enjoyment plus location of goods plus location of real property
Rule 6 Item 4(a) in section 38-190	Supplies in relation to rights if the rights are for use outside of Australia.	Character of supply and place of use or enjoyment
Rule 7 Item 4(b) in section 38-190	Supplies in relation to rights if the supplies are made to a non-resident who is outside Australia at the time of performance.	Location & residence of recipient

Section	Rule	Proxy
Rule 8 Item 5 in section 38-190	Supplies involving the repair, renovation, modification or treatment of goods from outside Australia that are destined for a location outside Australia.	Location of goods plus place of effective use or enjoyment
Section 38-190(2)	For all items above, the supply is not GST-free if it is a supply of a right or option to acquire something, the supply of which would be connected with Australia and which would not be GST-free.	Place of effective use or enjoyment
Section 38-190(2A)	For items 2, 3 and 4, the supply is not GST-free if its acquisition relates directly or indirectly, wholly or partly, to making a wholly or partly exempt supply of real property in Australia.	Location of real property
Section 38-190(3)	For item 2, the supply is not GST-free if it is made under an agreement with a non-resident, but is provided to another entity in Australia.	Place of effective use or enjoyment
Section 38-190(4)	For item 3, the recipient would be treated as being outside Australia if the supply is made under an agreement with a resident in terms of which the supply is provided to another entity outside Australia.	Location of recipient

Source: Australian GST Act; Millar (2008b)

2.6 Developing an initial place of activity section for South Africa

From an examination of extant literature, practical guides from the OECD and other countries' VAT/GST legislation, it is evident that there are various proxies that could be used to determine the place of supply for various types of transactions. The current zero-rating rules in the VAT Act are based on those of New Zealand and Australia and they work effectively from a place of supply point of view as the proxies effectively implement the destination principle. The study therefore does not address such rules further. The VAT Act does not have an explicit place of activity section other than for electronic services. The main purpose of the study is, accordingly, to develop a place of activity section that deals with all transactions other than electronic services as defined in section 1(1) read with the Regulations.

The following proposed place of activity section for the South African VAT Act was produced by the authors. The proposed section also does not consider the place of supply rules applicable to international transportation.

1A. Place of activities.-(1) For purposes of the definition of enterprise, an activity would be carried on in the Republic if it is a supply of
(a) goods, other than fixed property, if such goods are
(i) delivered or made available in the Republic to the recipient or at the recipient's request, to any other person;
(ii) installed, assembled or produced in the Republic;
(iii) imported into the Republic;
(iv) removed from the Republic;

Provided that a supply referred to in paragraph (a) would, at the election of the supplier, be deemed to be carried on outside the Republic if such an activity would, but for this proviso, constitute a taxable supply made to a registered vendor who utilises or consumes such a supply wholly for purposes of making taxable supplies or if such a supply is exported;
(b) fixed property situated in the Republic or goods supplied directly in connection with fixed property situated in the Republic;
(c) a real right or option directly in connection with goods ordinarily situated in the Republic or fixed property situated in the Republic;
(d) services physically rendered in the Republic;
(e) services, other than services referred to in paragraph (b)(vi) of the definition of enterprise and paragraphs (d) and (f) of this section, connected with any supply that is treated as being made in the Republic in terms of this section, not being services supplied directly in connection with
(i) fixed property situated outside the Republic;
(ii) moveable property ordinarily situated outside the Republic; or
(iii) intellectual property to the extent that the rights are for use outside the Republic;
(f) intellectual property to the extent that the rights are for use in the Republic; or
(g) goods or services supplied by a vendor in the course or furtherance of an enterprise carried on by the vendor.

In order to refine the standalone place of activity section developed from the theory above, this proposed section was discussed with five VAT experts to establish the validity of the proposed section and also for them to make further suggestions for improvement. This could be described as a quasi-Delphi research methodology: the Delphi method entails administering a number of rounds whereby experts give comments on an idea or concept, the idea is amended with the comments and is then discussed again, in order to reach consensus (Evans & Collier, 2012). In this article, however, only one round was administered. It was not deemed necessary to send the amended section back to the experts for further scrutiny as their comments were carefully considered and then the appropriate changes were brought about.

