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Square Kilometre Array ("SKA") Project Indirect Tax RFI Review South Africa

November 2011

Glossary of Terms

CC	Closed Corporations
FTA	Free Trade Agreement
GST	Goods and Services Tax
IMF	International Monetary Fund
RFI	Request For Information
SARS	South Africa Revenue Service
VAT	Value Added Tax
WTO	World Trade Organisation

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Section 1

What is Indirect Tax?

Section 1

What is Indirect Tax?

Indirect tax is a “consumption tax” that is levied on goods or services rather than individuals and is paid by generally by an ultimate end customer as an addition to the a price paid for those goods or services.

Indirect tax is generally designed not to be a financial burden for businesses as (a) although it is imposed on producers / suppliers, its cost is designed to be passed on to an ultimate end customer and (b) businesses can generally recover from tax authorities certain indirect taxes they incur i.e. import VAT / GST while others are irrecoverable e.g. customs and excise duty and paid directly by the producer or supplier.

Indirect tax is generally composed of the following three taxes which are levied at different times in the supply chain process. Most of those listed below are “ad valorem” taxes i.e. applied as a percentage of the cost of a supply i.e. VAT/ GST, customs duty while others such as excise duty are generally a specific tax i.e. a fixed amount per unit.

- a) Customs duties - is an irrecoverable tax levied at the time products are imported. Customs duty is generally an ad valorem tax payable by the importer of record. A number of elements such as the product tariff classification, its origin and economic sensitivity may influence the rate of duty payable. It is a material tax that has a direct impact throughout the lifetime of the project.
- b) VAT / GST – is a domestic consumption tax levied on goods and services. This is generally an ad valorem tax levied at each stage in the chain from raw materials to the final sale based on the price at each stage. It is typically not a cost to a producer or distributor as they can generally recover any tax paid, however ultimately the tax is generally borne by the end customer; and
- c) Excise duties - is a domestic consumption tax on fuel, tobacco and alcohol products (and other products in some jurisdiction eg luxury car tax) which is generally levied either upon importation or at the time of manufacture of the product. It is a specific tax generally a fixed amount per unit of commodity consumed.

The above listed indirect taxes form part of the costs SKA has to understand either from a cash flow or obsolete cost perspective. These taxes will apply during the construction phase and lifetime operation of the project either directly incurred by SKA or by third parties associated to the project. The impact of these indirect taxes is significantly material and could result in positively or negatively influencing the project. In general some of the mentioned above taxes will become irrecoverable for the SKA organisation while others can be mitigated / reduced / recovered through planning.

Section 1

What is Indirect Tax? (cont.)

The onus of managing indirect taxes has been shifted from the tax authorities to the businesses. Businesses are required to collect, account for and pay for the indirect taxes applied to the products or services, and therefore compliance with relevant local requirements is key in ensuring compliance and the ability to mitigate, reduce or recover any tax paid. Typically, a number of declarative requirements have to be fulfilled e.g. when goods physically cross borders on a transactional basis or monthly or quarterly returns may instead be required for VAT / GST reporting. Examples of triggers are:

- a) Goods move across borders – business who are involved in or connected to international trade involving the import and export of goods should ensure that they are familiar with general export and import processes and associated requirements in the country of export and importation to (1) meet any non tariff trade barrier requirements at export/import (2) fully comply with the declarative obligations and payments of taxes and (3) optimise the tax position where possible.
- b) Supplies or receipt of supplies – businesses who are involved in the movement of goods across borders or the provision or supply of goods or services should ensure that they are familiar with relevant VAT/GST obligations where these activities are undertaken. This typically involves (1) meeting the local registration requirements (2) registration (3) meeting reporting requirements and payment of the relevant tax. Generally, there is an ability to recover VAT incurred on goods and services procured for business purposes provided the costs relate to a taxable activity. Typically businesses are required to register for VAT when the value of their taxable supplies exceeds a particular threshold in a given jurisdiction an enterprise must be carried on by an organisation in order for it to be eligible to register for VAT.
- c) Products become liable to excise duty (eg. fuel tax) as they are manufactured or imported. However, the excise duty liability can be suspended whilst they are stored or processed in an approved excise (tax) warehouse. It may be stored there indefinitely until moved. The liability from there is dependent on the market of consumption and the method of movement. Excise duty generally becomes chargeable at the time goods are sold and removed from the supplier premise and sold on to the end user. The supplier will normally account and pay the excise duty to the relevant tax authorities while the cost will be passed on to the end customer. There are a number of excise duty exemption (eg. fuel tax credit) that may be applicable subject to the end use of the product.

