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TAX & EXCHANGE CONTROL ALERT

IN THIS ISSUE

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DECRYPTING THE LAW: PROPOSED VAT ACT AMENDMENTS AFFECTING CRYPTOCURRENCIES

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If one considers the provisions of the Value Added Tax Act, No 89 of 1991 (VAT Act), it defines 'money' as any coins or paper currency issued by the South African Reserve Bank (SARB) as a legal tender, or any coin or paper currency of any country other than South Africa which is used or circulated as currency. A cryptocurrency is not issued by the SARB or by any other country, and it is therefore not 'money' as defined.

The question is then whether a cryptocurrency comprises 'goods' or 'services' for VAT purposes. The term 'goods' is defined in the VAT Act to mean corporeal movable things. Accordingly, cryptocurrency does not comprise 'goods' for VAT purposes. The term 'services' is, however, widely defined in the VAT Act to include the granting or assignment of any right or the making available of any facility or advantage. In the absence of any exclusion or exemption in the VAT Act, a cryptocurrency will most probably fall within the ambit of the definition of a 'service' for VAT purposes.

It seems that National Treasury concurs with the view that cryptocurrency transactions comprise the supply of a 'service' for VAT purposes. It has therefore now proposed in the draft Taxation Laws Amendment Bill, 2018, that the activities involving the issue, acquisition, collection, buying or selling or transfer of ownership of a cryptocurrency are deemed to be 'financial services' as defined in s2 of the VAT Act.

If the proposal by National Treasury to treat the activities involving cryptocurrencies to be 'financial services' is accepted, then these activities will be exempt from VAT in terms of the provisions of s12(a) of the VAT Act.

If the cryptocurrency transactions are exempt from VAT, then no VAT will of course be payable on the sale or supply of cryptocurrencies. The supplier of the cryptocurrency will then also not be entitled to register for VAT purposes even if the trading income therefrom exceeds the R1 million VAT registration threshold, and no VAT may also be deducted in respect of expenses incurred in relation to such activities. The exemption also has further implications which require consideration.

If a person uses a cryptocurrency as mechanism to pay for goods or services, then the payment itself will not have any VAT consequences. A VAT registered

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DECRYPTING THE LAW: PROPOSED VAT ACT AMENDMENTS AFFECTING CRYPTOCURRENCIES

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The supplier is required to account for output tax on the supply of the goods or services on the value of cryptocurrency received as payment.

person may, however, deduct the VAT charged by the supplier of the goods or services if the goods or services are acquired for the purpose of making taxable supplies.

Where a supplier of goods or services accepts cryptocurrency as payment for a supply of goods or services, the supplier must convert the value thereof into South African Rand and must issue a tax invoice in Rand to the recipient. The VAT amount reflected in Rand on the tax invoice, must then be accounted for as output tax by the supplier. Any movement in the value of the cryptocurrency between the date of the tax invoice until the date of payment is expected to be treated in the same manner as foreign exchange differences, i.e. any movement in the value is ignored for VAT purposes, but SARS would need to clarify this aspect.

The trading of cryptocurrency through traders or on an exchange platform, will be exempt from VAT. However, any fees or commission payable in respect of such trades will be subject to VAT, and the persons buying or selling the cryptocurrencies will not be entitled to deduct such VAT as input tax.

Where a VAT registered supplier uses the services of an intermediary to accept a cryptocurrency as payment for the supply of goods or services, and the intermediary agrees to pay a Rand amount into the supplier's bank account, then two transactions would take place, ie the supply of the goods or services to the customer and the supply of the cryptocurrency to the intermediary. The supplier is required to account for output tax on the supply of the goods or services on the value of cryptocurrency received as payment. However, the supply of the cryptocurrency to the intermediary in exchange for the Rand amount received, is exempt from VAT, but any fee or commission payable to the intermediary will be subject to VAT. The supplier would not be entitled to deduct such VAT as input tax if the fee or commission is payable for the acceptance and acquisition by the intermediary of the VAT exempt cryptocurrency.

Although the proposal is to treat transactions involving cryptocurrencies as being VAT exempt financial services, to the extent that the counterparty is a non-resident, the supply of cryptocurrencies may qualify for VAT at the rate of zero per cent. This is because the zero-rating provisions of the VAT Act take precedence over the exemption provisions. In such case the cryptocurrency trader may be required to register for VAT and may deduct the VAT incurred on expenses attributable to the zero-rated cryptocurrency transactions.

Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory and Who's Who Legal: Corporate Tax – Controversy for 2017.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2017.