For purposes of this study, a VAT expert is considered to be an employee of an accounting or law firm who serves or has served on the VAT committee of a Recognised Controlling Body (RCB). Such employees are recognised by RCBs as thought leaders in the field of VAT.[13] It is therefore submitted that such employees are in possession of the requisite knowledge to scrutinise and add value to the place of supply section developed by this study. Each of the experts has at least ten years' experience in VAT (some over 20 years) and have dealt with many clients over this time. There is also representation from more than one profession: the respondents are chartered accountants and lawyers. It is, however, a limitation that respondents from a limited group of professions were involved in the study. It is evident from the discussion in the next section that their responses are aligned to some extent and thus it is expected that no new information would have been obtained if more experts from the same limited pool had been consulted. It is assumed that the VAT experts who completed the questionnaire have sufficient knowledge to properly scrutinise the proposed place of supply section for the VAT Act and answer the questions honestly and without any bias. Academics were not consulted as they are not involved in practice and do not deal with this situation as regularly as the experts that are in practice.

[13] Email from L Seforo, South African Institute of Chartered Accountants (SAICA) to authors, 11 November 2016.

There were five categories of questions put to the experts, with each category containing one closed and one open-ended question. The five categories of questions were developed in order to simplify the data analysis phase of the study and to ensure that each respondent would scrutinise all the different factors taken into account in developing the proposed place of activity section. The five categories of questions were aimed at gathering information on whether the proposed place of activity section:

1. would increase certainty in determining whether an enterprise is carried on in the Republic (Questions 1 and 2);
2. is in line with the Guidelines (Questions 3 and 4);
3. deals satisfactorily with all the different types of supplies (Questions 5 and 6);
4. contains any words or phrases that could lead to interpretational difficulties (Questions 7 and 8); and
5. would lead to an increase in the jurisdictional reach of the VAT Act (Questions 9 and 10).

Each of the five categories started with a closed-ended question asking whether the proposed place of activity section adheres to the requirement investigated by that category. If the answer was 'No', the respondent was required to answer an open-ended question by providing reasons. If the answer was 'Yes', the respondent was asked the next category's closed-ended question.

A thematic analysis technique was used to identify themes in the primary data collected through the consultation process. This was done by reading and re-reading the data, assigning codes to the excerpts and grouping codes with similar characteristics together into themes and subthemes (Fereday & Muir-Cochrane, 2006). To reduce the risk of inconsistently assigning codes to the excerpts in the data set, the authors compiled a coding manual for the open-coding process. These themes were scrutinised and used to amend the proposed place of activity section. The flexibility of the approach makes it an appropriate data-analysis technique for the analysis of the unique and diverse responses provided by the VAT experts to the open-ended questions (Braun & Clarke, 2006, p.16).

The results of this consultative process are discussed next.

3. RESULTS AND DISCUSSION

Useful feedback was received from the respondents on the proposed section. The general responses are discussed first, followed by the more specific issues. The discussion then examines how these responses were used to amend the proposed place of activity section.

3.1 Results

3.1.1 General findings

Three respondents were of the opinion that the proposed section would increase certainty when determining whether an activity was carried on 'in the Republic or partly in the Republic'. The other two indicated that the proposed section contained words and phrases that were ambiguous, which undermined this certainty.

Three respondents indicated that the proposed section was aligned with the Guidelines. The other two indicated that although the proposed section adheres to the requirements of the Guidelines, there are specific definitions in the proposed section that are unclear.

Four respondents indicated that the proposed section would lead to an increase in the jurisdictional reach of the VAT Act. The other respondent held that it was impossible to predict whether the proposed section would lead to either an increase or a decrease in the jurisdictional reach of the VAT Act.

In addition to the above general concerns regarding the proposed section, seven practical difficulties with specific subsections were also identified.

3.1.2 Specific practical difficulties

All five respondents foresaw practical difficulties with specific subsections of the proposed section, which can be summarised as follows:

1. contradiction of the proposed section with another existing section;
2. double taxation arising from the proposed section;
3. duplication by the new proposed section of an existing section;
4. location of the supplier being problematic;
5. unwanted exclusions in the proposed section;
6. contradiction of the proposed section with case law; and
7. uncertainty of the purpose of a part in the proposed section.