Section 2

What does the local landscape look like?

Section 2

What does the local landscape look like?

- South Africa has been a WTO member since 1 January 1995. The South African valuation system is based on the WTO valuation agreement with some variations. Generally, the customs value is determined by reference to the price of the goods at the place of export, with prescribed addition such as certain royalties and license fees. The legislation also provides for the exclusion of certain costs such as post-importation charges. Other methods of valuing goods exist depending on a number of factors including, where the sale of goods takes place relevant to the importation of goods and whether the relationship between the parties has affected the price of the goods.
- South Africa has submitted bound rates to the WTO (i.e., maximum duty rates), and duty rates may fluctuate within this range depending on the amount of protection required by local industry. Duty rates on the majority of products range between 0% and 20%, but there are products with much higher rates (textiles and clothing industry – 45%).
- Excise duties are limited to certain products (alcohol, tobacco, mineral products, chemicals and products of the chemical industry). Increases are typically announced annually in February when South Africa's National Budget is tabled in Parliament. Generally, the duty on alcoholic and tobacco products is increased every year.
- Value-Added Tax (VAT) was introduced in South Africa in 1991. The International Monetary Fund (IMF) supported the introduction of a VAT system. To find a suitable VAT system for South Africa, the South African Government launched a study into the VAT systems in use elsewhere in the world, particularly in Europe and New Zealand. The studies resulted in the introduction of a broad base, invoice based VAT system, largely based on the New Zealand Goods and Services Tax (GST). The South African VAT system aims to tax final domestic consumption and is a destination based system.
- South Africa's penalty system varies from less serious offenses (so called administrative offenses) to more serious offenses. The penalty regime for more serious offenses includes penalties of up to three times the value of the goods, with the possibility of forfeiture of up to once the value in addition thereto.
- The most common forms of business taxpayers in South Africa are companies, partnerships, trusts and Closed Corporations (CC). Companies are treated as taxable entities. A company is defined in the South African income tax legislation to include any body or association (other than a partnership) whether incorporated or unincorporated.

Section 3

Quality of response

Section 3

Quality of response

Key Areas	
Foreword	<ul style="list-style-type: none"> ■ The lack of current detail in respect of the envisaged legal structure and supply chains may have had an effect on the quality of responses from the Candidate in respect of providing sufficient certainty in the responses.
Summary	<ul style="list-style-type: none"> ■ The Candidate report is well structure with a number of sections and sub-sections relevant to the indirect tax considerations of the SKA project which answer the RFI brief in general i.e. brief and succinct responses. ■ The Candidate report lacks practicality and although covers a number of specific indirect tax issues / opportunities which are pertinent to the SKA project, there is little or no contextual references (i.e. the impact to the SKA project) and typically it does not provide certainty in respect of key aspects of indirect tax. However, the Candidate report in respect of the additional satellite countries does provide an appendices which details appropriate customs requirements in respect of goods being export from South Africa to the relevant satellite country. ■ There is evidence that the South Africa government and the African Union are working towards the introduction of favourable taxation status for the SKA project in relation to customs and excise duties, however this looks like it is in its early stages and cannot be guaranteed. ■ As a direct result of the above, there is still uncertainty as to the impact of the indirect tax regime and the tax treatment to be afforded to the SKA project which requires further dialogue, clarification and consideration without which there could be significant material risk and exposure for the SKA project.
Key Comments	<ul style="list-style-type: none"> ■ The Candidate report acknowledges that SKA's status for GST and other taxes is dependent on its legal status in Australia but does not expand on the GST implications of different legal options, which could if not fully considered lead to a material exposure e.g. GST becoming a sticking tax for the SKA project. ■ Given the many multi-jurisdictions involved with the Candidate the complexity of the indirect tax considerations has increased with each jurisdiction. The considerations and potential impact of this appears to be limited to the movement of goods directly between South Africa and the relevant satellite country rather than third countries and does not consider the other complexities that this raises. ■ Consideration is limited in terms of the practices, processes and procedures that must be put in place to ensure compliance and secure an optimum tax position which may hinder the set-up and could impact the SKA project during its life time.

