22 JANUARY 2021

TAX & EXCHANGE CONTROL **ALERT**

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VAT and vouchers: A recent High Court decision

The main difference is therefore that no VAT is accounted for when a section 10(18) voucher is issued, and VAT is only accounted for on the value of goods or services supplied when the voucher is redeemed whereas, in the case of a section 10(19) voucher, VAT is payable on the full consideration when the voucher is issued, and no VAT is payable when the voucher is redeemed for goods or services.

The VAT implications of vouchers may, on the face of it, seem to be of little significance and straightforward. However, VAT on vouchers has been the subject of a significant amount of litigation in the United Kingdom and the European Union. New Zealand has amended its VAT legislation twice in this regard and the United Kingdom substantially amended its VAT rules on vouchers from January 2019. SARS issued two draft interpretation notes during 2012 on the subject but neither have been finalised. It is therefore somewhat surprising that there have been very few VAT disputes in South Africa in relation to vouchers.

The VAT considerations applicable to vouchers

The problem with a voucher is that it is a prepayment for a later supply of goods or services on the redemption of the voucher. There is only a single consumption for a single consideration, but there are two transactions, i.e. the sale of the voucher and the subsequent supply of goods or services. If both the transactions are taxed, then it will give rise to double taxation since there is only one consideration. To avoid such double taxation, the VAT Act contains provisions which are specific to vouchers.

Section 10(18) deals with vouchers which grant the holder the right, in return for the payment of a consideration in money, to receive goods or services to the extent of the monetary value stated on the voucher. The voucher holder determines the goods or services to be acquired, and there is often more than one supplier to choose from. Since the nature, value or VAT status of the goods or services (whether they are standard rated, zero rated or exempt) cannot be determined upfront, no VAT is payable when the voucher is sold. VAT is only payable when the voucher is redeemed for goods or services, and then only on the value of the goods or services supplied. In terms of the *Explanatory Memorandum on the Value Added Tax Bill, 1991*, a section 10(18) voucher is regarded as a means of exchange, similar to money. Gift vouchers typically fall into this category.

Section 10(19) deals with vouchers issued for a consideration in money which entitle the holder to receive the goods or services specified thereon without any further charge. The VAT on these vouchers is payable when the vouchers are issued because the nature and VAT status of the goods or services are known when the voucher is sold, and no VAT is payable when the voucher is redeemed. Tickets entitling the holder entry to a specified sporting or entertainment event, a spa voucher entitling the holder to a specified treatment and prepaid electricity vouchers typically fall into this category.

The main difference is therefore that no VAT is accounted for when a section 10(18) voucher is issued, and VAT is only accounted for on the value of goods or services supplied when the voucher is redeemed, whereas, in the case of a section 10(19) voucher, VAT is payable on the full consideration when the voucher is issued, and no VAT is payable when the voucher is redeemed for goods or services.

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MTN applied in November 2017 to SARS for a binding private ruling to confirm that its multi-purpose vouchers fall within section 10(18).

High Court judgment

The High Court was recently called upon in the case of *MTN (Pty) Ltd v CSARS* (79960/2019) [2021] ZAGPPHC to determine whether prepaid vouchers issued for a consideration, entitling the holder to receive any services or products to the value of the monetary value attributed to the voucher on the MTN mobile network as selected by the holder (multi-purpose vouchers), comprise section 10(18) or 10(19) vouchers.

MTN applied in November 2017 to SARS for a binding private ruling to confirm that its multi-purpose vouchers fall within section 10(18). However, SARS ruled in April 2019 that these vouchers are section 10(19) vouchers. MTN then sought a declaratory order from the High Court that the multi-purpose vouchers indeed fall within section 10(18). As has seemingly become its standard practice in such cases, SARS firstly disputed the entitlement of MTN to declaratory relief. SARS argued that MTN was asking the court to advise it on which section of the VAT Act should be applied. SARS argued further that the court was requested to make a determination on general terms, that it was not time specific and that there were not sufficient facts upon which a determination could be made.

In the judgment handed down on 12 January 2021, Hughes J confirmed the entitlement of MTN to seek declaratory relief. In relying on the judgment of the Supreme Court of Appeal in *CSARS v Langholm Farms*, he stated that nothing would change SARS' interpretation of this specific section and no amount of further facts or information would alter SARS' legal view. In these circumstances, a declaratory application is appropriate.

Turning to the application of section 10(18) and 10(19), the court considered that the vouchers are prepaid vouchers which allow the subscriber access to any of MTN's services. When the subscriber purchases and activates the multi-purpose voucher, the subscriber's SIM card is credited with the value of the voucher. This is described as the 'main wallet' which can then be used to acquire any product or service on the MTN network at the choice of the subscriber. Once a particular product or service is accessed, the cost thereof at the prevailing tariff is deducted from the main wallet.