Other practical difficulties were also identified, such as that the proposed section did not cater for specific types of supplies, nor did it deal with the 'level of activity' required for an enterprise to come into existence.

Finally, interpretational difficulties were encountered by the experts regarding certain words or phrases that is discussed below.

All these difficulties identified by the experts are now considered in amending the proposed place of activity section.

3.2 Revision of the place of activity section

Valuable critiques and reviews were received from the participating experts to improve the proposed place of activity section. The issues identified by these experts with the proposed section and their reasoning were considered and evaluated against other sources. From this evaluation, it was decided whether the amendment suggested should be made, or whether the proposed section should remain the same.

A summary of the practical difficulties with specific sections of the proposed place of activity rules are discussed below:

3.2.1 Proposed section 1A(1)(a)(i): goods delivered or made available in the Republic

It was pointed out that proposed section 1A(1)(a)(i) contravenes the policy reasons behind the section 12(k) exemption that applies to so-called 'pre-entry sales' by foreign persons. In the absence of section 12(k), pre-entry sales by foreign persons would lead to such persons carrying on an enterprise in the Republic, where their pre-entry sales are concluded 'continuously or regularly'. Such foreign persons would then be required to levy output VAT in terms of section 7(1)(a) on their pre-entry sales if they have

exceeded the compulsory registration thresholds in section 23(1). The goods supplied under pre-entry sales would then again be subject to import VAT in terms of section 7(1)(b) when cleared for home consumption at ports or border posts. Section 12(k) was therefore introduced to prevent such foreign persons from having to register for VAT as a result of their pre-entry sales and to prevent the goods supplied under pre-entry sales from being subject to VAT twice.

This comment is true from a policy perspective. However, the practical application of the proposed section 1A(1)(a)(i) would not influence the *status quo* as such foreign suppliers would still not be required to register as vendors in the Republic and their pre-entry sales would continue to be exempt from VAT in terms of section 12(k). This is based on the fact that proviso (v) to the definition of 'enterprise' in section 1(1) determines that an activity would not be deemed to be the carrying on of an enterprise to the extent that it involves the making of exempt supplies. Therefore, even though the proposed section 1A(1)(a)(i) would deem pre-entry sales to constitute an activity carried on in the Republic, proviso (v) to the definition of 'enterprise' in section 1(1) would deem such pre-entry sales as not forming part of an enterprise in the Republic. The *status quo* would therefore remain as the pre-entry sales of foreign persons would continue to be exempt from the liability of VAT registration after the introduction of the proposed section. The proposed section was not amended.

3.2.2 Proposed section 1A(1)(a)(iii): goods imported into the Republic

One of the respondents held that proposed section 1A(1)(a)(iii) would lead to double taxation. This response was based on the fact that imported goods are subject to VAT in terms of section 7(1)(b). If an offshore supplier of goods with no business presence in the Republic is required to register for VAT in the Republic as a result of the proposed section 1A(1)(a)(iii), such a supply would again be subject to VAT in terms of section 7(1)(a).

The respondent's view is acknowledged and *section 1A(1)(a)(iii)* is thus deleted from the proposed section.

3.2.3 Proposed section 1A(1)(c): real rights and options

A recommendation was made to delete proposed section 1A(1)(c) because the definition of 'goods' in section 1(1) already includes 'real rights' in goods. The place of activity of real rights is therefore already determined in terms of proposed section 1A(1)(a). The respondent further held that options constitute services and as such should qualify to be dealt with in terms of the proposed section 1A(1)(e).

The respondent's view is acknowledged and this proposed subsection is thus deleted.

3.2.4 Proposed section 1A(1)(d): services physically rendered in the Republic

One respondent expressed concern over the fact that this proposed section would include the activities of foreign service providers in the Republic. In this regard the respondent held the following:

> Foreign service suppliers with no physical or business presence in South Africa often render services via subcontractors, agents or intermediaries. A transaction often encountered is where a foreign company seconds staff to a local entity to render services under [the] supervision and for the benefit of

> the local entity in South Africa. To require these foreign entities to register for VAT in South Africa when they recover only the actual employee cost, seems to be counter-productive.

