Discussion Paper

Value-Added Tax Modernisation

Value-Added Tax

South African Revenue Service

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1. Purpose

This discussion document seeks to achieve the following:

- Explain, at a high level, the modernisation of the South African Value-Added Tax (VAT) administrative framework.

  The modernisation will impact businesses that are registered or required to be registered for VAT (vendors). In line with international trends in making the VAT system agile and easy to administer (both for the tax authority and vendors), there is a growing acceptance for the adoption and implementation of real-time or close to real-time transmission of VAT data from vendors to the tax authority, and the reporting of VAT data using the modern VAT return.

- Invite businesses (vendors), accounting system software developers or suppliers, recognised controlling bodies, public finance entities, municipal finance entities and the public to submit contributions, and comments, as part of a consultative process to modernise the VAT administrative framework.

Contributions, comments and feedback will be followed by further engagements and consultations.

2. Background

Value-added tax in South Africa was introduced in 1991 and replaced the general sales tax regime. The objective of VAT is to un-interruptedly raise revenue for government, throughout the fiscal year. VAT is a self-assessment tax, and the VAT liability is determined using the subtractive or invoice-based credit input method.

The general maintenance of proper accounting records and documents are important aspects of how the VAT system operates. These documents create an audit trail that is used to ensure that the vendor has complied with the law in calculating its VAT liability or refund for a tax period. A tax invoice comprises a critical aspect of the audit trail that is required under a VAT system. Therefore, much emphasis is placed on the requirement to issue a tax invoice, with prescribed details that are aligned to business, accounting, and financial principles, to maintain the integrity of a VAT system. A tax invoice is an important indicator that a supply has been made and it also serves as a VAT source document for the deduction of input tax.

While VAT ensures a steady and predictable stream of revenue, its self-assessment mechanism places the onus, in the form of maintaining proper accounting records and documentation, on vendors. Of equal measure, it also requires an effective and efficient tax administration capability by SARS to administer VAT across the value chain of registration, filing or declaration, payments or refunds, debt collection, audit or inspection, and disputes.

While VAT is the second-highest contributor to revenue collection for SARS, its modernisation has largely not progressed over the past decade in comparison to other tax and customs products. Although the administration of the VAT value chain has adopted the use of technology, such as e-registration, eFiling and e-payments, it is the tax type with the least supply chain visibility from a self-assessment perspective. This lack of supply chain visibility exposes the *fiscus* to revenue leakages, which is time-consuming to detect, and requires frequent audits and verifications, placing a burden on vendors and their business. These frequent audits and verifications could potentially result in delaying the finalisation of a vendor’s VAT liability or VAT refund.

The Minister of Finance announced in the 2023 Budget Announcement that, over the period ahead, SARS intends to review the VAT administrative framework to simplify and modernise the current system, in consultation with all affected parties.

3. Discussion

SARS's vision is to expand on its successes by building a smart, modern SARS with unquestionable integrity that is trusted and admired.

SARS's strategic intent is to develop and administer a tax and customs system of voluntary compliance, and where appropriate, ensure compliance responsibly and decisively.

The SARS compliance philosophy is that SARS will achieve voluntary compliance when –

(a) everyone is aware of their tax obligations (clarity and certainty);

(b) it is reasonably easy and less costly to meet these obligations (ease of compliance); and

(c) there is a credible threat of detection and consequences for those who do not comply with their obligations (making it hard and costly for those who do not comply).

In support of SARS's strategic intent, and to give effect to SARS compliance philosophy, SARS is committed to achieving its strategic objectives.

In addition to the strategic objective of modernising our systems to provide digital and streamlined online services, the journey to modernising the VAT administrative framework also seeks to achieve the following strategic objectives:

(i) Providing clarity and certainty for taxpayers of their obligations.

(ii) Making it easy for taxpayers to comply with their obligations.

(iii) Detecting taxpayers who do not comply and making non-compliance hard and costly for such taxpayers.

(iv) Developing a high performing, diverse, agile, engaged, and evolved workforce.

(v) Increasing and expanding the use of data within a comprehensive knowledge management framework to ensure integrity, drive insight, and improve outcomes.

(vi) Demonstrating effective resource stewardship to ensure efficiency and effectiveness in the delivery of quality outcomes and performance excellence.

(vii) Working with and through stakeholders to improve the tax ecosystem.

(viii) Building public trust and confidence in the tax administration system.

SARS is at the early stages of commencing its modernisation of the VAT administrative framework. This modernisation initiative will entail a staged approach, which will include, amongst others, the following:

- development of VAT data models
- determining suitable technologies to be used
- consultation and collaboration with vendors and other relevant stakeholders
- integration of vendors accounting information systems with SARS systems
- testing and implementation of the data models, the vendors accounting information systems and SARS systems.