Section 3

Quality of response – Comments (cont.)


Key Areas	
Omissions	<ul style="list-style-type: none"> ■ The Candidate report focus has been limited to the initial phase of the project and not from an on-going perspective. ■ The potential impact of the commercial registration issues have not fully considered, in particular the potential impact. ■ Alternative customs reliefs have not been considered. ■ The Excise duty position has not been fully considered.
Risks & Impact Identification	<ul style="list-style-type: none"> ■ There is a substantial material risk that the SKA project may not be able to recover VAT in South Africa and potentially the satellite countries unless further consideration and understanding is provided. ■ The position in terms of the SKA projects exposure to customs duty needs further clarification, consideration and quantification. ■ Further clarification in respect of the potential impact of Excise duty, such as fuel tax, is required. ■ Although the Candidate report focuses on South African and considers the satellite country indirect tax issues it does sufficiently clarify the potential complexities of the full impact of a multi-jurisdictional indirect tax environment in relation to the response.
Practicality	<ul style="list-style-type: none"> ■ Candidate report lacks practical input and consideration, is typically generic in its responses and does not provide any certainty in respect of the indirect tax treatment in the different phases of the SKA project.

Section 4

General high level comments

Section 4

General high level comments – VAT overview


Priority	Risk / Opportunity	Impact	Recommendations
1	VAT overview		
 High	<p>Candidate report states that a non-profit company operating under the SKA project will have to register for VAT and may have to levy VAT at 14% on the funds it receives.</p> <p>This statement is not considered in the context of whether the entity will be carrying on an enterprise within the scope of South African VAT.</p> <p>VAT (both import and VAT charged on domestic purchases) is recoverable only to the extent that:</p> <ul style="list-style-type: none"> ■ A business is VAT registered; ■ It holds the required evidence to support the claim; and ■ The goods/services are to be used by the business in making taxable supplies. <p>Taxable supplies are defined as a supplies made in the course or furtherance of an enterprise carried on by the business.</p> <p>An enterprise is defined as any activity continuously or regularly carried on in, or partly in South Africa, whereby goods and services are supplied to another person for a consideration.</p>	<p>Should the SKA entity not be considered to be carrying on an enterprise within the scope of South African VAT, import VAT at 14% will represent an absolute cost to the project unless specific exemptions can mitigate this cost.</p> <p>This cost would be borne at the outset and for the life of the project in respect to ongoing operation costs.</p>	<p>Analysis by the candidate of the VAT registration edibility criteria and consideration of how operations may be structured to maximise VAT recovery or mitigate the potential VAT cost across all relevant jurisdictions.</p> <p>Further consideration by the Candidate of the considerations of ongoing VAT implications in light of above analysis.</p> <p>Additionally, analysis by the candidate of the recoverability of VAT incurred in satellite countries and consideration of the optimal structure to minimise VAT costs.</p>

The detailed findings and recommendations set out in this section have been prioritised in the form of a strategic plan as follows:

- High priority for Candidate to address.
- Medium priority for Candidate to address.
- Lower priority for Candidate to address.


Section 4

General high level comments – VAT overview (cont.)

Priority	Risk / Opportunity	Impact	Recommendations
1	VAT overview (cont.)		
 High	<p>Candidate report states that imports are subject to VAT at 14% unless a specific exemption applies. It goes on to describe two such exemptions and expands on the possibility of negotiating an overall exemption for the SKA with the National Treasury.</p> <p>Candidate report fails to highlight the special valuation rules for imports for VAT purposes. Furthermore the report makes no reference to any potential VAT regimes (e.g. a deferment scheme) to mitigate the cash flow impact of import VAT.</p> <p>Candidate report makes no reference to the VAT implications of ongoing costs relating to the project, including maintenance and eventual decommissioning of the project.</p> <p>Candidate report fails to comment on the recoverability of VAT incurred on imports into satellite countries. The Aurecon report does little more than confirm the rate of VAT applicable on imports. There is no reference to ongoing costs in satellite countries or the VAT implications arising.</p>	<p>Furthermore, VAT incurred on domestic purchases will also represent an absolute cost (at 14%) if the SKA entity is not eligible to register for VAT.</p> <p>Should the SKA entity be unable to recover VAT it incurs in the satellite countries, there will be an additional cost in each country.</p>	