This view is accepted when considered against the fact that the South African Revenue Service (SARS) does not currently have a simplified compliance and administrative regime for foreign service providers where such services do not constitute 'electronic services' as defined in section 1(1). However, such services are consumed in the Republic and as such must be subject to VAT in the Republic, irrespective of the administrative burden that may be experienced by such foreign service providers in having to register as vendors and having to submit VAT returns regularly. This subsection was not amended.

3.2.5 Proposed section 1A(1)(e): services not dealt with elsewhere in the proposed section

One respondent held that the exclusions in subparagraphs (i) to (iii) of proposed section 1A(1)(e) should be deleted on the grounds that proposed section 1A(1)(e) would only apply to services that are connected with any supply treated as being made in the Republic in terms of the proposed section. Such services would therefore, by necessary implication, not be connected to other supplies that have their place of consumption outside the Republic.

The respondent's view is acknowledged and thus subparagraphs (i) to (iii) of proposed section 1A(1)(e) is deleted.

3.2.6 Proposed section 1A(1)(f): intellectual property rights for use in the Republic

Two respondents held that the proposed section 1A(1)(f) is in contravention of the judgment handed down in *Stellenbosch Farmers' Winery Ltd v Commissioner of the South African Revenue Service* 2012 (5) SA 363, 74 SATC 235 (SCA). In this case it had to be determined whether the surrender of an exclusive distribution right by a vendor, granted to the vendor by an offshore business, may be zero-rated in terms of section 11(2)(l) dealing with services supplied to a person who is not a resident. The supply was zero-rated because the court held that the *situs* of incorporeal property (the location thereof) is where the debtor 'resides' and that the surrender of the distribution right can therefore not be connected with the vendor's movable property in the Republic as the debtor was a company based in the United Kingdom. The principle resulting from *Stellenbosch Farmers' Winery Ltd v CSARS* cannot be applied to the definition of 'enterprise' to hold that the place of supply of intellectual property by offshore businesses to recipients in the Republic is outside the Republic.

Section 11(2)(m), not section 11(2)(l), is the section that deals with the zero-rating of outbound supplies of intellectual property rights. Section 11(2)(m) applies a pure consumption test as it would only exempt intellectual property rights to the extent that they are used outside the Republic. Proposed section 1A(1)(f) is based on section 11(2)(m), with the only exception being that it applies to inbound supplies of intellectual property rights.

One of the respondents commented that this section is in contravention of the views expressed by SARS in VAT News 37, where it was held that offshore businesses supplying intellectual property to consumers in the Republic need not register for VAT in the Republic if they do not have a physical presence or fixed place of business in the

Republic, and provided that the activities resulting in their fees are completely 'passive' in nature (SARS, 2011).

We do not agree with this view. The purpose of the proposed section is to determine when an activity would be carried on in the Republic for purposes of applying the definition of 'enterprise' in section 1(1). Even if the proposed section determines an activity to be carried on in the Republic, all the other elements of the definition of 'enterprise' in section 1(1) must still be satisfied before an enterprise could be carried on in the Republic. An offshore business supplying intellectual property to recipients in the Republic would therefore still only carry on an enterprise in the Republic if its activities in the Republic are carried on 'continuously or regularly' as required by the definition of 'enterprise' in section 1(1). The views expressed by SARS in VAT News 37 would therefore continue to apply, in spite of the introduction of the proposed section that would hold the supply of intellectual property for use in the Republic to constitute the carrying on of an activity in the Republic.

The section was not amended.

3.2.7 Proposed section 1A(1)(g): extent of activities forming part of an enterprise

Two respondents stated that the purpose of proposed section 1A(1)(g) is unclear. After careful consideration, it was decided that this section is not necessary to be included in the proposed section.

3.2.8 Other practical difficulties pertaining to the proposed section

One of the respondents maintained that the proposed section did not cater for specific types of supplies and commented as follows:

> The suggested wording assumes a homogenous population of transactions to which generic rules can apply. The world we live in today is categorised by complexity and diversity and changes on a daily basis.