The future state of VAT modernisation is to receive digitally transmitted VAT data

There is opportunity to leverage-off available information technologies to enable digital transmission of VAT data that will provide visibility of all parties to a transaction, that is, visibility of the whole VAT supply chain. Accounting information system enhancements over the years have demonstrated that transactions, both on the income (supply) and expenditure (acquisition) streams, allocate these transactions with specific detail to provide business owners or management with detailed transactional data to inform and make business or management decisions. This also includes allocation and processing of VAT source documents. Like the Pay As You Earn data that is transmitted by an employer or vendor from the payroll segment of its accounting information system, the VAT data obtained from source documents (for example, tax invoices or electronic tax invoices issued and received and/or payments received or made) that is processed in the accounting information system will be digitally transmitted to SARS using secure data submission channels. Similarly, technology-based point of sale systems, such as cell phones and other cash receipt devices (regarded as forming part of the vendor's natural systems) have the capability of transmitting VAT data to the tax authorities for certain types of industries. The digital transmission of VAT data is aimed at almost near to real-time transmission. This may commence with daily transmissions, thereafter, reducing the transmission time to six-hourly, then hourly, depending on the capability of the vendor's accounting information system, resource planning and priorities. At the initial stages, as and when VAT data is digitally transmitted, the VAT data will be used to simulate the vendor's VAT return. The self-assessment concept will still be retained, that is, the vendor will still be required to submit its VAT return for a tax period on or before the due date. SARS will also be more informed when making an assessment based on an estimate when no VAT return is filed.

The principle is to enable vendors to digitally transmit VAT data via a secured channel to SARS, namely, to provide a secure flow of data between a vendor's accounting information system and SARS's systems. SARS currently has the Connect Direct, Secure File Gateway, Message Queue File Transfer and Secure File Transfer Protocol channels that are available for the transmission of data. An alternative is to transmit a limited VAT invoice file through RESTful API, eFiling or e@syFile https channels. Depending on the channel that is ultimately decided upon, SARS will ensure that the data files conform to prescribed validation standards.

The proposal is to implement the digital transmission of VAT data, initially, for a segment of the VAT vendor base, that contributes eighty percent of the total VAT revenue. Current estimates indicate that approximately twenty percent of the VAT vendor base utilises technology-based accounting information systems. This base is generally classified as medium to large vendors.

Approximately thirty percent of the vendor base consisting of –

- vendors registered under the VAT monthly Category C filing tax period.
- Large Business and International vendors.
- vendors that transact with Government (vendor to government (B2G) supplies).
- other vendor segments that represent a high risk to the fiscus as informed by the SARS compliance program and
- any vendor that wishes to participate voluntarily.

will be required to digitally transmit VAT data to SARS. This will be enabled by amending legislation to allow for a Public Notice to be issued by the Commissioner.

The later phases of the modernisation initiative will focus on integrating the remainder of the VAT vendor base, comprising of micro, small and medium sized vendors. Specific data models and technologies suited to these vendors will have to be developed, whilst acknowledging the pace at which these vendors can migrate to the modernised system of digitally transmitting VAT data to SARS.

The need for a modern VAT return?

Many foreign tax jurisdictions have reported at least a five-year development, implementation, and onboarding period. Further postponements to this period were also reported, citing vendor readiness and ongoing stakeholder consultation to determine appropriate technologies. In South Africa, whilst the data model for the digital transmission of VAT data is planned for the earliest possible implementation, in respect of the segmented vendor base, implementation may only realistically take place in approximately five years. In the interim, it may be necessary to commence with the transition for the entire vendor base to report on detailed VAT data, thereby preparing the vendor base for the future state of VAT modernisation. This transition can be achieved by modernising the current VAT return.
The limited data input disclosure points on the current VAT return have remained essentially the same since the implementation of VAT and the return is outdated. Integrated accounting information systems have evolved in the marketplace to provide more meaningful financial and tax reporting data, namely, existing accounting information systems have become agile in its development. They have the capability to separate and allocate individual supply and acquisition transactions that can be recorded and reported on for multiple purposes, for example, management reporting and cost accounting reporting.

Therefore, as part of transitioning to the future state of VAT modernisation, there may be a need to modernise the VAT return to disaggregate (expand) the data input disclosure points based on a data model that is scalable for real time reporting and to also add new data input disclosure points, to enable more meaning disclosure of tax data. It is envisaged that, differentiating between the supply of goods and services, identifying various types of zero-rated supplies, distinguishing between deemed supplies and their applicable VAT rate, input tax deductions for imported goods, capital goods, trading stock, operational overheads or expenses, apportionment of input tax, and the apportionment ratio, will form part of this modernisation initiative.