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The court therefore held that the voucher is for specified goods or services and is therefore a section 10(19) voucher.

The court stated that the multi-purpose voucher is described as an *"airtime"* voucher. The *"airtime"* voucher can be used to make calls, receive calls, send messages, use the internet and for data. It is this *"airtime"* which the court regarded to be a specific good or service as contemplated by section 10(19), which can then be used for multiple purposes. The court therefore held that the voucher is for specified goods or services and is therefore a section 10(19) voucher.

A deeper dive – analysis and practical implications of the judgment

It is not clear whether the court considered the judgment of the Tax Court in Income Tax Case *IT 24510*. In that case Binns-Ward J ruled that pre-paid vouchers are regulated by sections 63 and 65 of the Consumer Protection Act 68 of 2008 (CPA). Section 63(3) of the CPA provides that any consideration paid by a consumer in exchange for a prepaid voucher is the property of the bearer of that voucher to the extent that the recipient has not redeemed it in exchange for goods or services. Section 65(2)(a) of the CPA provides that the supplier must not treat the prepayment as being the property of the supplier. On this basis the Tax Court held that it is only when the voucher is redeemed or expires that the sale proceeds of the voucher accrues to the taxpayer, for it is only then that the taxpayer becomes legally entitled to the proceeds. The Tax Court therefore held that the proceeds are not gross income for income tax purposes until the voucher is redeemed or expires. The same principles should also apply in a VAT context.

MTN argued that the sale proceeds of its multi-purpose voucher only comprise revenue when the voucher is activated and used. Hughes J stated that this contention is not correct because section 9(1) of the VAT Act requires MTN to account for VAT in the tax period in which the voucher is sold. This is, however, incorrect on two counts. Firstly, if it is a section 10(18) voucher, then the supply of the voucher is disregarded for the purposes of the VAT Act. There is then no supply which triggers the time of supply in terms of section 9(1). Secondly, the time of supply in terms of section 9(1) is triggered at the earlier of when an invoice is issued or the time any payment of consideration is received by the supplier. Assuming no invoice is issued in respect of a prepaid voucher, VAT is then only payable when payment of consideration is received by the supplier. Section 63(3) of the CPA provides specifically that any consideration paid for a prepaid voucher is the property of the bearer of that voucher to the extent that the supplier has not redeemed it in exchange for goods or services. Section 65(2)(a) of the CPA further places prohibition on the supplier to treat such prepayment as the supplier's property. The consideration paid for the multi-purpose voucher is therefore not a consideration received by the supplier which triggers the time of supply under section 9(1), as it remains the property of the bearer.

The judgment in the *MTN* case also has further implications. One of the reasons why section 10(18) delays the VAT payment until the voucher is redeemed, is because the nature of the goods or services, and whether they are standard rated, zero rated or exempt cannot be determined at the time the voucher is sold. In the case of MTN, the current products or services

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The VAT Act has not kept up with the rapid expansion in digital technologies and the proliferation in business promotion initiatives involving vouchers. Perhaps now is the time to review and amend these provisions.

for which the multi-purpose voucher can be used are all standard rated. However, if MTN adds zero rated, exempt or non-taxable options for which the main wallet can be applied, for example to make a donation to a charity or to pay a credit life insurance premium, such non-taxable transactions will be subject to VAT because the multi-purpose voucher is now ruled to be a section 10(19) voucher. A further question that arises is who should pay the VAT, and when, if a multi-purpose voucher such as the MTN voucher is issued by a third party. What would the position be if a third party issues a multi-purpose voucher which can be redeemed for services or products provided by multiple service providers?

The judgment in the *MTN* case leaves us with more questions than answers on the complex subject of VAT and vouchers. The provisions of the VAT Act which deal with vouchers were included in the VAT Act when VAT was introduced almost 30 years ago and have not been amended since. The VAT Act has not kept up with the rapid expansion in digital technologies and the proliferation in business promotion initiatives involving vouchers. Perhaps now is the time to review and amend these provisions.

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Prohibition no more: Loop structure rules amended and related considerations

In terms of the Circular, *"in order to support South Africa's growth as an investment and financial hub for Africa, it is advised that the full 'loop structure' restriction has been lifted to encourage inward investments into South Africa"*.

In our Tax & Exchange Control Alert of 17 August 2018, we discussed how South Africa's exchange control rules prohibit the creation of so-called loop structures, with certain exceptions. A loop structure entails the formation by a South African resident of an offshore structure which, by reinvestment into the Republic, acquires shares, loan accounts or some other interest in a South African resident company or a South African asset. Fast forward to January 2021 and it is now official that the loop structure prohibition is no more, after the release of Exchange Control Circular 1/2021 (Circular) by the South African Reserve Bank (SARB) on 4 January 2021.