The VAT Act is based on the modern VAT system making use of a broad set of rules that must be applied on an iterative basis to all types of supplies imaginable (OECD, 2003). The proposed section was developed on this premise and therefore this comment was not accepted.

Another respondent indicated that the proposed section did not deal with the 'level of activity' that is required in order for an enterprise to come into existence. According to this respondent,

> [i]t is not clear as to whether a foreign company that is involved in a once-off contract with a South African entity would be considered to carry on an enterprise in South Africa if such activities are carried out for a short period of only three to six months, as opposed to a longer period.

Although the literature review indicated that practical difficulties are encountered in establishing the level of activity required for an enterprise to come into existence, it is submitted that such difficulties cannot be remedied through a place of activity section. This submission is based on the fact that the level of activity that is required for an enterprise to come into existence is determined by the phrase 'continuously or regularly' in the definition of 'enterprise' in section 1(1), and not by the phrase 'in the Republic or partly in the Republic' in the definition of 'enterprise' in section 1(1). It is for the

latter phrase as opposed to the former for which the proposed section was developed and this comment is therefore not accepted.

3.2.9 Interpretational difficulties

All the respondents indicated that there are interpretational difficulties with the following words: 'delivered or made available', 'utilises or consumes', 'goods supplied directly in connection with fixed property', 'goods ordinarily situated in the Republic', 'services physically rendered', 'services … connected with any supply' and 'ordinarily situated outside the Republic'.

The phrase 'delivered or made available' is based on section 9-25(1) of the Australian GST Act. This phrase covers the physical delivery of goods or goods physically made available to a recipient in the Republic by a foreign supplier. It will also cover instances where a foreign supplier acquires goods in the Republic which are then made available or delivered to a recipient in the Republic. The phrase also includes instances where a foreign supplier imports goods into the Republic that are subsequently delivered or made available to a recipient in the Republic. It will, however, not include instances where the recipient imports the goods into the Republic, as such goods will not be delivered or made available in the Republic by the supplier.[14]

The phrase 'utilises or consumes', as it appears in the proviso to proposed section 1A(1)(a), is based on the phrase 'utilised or consumed' as it appears in the definition of 'imported services' in section 1(1). As identified in previous studies, the phrase 'utilised or consumed' is ambiguous (Van Zyl, 2013a; Van Zyl, 2013b; Olivier & Honiball, 2011; Silver & Beneke, 2016). The proviso to proposed section 1A(1)(a) is based on section 8(4) of the New Zealand GST Act. Section 8(4) of the New Zealand GST Act makes use of the phrase 'supplies goods and services … to a registered person for the purposes of carrying on the registered person's taxable activity'. It is submitted that the phrase 'for purposes of carrying on' in section 8(4) of the NZ GST Act is similarly based on a pure consumption test. Therefore, replacing the phrase 'utilised or consumed' with the corresponding phrase in section 8(4) of the New Zealand GST Act would not increase certainty when interpreting the proviso to proposed section 1A(1)(a). It is therefore submitted that the exact meaning of the phrase 'utilised or consumed' should rather be clarified by way of an interpretation note issued by SARS. SARS' interpretation of the phrase can then be applied for purposes of both the definition of 'imported services' in section 1(1) and the proviso to proposed section 1A(1)(a).

The phrase 'goods supplied directly in connection with fixed property' will be deleted from proposed section 1A(1)(b) as such goods are adequately dealt with in proposed section 1A(1)(a).

Proposed sections 1A(1)(c) and 1A(1)(e)(ii) are based on section 142(1) of the Canadian GST legislation (in *Excise Tax Act*, RSC 1985, c. E-15). The phrase 'ordinarily situated' requires the adoption of a practical test, based on all surrounding facts and circumstances available to the supplier, to determine whether the moveable property will be ordinarily situated inside or outside of the Republic. Based on the responses received from the VAT experts, section 1A(1)(c) and subparagraphs (i) to (iii) of

[14] Australian Taxation Office, 'Goods and services tax: supplies connected with Australia', GSTR 2000/31 (consolidated to 10 August 2016).

proposed section 1A(1)(e) will be deleted. The phrase 'ordinarily situated' will therefore be removed from the proposed section.