DECRYPTING THE LAW: PROPOSED VAT ACT AMENDMENTS AFFECTING CRYPTOCURRENCIES

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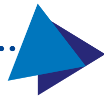
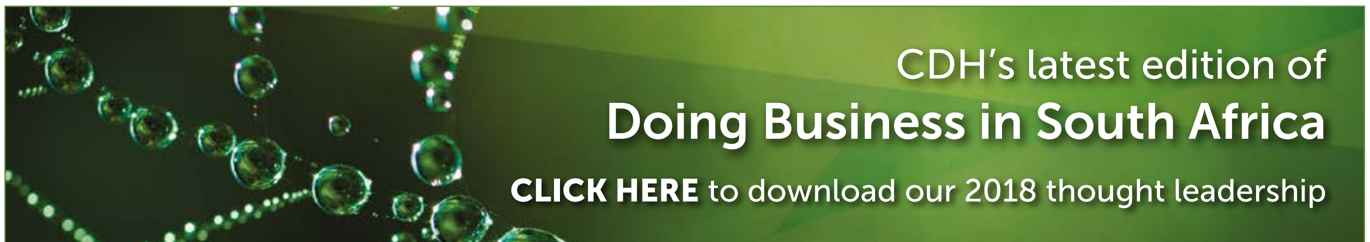
What seems to be lacking is a definition of what exactly is meant by a 'cryptocurrency' for VAT purposes.



What seems to be lacking is a definition of what exactly is meant by a 'cryptocurrency' for VAT purposes. In the absence of a clear definition, it could be considered that electronic loyalty points awarded by retailers to customers for redemption for goods or services specified in a loyalty scheme, or digital tokens or vouchers entitling the holder to acquire specific goods or services, could also be 'cryptocurrency'. Hopefully National Treasury will still clarify the meaning of 'cryptocurrency' for VAT purposes.

The exemption of cryptocurrency transactions from VAT is no doubt the preferred route. If they are taxable, then all taxable supplies for which cryptocurrencies are used as payment mechanism will be barter transactions, and both the supplier and recipient would need to account for VAT on the same transaction. Also, most countries with a VAT system have opted for the exemption. The clarification of the treatment of cryptocurrencies eliminates any uncertainty regarding their VAT status and is certainly welcomed.

Gerhard Badenhorst



TREASURY INCLUDES CRYPTOCURRENCY IN DRAFT TAX LEGISLATION

South African Revenue Service announced on 6 April 2018 that normal tax rules would apply to cryptocurrency in South Africa.

In their operations within the cryptocurrency sphere, taxpayers have thus far simply been required to declare any cryptocurrency gains or losses as part of their taxable income.

On 16 July 2018, National Treasury's draft Taxation Laws Amendment Bill (draft TLAB) was published for public comment. The draft TLAB has encapsulated a first for South African taxpayers by introducing legislative provisions for cryptocurrency in the proposed amendments.

Taxation of cryptocurrency prior to the draft TLAB

The South African Revenue Service (SARS) announced on 6 April 2018 that normal tax rules would apply to cryptocurrency in South Africa. As noted in our Tax and Exchange Control Alert of 20 April 2018 in this respect, despite the continued popularity of cryptocurrency trade, South African legislation has, until the 2018 draft TLAB, been silent on the taxation and regulation of cryptocurrency.

In their operations within the cryptocurrency sphere, taxpayers have thus far simply been required to declare any cryptocurrency gains or losses as part of their taxable income. Moreover, in accordance with SARS's April announcement, in order to determine whether cryptocurrency and cryptocurrency transactions are of a capital or revenue nature, the taxpayer's intention when acquiring the cryptocurrency would be considered. For example, if the taxpayer obtained cryptocurrency so as to pursue profit-making, the cryptocurrency would be considered trading stock and any transactions would be of a revenue nature. This test is applied to the facts and circumstances of each individual case.

Cryptocurrency in the draft TLAB

Though the draft TLAB has included cryptocurrency in three separate sections and with effect in both the Value Added Tax Act, No 89 of 1991 and in the Income Tax Act, No 58 of 1962 (Act), this alert will focus solely on the impact of the proposed amendments in the Act.

The definitions section of the Act may be amended by the draft TLAB to include "any cryptocurrency" in the definition of "financial instrument", whilst s20A of the Act may be amended by the draft TLAB to include "the acquisition or disposal of any cryptocurrency" under the contemplated trades within the ring-fencing provisions thereof.