This modern VAT return will –

- align to accounting principles configured in a vendor's accounting information system, such as the allocation of transactional amounts to specific income (supply) and expenditure (acquisition) streams.
- improve data management, analysis and reconciliations by the vendor before submitting the self-assessment VAT return to SARS.
- facilitate risk analysis by SARS supported by the VAT transactional data transfer validations and
- enable the building of more intuitive rules (artificial intelligence learning) to inform the SARS risk engine.

Education and awareness

SARS intends creating effective, efficient, targeted and dedicated education and awareness campaigns, using multiple forums, such as webinars etc. These campaigns are intended to provide vendors and other relevant stakeholders with the necessary information that would empower them to understand what is expected of them, so that they can comply with the requirements of the modernised VAT administrative framework.

Under the modernisation initiative, the proposed aim and vision is for the modernised VAT return to apply to the entire VAT vendor base. SARS is aware of the accounting information systems and VAT reporting impact changes of this initiative. The extent to which the VAT return is to be disaggregated and inclusion of additional data input disclosure points, is not concretised and will depend on feedback during the consultative, awareness and training processes.

As regards the implementation of the digital transmission of VAT data to SARS, this aspect of the modernisation initiative adopts a phased approach, as outlined above. SARS recognises the possible challenges that small to medium vendors may encounter to ensure compliance with this phase. Therefore, it is envisaged that these vendors are given sufficient time, awareness, and education to familiarise themselves with the implementation of the digital transmission of VAT data to SARS. The co-operation and support of Independent Software Vendors and other similar stakeholders, as development partners to develop accounting information systems and provide training for the implementation of the digital transmission of VAT data to SARS, is also included as a part of the stakeholder engagement plan.

The benefits

The above modernisation initiative is intended to improve overall compliance and efficiency of the VAT system, make it easy for vendors to comply with their obligations, increase taxpayer satisfaction, detect vendors who do not comply and increase taxpayer digital offerings. In planning, developing, and implementing this modernisation initiative, SARS is committed to working with and through all stakeholders to improve the VAT ecosystem.

The benefits, also informed by international benchmarking, include, amongst others, the following:

- Resolving inherent delays in releasing VAT refunds (opportunity to reduce the turnaround times to pay VAT refunds).
- Reduction in the high percentage of inaccurate VAT returns.

- Easier and simpler updating of demographic information.
- Reducing the need for manual verifications or audits and migrate to the concept of e-verification or e-audits for a segment of vendors.
- Free up resources that can be re-directed to perform verifications on all vendors every five years, as is the international norm.
- Perform auto registration and deregistration.
- Decrease in the number of disputes lodged.
- Making of an assessment based on an estimate when there is filing non-compliance; and
- Simplifying, using digital online services, the calculation of VAT, and lowering the burden of traditional VAT recording systems for vendors.

The modernisation of the VAT administrative framework will require enhancing and building of information technology infrastructure by SARS to, amongst others, digitally receive VAT data. Vendors are also required to ensure that their accounting information systems are capable of, firstly, digitally transmitting VAT data (tax invoice or electronic tax invoice data) in the format as required by SARS, and secondly, extracting the necessary transactional data to complete and file the modern VAT return.

Although vendors will be required to incur initial costs regarding changes to be made to their accounting information systems, there are also long-term benefits for vendors. It is anticipated that the long-term benefits of accurate VAT allocations and reporting required by the modernised VAT administrative framework may outweigh this initial cost. Exposure to VAT miscalculations, errors or omissions, and contingent tax liabilities (including penalties and interest) may be minimised. It will ensure systematic and easy VAT compliance over the medium to long-term with less verification and audit interventions from SARS. Further, these initial costs may be deducted for income tax and VAT purposes, as an incentive for complying and participating in the modernised VAT administrative framework.

4. International benchmarking

Many countries have commenced their VAT modernisation and are at various stages of development. Most common and prolific is the consensus theme of digitising VAT source data by introducing the electronic VAT invoice in their VAT systems to enable VAT data transmission from vendors accounting systems to tax authorities, to ensure compliance.

The benchmarking shows limited uniformity in terms of how tax authorities have implemented electronic invoicing. Tax authorities are at various levels of maturity with only a few having implemented electronic invoicing for the whole VAT vendor base.

Electronic invoicing was introduced to address the VAT tax gap, improve filing compliance, reduce the cost of compliance, ease the administrative cost of the tax authority, and work with tax stakeholders to make the tax system more efficient. Research also shows that electronic invoicing is identified as a digital tool to drive tax compliance.

Data is, however, not readily available to quantify the degree of success, at this stage.