What is the reason for the change?

In terms of the Circular, *"in order to support South Africa's growth as an investment and financial hub for Africa, it is advised that the full 'loop structure' restriction has been lifted to encourage inward investments into South Africa"*.

What exactly does the change entail?

The Circular, amongst other things, amends sections B.2(B)(i), B.2(C)(i)(f), B.2(C)(ii)(e) and B.2(G) of the Currency and Exchanges Manual for Authorised Dealers (AD Manual). These sections deal with the loop structure prohibition applicable to South African individuals, companies and private equity funds. Whereas these persons were previously only allowed to hold up to a 40% interest, collectively with other South African residents, in an offshore entity, this limitation will no longer apply. Pursuant to the amendment, the rules that now apply to each category of persons are the following:

- Resident individuals, companies and private equity funds with authorised foreign assets may invest in South Africa, provided that where South African assets are acquired through an offshore structure (loop structure), the investment is reported to an Authorised Dealer as and when the transaction(s) is finalised. An annual progress report must also be submitted to the SARB's Financial Surveillance Department (FinSurv) via an Authorised Dealer. The aforementioned party also has to view an independent auditor's written confirmation or suitable documentary evidence verifying that such transaction(s) is concluded on an arm's length basis, for a fair and market-related price.
- Upon completion of the abovementioned transaction, the Authorised Dealer must submit a report to FinSurv which should include, amongst other things:
  - the name(s) of the South African affiliated foreign investor(s);
  - a description of the assets to be acquired (including inward foreign loans, the acquisition of shares and the acquisition of property);

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In the case of South African companies, the remaining rules regarding the foreign investment allowance for investments below and above R1 billion per year, as contained in section B.2(C) of the AD Manual still apply.

  - the name of the South African target investment company, if applicable; and
  - the date of the acquisition as well as the actual foreign currency amount introduced including a transaction reference number.
- All inward loans from South African affiliated foreign investors must comply with the directives issued in section I.3(B) of the AD Manual.
- Existing unauthorised loop structures (i.e. created prior to 1 January 2021) and/or unauthorised loop structures where the 40% shareholding threshold has been exceeded (created prior to 1 January 2021), must still be regularised with FinSurv.

What is not affected by this change?

Despite the above, it should be noted that there are some exchange control rules that still remain in place and that need to be complied with where an investment is made into an offshore structure, including:

- In the case of individuals, the remaining rules regarding the foreign investment allowance, limited to R10 million per year still apply.
- In the case of South African companies, the remaining rules regarding the foreign investment allowance for investments below and above R1 billion per year, as contained in section B.2(C) of the AD Manual still apply. This means that in practical terms, where a company wishes to make use of this allowance to invest offshore, it will still require prior approval from an authorised dealer or FinSurv, depending on the nature and terms of the investment. Furthermore, one should appreciate that as things stand, the investment into an offshore structure that invests into South Africa will now potentially create an additional reporting requirement. This is because any approved investment made under the foreign investment allowance is subject to a requirement that an annual report must be submitted. It is not yet clear whether the annual reporting requirement applicable to the loop structure (as set out in sections B.2(C)(i)(f) and B.2(C)(ii)(e) of the AD Manual) can be combined with the existing annual reporting requirement applicable to offshore investments.

Prohibition no more: Loop structure rules amended and related considerations...*continued*

Any person who considers investing into an offshore company or structure with a loop structure component, would be well advised to obtain professional advice beforehand so as to understand the tax and exchange control considerations that will apply to their investment.

- In the case of private equity funds, the remaining rules regarding investing offshore will still apply, including the requirement that private equity funds that are members of the South African Venture Capital Association, mandated to invest outside the CMA, may only do so with FinSurv's prior approval.

Other considerations

The other important consideration is that the Income Tax Act 58 of 1962 (Act) has been amended and as a result, there will now be specific tax consequences applicable to loop structures. We will not delve into the amendments, as they only became final this week with the publication of the Taxation Laws Amendment 23 of 2020. However, some of the issues that may have to be considered from a tax perspective are the following:

- The potential application of the controlled foreign company rules in section 9D of the Act;
- The tax treatment of dividends paid to a South African shareholder in an offshore loop structure; and
- The provisions of paragraph 64B of the Eighth Schedule to the Act, dealing with the participation exemption where shares are sold by a South African shareholder in an offshore structure.

Any person who considers investing into an offshore company or structure with a loop structure component, would be well advised to obtain professional advice beforehand so as to understand the tax and exchange control considerations that will apply to their investment.

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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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