Section 4

General High Level Comments – VAT general administration

Priority	Risk / Opportunity	Impact	Recommendations
2	VAT general administration		
 Low	Candidate response contains no information regarding: <ul style="list-style-type: none"> ■ Frequency of returns; ■ Payment requirements; ■ Fiscal representatives for overseas entities; ■ Additional reporting requirements; ■ Reputational implications for non-compliance; ■ Penalties for non-compliance; and ■ The cost associated with maintaining a good level of compliance with the tax authority. Furthermore there is no indication of the tax authority's approach/attitude to compliance 	Likely no material financial impact; an issue of understanding compliance requirements and developing suitable processes to mitigate against penalties, managing the relationship with SARS and factoring in the ongoing costs involved in doing so.	Determination by Candidate of exact requirements and cost of compliance.


Section 4

General High Level Comments – Import process

Priority	Risk / Opportunity	Impact	Recommendations
3	Import process		
 Low	<p>Candidate report makes reference to electronic submission of customs declarations in some of the relevant jurisdictions but not all and the degree and nature of the electronic submissions are unclear in some instances. This suggests that the declaration process and procedures vary across the relevant jurisdictions which could give rise to increased administration costs and processing time – leading ultimately potentially to an increased supply chain lead time.</p> <p>Although an attachment provides an overview of the documentation requirements in each of the Candidates proposed jurisdictions that have to accompany the goods, the report does not provide in relation to South Africa a general understanding and practical details of the prospective processes, unlike the satellite countries.</p> <p>In addition to the above, the report does not highlight sufficiently the key national requirements for South Africa that the SKA project would have to consider in terms of registration / reporting requirements that could hinder / benefit the project.</p>	<p>No / minimal material impact. Issue is one of processes and procedures.</p> <p>It is unclear at this time if prompt customs clearance is available across the geographical reach of the Candidates jurisdictions.</p> <p>There are considerations in respect to a layer of complexity that the number of satellites countries involved would add in terms of registration / administration requirements.</p> <p>Prior authorisation / registration must generally be obtained before imports can take place in a number of the satellites countries which would need to be put in place in relevant jurisdictions.</p>	<p>Seek clarification from the Candidate with regards to its national import / export process and associated requirements.</p> <p>This clarification should include details of:</p> <ol style="list-style-type: none"> 1) The local declarative obligations; 2) The local registration process along with any local advantage / simplification that may be available eg pre customs clearance; 3) Clarification on whether its non commercial status will have an impact on the registration / authorisation process. 4) Typical likely costs.


Section 4

General High Level Comments – Customs duty

Priority	Risk / Opportunity	Impact	Recommendations
4a	Customs duty		
<p> High</p>	<p><i>Customs duty – Tariff classification</i></p> <p>The Candidate report stipulates that “from the information that has been provided, the majority of the goods that will be imported into South Africa for the SKA project are free of duty”.</p> <p>In addition of the above, the Candidate site states that “The Southern African Customs Union shares an external tariff. The import tariffs in the member states (South Africa, Botswana, Namibia, Lesotho and Swaziland) are, therefore, the same.”</p> <p>Although it is reasonable to envisage that some of the goods to be imported in South Africa and its satellites countries will not be the subject to positive rate of customs duty upon importation, it is conceivable that some of the products will however be the subject to a positive customs duty rate, which could be up to 30 percent of their value (based on the rates provided by the Candidate attachment e.g. Botswana).</p> <p>A number of the satellites countries do not share a common customs Tariff and therefore may impose differing customs duty rates. In addition, some of South Africa’s neighbouring countries impose additional tax levies e.g. an Import Declaration Fee.</p> <p>The Candidate report does not clearly specify on whether the non imposition of customs duty is subject to the SKA project obtaining customs duty rebates or based on the product tariff classification.</p>	<p>Customs duty is an <u>irrecoverable tax</u> levied at the time products are imported into South Africa or the relevant satellite countries.</p> <p>The financial impact of customs duty could be significant as it represents an absolute cost potentially of between 0 to 30 percent of the value of goods imported.</p> <p>It is therefore potentially a material tax that has a direct impact throughout the lifetime of the project on any goods being imported whether directly by SKA or indeed a third party associated to the project as these costs are likely to be passed directly on in the cost of any goods i.e. hidden duty not directly incurred by SKA.</p>	<p>Obtain further clarification from the Candidate, following; (a) the “Letter of Commitment” from the Ministry of Trade and Industry in South Africa and (b) the “Decision to Support” from the African Union, confirmation and clarity in respect of the potential for an exemption from customs duties on any goods (finished, component or raw material) to be imported in relation to the SKA project e.g. a project concession across all relevant jurisdictions.</p>