Cryptocurrency forms part of the definition of "financial instrument"

Per the proposed amendments set out in the draft TLAB, cryptocurrency will be found alongside, for example, loans, debentures, financial arrangements determined with reference to the time value of money, bonds, option contracts and interest-bearing arrangements in the definition of "financial instrument" in s1 of the Act.

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TREASURY INCLUDES CRYPTOCURRENCY IN DRAFT TAX LEGISLATION

CONTINUED

Assessed losses derived from a trade listed in s20A, may only be set-off against income derived from that trade in future years of assessment.

One of the contexts in which the inclusion of cryptocurrency in the definition of "financial instrument" in the Act is relevant is the trading stock provisions in s22 of the Act. The section sets out the amounts to be taken into account in respect of values of trading stocks in relation to determination of taxable income, and financial instruments are, for example, excluded from the considerations at s22(1)(a).

Furthermore, there may be capital gains tax (CGT) implications for including cryptocurrency in the definition of "financial instrument". One example of where its impact may be felt is in the context of paragraph 42 of the Eighth Schedule to the Act, which provides for the taxation of short-term disposals and acquisitions of identical financial instruments. The paragraph applies where a person makes a capital loss on the disposal of financial instruments, subsequent to which the same person or any of its connected persons acquires a financial instrument that is of the same or equivalent quality within a 91-day period (beginning 45 days before the date of disposal and ending 45 days after that date). In these instances, according to paragraph 42, the capital loss cannot be taken into account at the time of disposal and must instead be carried forward and added to the base cost of the replacement instrument.

According to the Comprehensive Guide to Capital Gains Tax, paragraph 42 essentially encompasses an anti-avoidance rule which governs instances that are informally referred to as "wash sales", where financial instruments are disposed of towards the end of a year of assessment, in order to realise losses. Considering the nature of cryptocurrency trade, it is conceivable that short-term disposals and acquisitions are common, and that paragraph 42 will therefore seek to ensure that traders who hold cryptocurrency as capital in these circumstances will be treated as having disposed of the asset for proceeds equal to base cost, with the capital loss being "held over". The exclusions in paragraph 42(3) and 42(4) will still apply.

Ring-fencing provisions now apply to cryptocurrency

The acquisition or disposal of any cryptocurrency is now, due to the proposed amendments in the draft TLAB, contemplated as a specified trade in s20A, should the amendment come into effect. As such, s20A becomes relevant to cryptocurrency traders, as the section ring-fences assessed losses associated with the acquisition or disposal of any cryptocurrency. The section applies to natural persons only and effectively prevents the taxpayer from setting-off assessed losses incurred from the kinds of trades contemplated in the section against the income derived from carrying on other trades. In other words, assessed losses derived from a trade listed in s20A, may only be set-off against income derived from that trade in future years of assessment.

Colloquially, s20A has been said to ring-fence the setting-off of assessed losses associated with "suspect trades". The Act lists amongst such contemplated trades at s20A(2)(b), for example, the dealing of collectibles, the rental of residential accommodation to connected persons, any form of gambling or betting and the practicing of sports. In this way, s20A differentiates between losses resulting from the actual trading activities of a taxpayer, and the losses resulting from what could be perceived as the taxpayer's hobbies or lifestyle activities.

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CONTINUED

In a volatile market such as cryptocurrency trading, losses are to be expected.

As a result of this proposed amendment, taxpayers who trade in cryptocurrency may face potential restrictions in netting off their assessed losses incurred in trading cryptocurrency against their taxable income. The inclusion of "acquisition or disposal of any cryptocurrency" certainly limits the taxpayer who does not hold cryptocurrency as a capital asset, however, cryptocurrency traders are not prevented from setting off losses from their cryptocurrency trade specifically against the income from their cryptocurrency trade.

National Treasury's stance on cryptocurrency

In a volatile market such as cryptocurrency trading, losses are to be expected. The proposed amendment to s20A appears to be an attempt to limit the effect of these losses on SARS's revenue collection prospects. This is further evident in the proposed effective inclusion of cryptocurrency in the anti-avoidance provisions of paragraph 42 of the Eighth Schedule to the Act.

The draft TLAB has given an indication of National Treasury's approach in respect of the tax treatment of cryptocurrencies, with the proposed amendments displaying an identifiable impact on cryptocurrency traders at the outset. Whilst taxpayers may welcome the further clarifications in the ever-expanding cryptocurrency environment, SARS and National Treasury have invited written public comment in respect of the suggested amendments and are engaging in a full consultation process herein.

Jessica Carr

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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