The phrase 'services physically rendered in the Republic' requires the supplier to be physically present in the Republic when the services are supplied. Proposed section 1A(1)(d) is not limited to on-the-spot supplies. It would therefore apply to any other supply of services if the supplier is physically present in the Republic while the supply is being made, irrespective of whether the supply is made to a recipient located inside or outside the Republic and would be zero-rated.

To ensure that services consumed in the Republic do not escape the Republic's VAT net, a deliberate decision was taken to include the phrase 'connected with' as opposed to 'directly connected with' in proposed section 1A(1)(e). The phrase 'connected with' requires a causal link between the services and the supply connected with the Republic. Such a causal link need not be a direct link. In *ITC 885*, 23 SATC 336, 338 (1959) (C) it was held that the words 'in connection with' should be given a wide meaning, but not so wide that it includes a remote or completely indirect connection.

From the above it is evident that the respondents had some concerns with the proposed place of activity section. A thematic analysis was done to identify the main themes emerging from their concerns.

3.3 Thematic analysis

The thematic analysis process led to the identification of two main themes. The first one holds that the proposed section should only apply to the activities of persons who are not residents of the Republic. The introductory sentence in the proposed subsection (1) was amended by specifically referring to 'an activity of a person who is not a resident of the Republic'. This would ensure that the proposed section does not apply to residents of the Republic.

The second theme holds that offshore suppliers should be brought into the Republic's VAT net only if their introduction would lead to an increase in the revenue accruing to the *fiscus* and provided that they are actually carrying on activities in the Republic.

This theme consists of two subthemes which are:

- the revenue requirement for the introduction of foreigners into the Republic's VAT net; and
- the physical activities of the foreigners in the Republic.

3.3.1 Subtheme 1: revenue requirement for foreigners

Some of the respondents provided commentary to the effect that the proposed section would require foreign persons to register as vendors even though such registrations would not lead to an increase in revenue accruing to the *fiscus*. In this regard, one of the respondents commented:

> It makes no logical sense to bring all non-resident suppliers of … intellectual property into the Republic's VAT net where such supplies are made to persons who use the same wholly for taxable purposes.

The proposed section would have the effect of requiring such foreign persons to register as vendors and to submit VAT returns regularly if they 'continuously or regularly'

supply services such as intellectual property to recipients located in the Republic and if the value of such supplies exceeds the compulsory registration thresholds in section 23(1). Such foreign persons would then be required to incur administrative and compliance costs in the Republic without any additional revenue accruing to the *fiscus.* No additional revenue would accrue to the *fiscus* if the recipients in the Republic use the supplies wholly for purposes of making taxable supplies as the full amount of output tax raised by such foreign persons on their supplies would be allowed as input tax credits to the recipients.

3.3.2 Subtheme 2: physical activities of foreigners in the Republic

VAT registrations for foreign persons without any place of business in the Republic should be limited to the greatest possible extent. One of the respondents said that unnecessary registrations must be avoided so as not to deter foreign companies from undertaking meaningful operations in South Africa.[15]

Proposed section 1A(1)(a)(iii) would require a foreign supplier of goods to register for VAT in the Republic if the recipient of the goods initiates the importation into the Republic, and if the value of the goods so imported from the foreign supplier exceeds the compulsory registration thresholds in section 23(1). This would apply even if the foreign supplier does not initiate the importation and irrespective of whether or not the foreign supplier has a place of business in the Republic.

It is submitted that relief could, to a limited extent, be provided to foreign suppliers of goods by deleting subparagraph (iii) of the proposed section 1A(1)(a). This would have the effect that the importation of goods into the Republic that was initiated by the recipient would not give rise to a VAT registration liability in the Republic for the foreign supplier. In such an instance the recipient would be required to levy import VAT on the imported goods in terms of section 7(1)(b), read together with section 13. The place of taxation for goods imported into the Republic at the instance of the recipient would therefore continue to be within the Republic. The deletion of the proposed section 1A(1)(a)(iii) would, however, not dissolve the registration liability for foreign suppliers who initiate the importation of the goods into the Republic. In such a case, the proposed section 1A(1)(a)(i) would deem such an importation to constitute an activity carried on by the offshore supplier in the Republic. To provide more clarity that the proposed section would only deem an activity to be carried on in the Republic when it is the foreign supplier who imports the goods into the Republic as opposed to the recipient, proposed section 1A(1)(a)(i) will be amended by specifically requiring the goods to be delivered or made available in the Republic by the foreign supplier.