Section 4

General High Level Comments – Customs duty

	Priority	Risk / Opportunity	Impact	Recommendations
4		Customs Duty (cont)		
	 High	<p><i>Customs Duty - Customs Duty Relief</i></p> <p>The Candidate report states that “in order to simplify administration and further facilitate the SKA, Government has begun a consultative process to investigate the creation of a special rebate facility (...) to provide for a full rebate of duty for all goods imported by the SKA project.”</p> <p>In support of the above, the Candidate report makes reference to case studies of previous large projects in South Africa which have been accorded special status with regard to customs and excise duties e.g. FIFA World Cup 2010. However, this facilitation make not be applicable elsewhere outside of South Africa.</p> <p>Aside from this the Candidate report states that South Africa’s customs legislation provides for a number of customs duty rebates. The report mentions a number of specific examples such as the temporary importation of machinery or plant (excluding tower cranes) along with the importation of household products. Although the SKA project may benefit from some of the above mentioned, the Candidate report only focuses on temporary importation of product and does not envisage other options and also does not mention any specific relief for scientific instruments and apparatus.</p> <p>In addition to the above, the report does not provide practical insights on whether a specific legal structure would compromise the benefit of any such concessions or reliefs.</p> <p>Finally, the Candidate report does not make reference to any alternative customs relief and / or procedure with economic impact that may be relevant to the SKA project e.g. customs warehouse, end use relief etc...</p>	<p>There is a high chance that a number of products to be imported will not benefit from this tariff exemption and will therefore potentially create a material cost.</p> <p>The multi-jurisdictional nature of the SKA project needs to considered in this respect.</p> <p>By ignoring any alternative customs relief with economic impact from the response, that may be applicable to the project, could financially hinder the SKA project.</p>	<p>Obtain update from Candidate site on the status of the consultative process initiated by the Government to create a special rebate for the SKA project.</p> <p>Obtain clarification from Candidate Site on whether the SKA project could benefit, in all jurisdictions, from customs duty relief by way of major project rebate.</p> <p>Obtain clarification on the ability of any rebate to the project to other entities involved in the SKA project e.g. third party suppliers.</p> <p>Seek clarification from the Candidate with respect of alternative customs procedures (along with requirements), in addition to the above, that could be used to mitigate any duty liability if goods do not qualify for a concession or as scientific apparatus, e.g. customs warehouse, temporary admission.</p>
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Section 4

General High Level Comments – Customs duty (cont.)

Priority	Risk / Opportunity	Impact	Recommendations
4b	Customs duty (cont.)		
<p> High</p>	<p><i>Customs Duty – Free Trade Agreement</i></p> <p>The Candidate report states that : “<i>The Trade, Development and Cooperation Agreement with the European Commission, the South African Development Community Agreement and the South African Customs Union Agreement with the European Free Trade Association provide the opportunity for preferential rates of duties on imported goods originating in those jurisdictions.</i>”</p> <p>Such bilateral or multilateral trade agreements signed by two or more countries generally reduce or eliminate tariffs, import quotas, and preferences on most (if not all) goods and services traded between them. The origin of goods is important as the FTA would only apply to goods originating from and to signatories parties of the FTA. Specific rules with regards to a specific percentage of value added on a product or place of last substantial transformation would need to be determine at product level. It is unclear currently exactly which origin and trade between which countries would benefit from these reduced customs duties without further analysis.</p> <p>Candidate report highlights at a high level the documentary requirements for the eligibility for preferential treatment e.g. certificate of origin, invoice declaration etc.</p> <p>A number of South Africa satellites countries i.e. Ghana and Kenya are not members of the economic grouping to which South Africa has assented.</p> <p>26 African countries have agreed to establish a free trade area between them. Phase one of its implementation is due to come into effect in three years.</p>	<p>FTAs for a project of this size would generally be a secondary source of concession after being granted a project rebate.</p> <p>There could be a material impact should the preferential rates of duties not materialise e.g. not meeting the FTAs requirements and other reliefs or concessions are not available. This would however only impact goods with an origin within the FTA countries.</p> <p>The risk and complexity of dealing with multiple countries some of which are subject to FTA agreements and some potentially not is that goods originating in one jurisdiction may not concur FTA status within another and therefore be subject to a higher rate of customs duty.</p>	<p>Analysis by the Candidate of the potential scope of duty mitigation that this may provide.</p> <p>Determination by Candidate jurisdiction of documentary evidence requirements under the FTAs and the process for obtaining any FTA relief.</p> <p>Seek clarification from Candidate on discussion progress with regards to the new FTA under discussion and on the potential date of provisional entry in force of the new FTA and the likely scope of applicability.</p>