A sample of 11 countries (such as Chile, India, Kenya, Singapore, Uganda and United Kingdom) plus a segment of the European Union were researched. The sample is based on tax authorities that have already implemented electronic invoicing, as tax authorities are at various stages of the journey towards electronic invoicing. Several other advanced tax authorities are at the same consultative or planning stage as SARS. The commonalities of the sampled countries include the following:

(a) A segmented approach is used, in which business to government (B2G) transactions are prioritised, followed by business to business (B2B) and business to consumer (B2C) transactions.

(b) Implementation can also be achieved using turnover, for example, large businesses.

(c) The costs to be compliant with electronic invoicing requirements are borne by the vendors.

Since the costs are borne by the vendors, a range of software products are available and certain tax jurisdictions provide a list that are compatible, including low-cost options.

(d) Electronic invoicing models show that tax authorities not only receive electronic invoicing data but also validate the invoice before it is issued.

(e) Software solutions are used by tax authorities.

(f) Some tax authorities use electronic invoicing information to pre-populate VAT returns.

(g) The scope of electronic invoicing implementation normally guides the due dates for submission of electronic invoice data.

To achieve the aforementioned, certain key and critical requirements must be met, for example –

(i) recordkeeping for five years.

(ii) working with the tax community to drive compliance.

(iii) the systems adopted by the tax authority should be designed to manage, process and store large volumes of transactional data.

(iv) an invoice validation framework needs to be established which adheres to the law and remains business or vendor centric.

(v) the tax authority's invoice validation process should be efficient and have limited downtime as any delays will have a significant impact on business transactions.

(vi) a phased implementation is normally followed, starting with larger vendors that will most probably have the hardware and software in place to transmit transactional data to the tax authority.

(vii) the level of detail required on the invoice should also be considered with the long-term VAT vision as jurisdictions have various requirements, but more granular information increases the likelihood that the information can be used to pre-populate VAT returns.

(viii) the implementation of electronic invoicing increases the impact that cyber-attacks pose to the tax authority and invoice processing therefore tax authorities information security framework should be robust.

(ix) penalties should be imposed to deter non-compliance

Research also indicates that the cost structures are complex. Cost is determined, amongst others, by the third-party and electronic invoicing compliance requirements, vendor business size, business complexity and existing business software and hardware. Tax authorities in African countries have electronic fiscal devices as an option (which are, in most instances, incentivised or subsidised by government), while all the other tax authorities' electronic invoicing solutions (or similar type platforms) are software driven.

The international benchmarking indicates that three electronic invoicing software solutions are normally used:

(aa) Custom built e-invoicing packages mostly aimed at large vendors to cater for cross-jurisdictional needs, for example –

(A) Directive 2014/55/EU for the European Union (EU)

(B) Making Tax Digital (MTD) for the United Kingdom (UK)

(C) Goods and Services Tax (GST) for India

These large vendors normally have their own inhouse Customer Relationship Management (CRM), Enterprise Resource Planning (ERP), accounting and tax software. Therefore, the e-invoicing solutions are custom-built to fit their existing business software.

(bb) The Australian Government noted that most small business accounting software providers are building e-invoicing into their products and some already have it available. This may include free or low-cost solutions depending on how many invoices are exchanged. The free versions do however have very limited e-invoicing capabilities.

(cc) Standalone e-invoicing software packages that are integrated with vendors' existing accounting or ERP software – targeted at micro, small and some medium size vendors. These are normally standard packages.

5. Legislative amendments

The formulation of a modern VAT return and the implementation of the digital transmission of VAT data to SARS, will require amendments to current primary and secondary legislation. It is envisaged that legislation be introduced that, amongst others –

- clearly prescribes the mandatory requirements that must be disclosed on the modern VAT return.
- identifies the categories of vendors and/or transactional types for which vendors will be obliged to digitally transmit VAT data from their accounting information systems to SARS systems via a compatible and secure channel and
- introduces a penalty to discourage any non-compliance in respect of the digital transmission of VAT data.

Contributions and comments towards modernising the VAT administrative framework

In commencing the consultation process, all affected stakeholders, such as businesses or vendors, accounting system software developers or suppliers, technology entities, recognised controlling bodies, and the public are invited to submit contributions and comments on –

a) the formulation of the VAT data models;

b) the digital transmission of VAT data (data that is typically used to compile and report on a VAT return to SARS and technology; and
c) the formulation of a modern VAT return with disaggregated and new data disclosure fields,

as part of the process to modernise the VAT administrative framework.

Contributions and comments received will be followed by further engagements and consultations.

Contributions and comments must be e-mailed to **policycomments@sars.gov.za** by no later than 31 October 2023.