3.3.3 Conclusion on the responses

To increase clarity, three of the seven phrases that were identified by the respondents as ambiguous were removed from the proposed section. These phrases are ‘goods supplied directly in connection with’, ‘goods ordinarily situated in the Republic’ and ‘ordinarily situated outside the Republic’. The meanings of the phrases ‘delivered or made available’, ‘services physically rendered’ and ‘services connected with any supply’ were provided. It is submitted that SARS should issue an interpretation note to clarify the

[15] Explanatory memorandum on the Taxation Laws Amendment Bill, 2012.

meaning of 'utilised or consumed' for purposes of the proviso to the proposed section and for the definition of 'imported services' in section 1(1).

The next and final section draws a conclusion based on the results from this research and provides the amended proposed place of activity section that could be included into South Africa's VAT Act.

4. SUMMARY AND CONCLUSION

The main objective of this study was to develop a standalone place of activity section for the VAT Act that adheres to the OECD Guidelines. This is in line with the suggestions by a former Minister of Finance, Mr Trevor Manuel (National Treasury, 2006) and the Davis Tax Committee (DTC, 2014). The importance of such a section is that it increases certainty when determining whether a supply should be subject to VAT in the Republic and whether a foreign supplier should register as a vendor in the Republic. This makes cross-border supplies involving the Republic less susceptible to double taxation or double non-taxation and may therefore lead to an increase in foreign direct investment in the Republic.

The final proposed section was drafted after evaluating the critique and comments of the experts collected through the survey:

1A. Place of supply. (1) For purposes of the definition of enterprise, an activity of a person who is not a resident of the Republic will be deemed to be carried on in the Republic to the extent that it consists of a supply of

(a) goods, other than fixed property, if such goods are-
(i) delivered or made available in the Republic by the supplier to the recipient or at the recipient's request, to any other person;
(ii) installed, assembled or produced in the Republic; or
(iii) removed from the Republic;
(b) fixed property situated in the Republic;
(c) services physically rendered in the Republic;
(d) services, other than services referred to in paragraph (b)(vi) of the definition of enterprise and paragraphs (c) and (e) of this section, connected with any supply that is treated as being made in the Republic in terms of this section; or
(e) intellectual property to the extent that the rights are for use in the Republic;

Provided that an activity referred to in paragraphs (a) to (e) would, at the election of the supplier, be deemed to be carried on outside the Republic if such an activity would, but for this proviso, constitute a taxable supply made to a registered vendor who utilises or consumes such a supply wholly for purposes of making taxable supplies.

The study has a number of limitations: A standalone place of supply section was developed by considering the legislation of only two other countries: Australia and New Zealand. Furthermore, only one round to the experts for comment on the proposed section was administered, which is a deviation from the normal Delphi method. Although we are of opinion that sufficient responses were received from the experts to develop the section, it is a limitation that only five experts were consulted. The fields from which the experts were selected are also limited as it does not include academics and also no representatives from SARS.

Should this section be promulgated, modifications are required in other sections that could become void or irrelevant. These modifications to other sections were not considered for purposes of this study. As suggested in the article, interpretation notes should be issued explaining some of the problematic phrases. This study did not, however, intend to draft these interpretation notes. Further research could be undertaken by addressing the abovementioned limitations.

From a theoretical point of view, this study developed a standalone place of activity section for the VAT Act that adheres to the OECD Guidelines. From a policy and technical perspective, this study can assist the National Treasury in developing a specific place of activity section for the VAT Act. The fact that the participating experts had differences of opinion as to what we presented, confirms that determining the place of consumption, which was used to develop place of supply rules for a nation, is like 'wrapping one's hands around a piece of jelly'.

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