Section 4

General High Level Comments – Excise duty

Priority	Risk / Opportunity	Impact	Recommendations
5	Excise duty		
 Medium	<p>It is unclear if the report has envisaged and detailed the full impact of excise duty on the project during its entire lifetime e.g. on the number of vehicles / generators to be used for the construction and maintenance of the project rather than just the potential for any excise duty payable upon importation.</p> <p>Excise duty has been mentioned in some of the satellites countries e.g. Mauritius, which it is being suggested could levy excise duty on certain types of goods.</p> <p>The Candidate report is silent in certain areas and certain aspects in relation to excise duties and therefore it is unclear in respect of for example local fuel tax / electricity tax potential costs associated with the consumption of fuel commodities.</p>	<p>Excise duty could represent a material impact as fuel tax could be levied on fuel used to propel the vehicles during the lifetime of the project and potentially on other use.</p> <p>Excise duty could be a significant ongoing costs that will apply over the project lifetime and therefore any mitigation could have a be beneficial impact.</p>	<p>Obtain confirmation and clarification from Candidate of the potential for excise duties including any post importation e.g. fuel tax rate from the Candidate.</p> <p>Seek clarification from Candidate site on whether fuel tax rebate would be available for the SKA project e.g. fuel use on off road vehicles, fuel used to generate electricity along with a detailed description of the attached conditions eg. legal structure required, declarative requirements.</p>

Section 4

General High Level Comments – Import restrictions /export restrictions

Priority	Risk / Opportunity	Impact	Recommendations
6	Import restrictions /export restrictions		
<p> Medium</p>	<p>Candidate report state that <i>“from the information that has been provided, there will be no import or export restrictions that will apply during the construction and operation of the SKA except in respect of those goods having dual purpose capabilities as provided for in the Non Proliferation of Weapons of Mass Destruction Act, 1993”</i>.</p> <p>The Candidate report does not provide examples of products that may fall under these above mentioned restrictions. In addition the Candidate report does not advise on the process to follow and conditions should the SKA needs to import any of these products should they fall under any restriction.</p> <p>Import restrictions are generally imposed on a limited number of prohibited and restricted goods such as certain chemicals, weapons and radioactive substances for example.</p> <p>Generally, countries worldwide impose export restrictions for more advanced electronic integrated circuits and products with encryption technology. Some of these products may be controlled and the subject of export licence requirements when the goods leave the local country e.g. The US. The more advanced the product is the higher the risk is that it may be controlled by the originating country.</p>	<p>Goods will typically not receive Customs clearance unless the relevant permit is obtained and presented, therefore it could potentially restrict the flow of certain technology out of or into a relevant jurisdictions.</p> <p>Typically, this is likely to be more of a procedural impact, requiring assessment and implementation of relevant policies, statements and procedures to be implemented.</p> <p>Contravention of relevant export / import controls could give rise to substantial fines and penalties.</p>	<p>Identify with the Candidate what determination has been undertaken to suggest that no restrictions apply.</p> <p>Examine what consideration has been given to origin export control requirements in the statement made e.g. US export control laws.</p> <p>Determination by Candidate Site of exact requirements for the approval to be obtained, the process required, costs and timescales.</p> <p>Whether any consideration has been given to intangibles and the potential restrictions on information, data etc being transferred into and out of the jurisdictions.</p>



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