

**THE IMPACT OF THE AMENDMENTS TO THE VAT ACT IN RESPECT OF INDIRECT
EXPORT TRANSACTIONS BY ROAD OR RAIL**

by

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DECLARATION

I, Zunique Cindy Sieberts, hereby declare that this dissertation is my own unaided work. It is being submitted in partial fulfilment of the prerequisites for the degree of Master's in Tax Law at the University of Pretoria. It has not been submitted before for any degree or examination in any other University.

Zunique Cindy Sieberts

3 November 2014

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CONTENTS

CHAPTER 1	1
INTRODUCTION AND PROBLEM STATEMENT	1
1.1 BACKGROUND.....	1
1.2 PROBLEM STATEMENT.....	3
1.3 RESEARCH OBJECTIVES.....	4
1.4 SIGNIFICANCE OF THE RESEARCH.....	5
1.5 ETHICAL CONSIDERATION.....	5
1.6 RESEARCH METHODOLOGY.....	5
1.7 DATA COLLECTION AND ANALYSIS.....	6
1.8 LIMITATION	6
1.9 SUMMARY	7
CHAPTER 2.....	8
VAT AND CUSTOMS MEDLEY	8
2.1 INTRODUCTION.....	8
2.2 RELATIONSHIP BETWEEN VAT AND CUSTOMS.....	8
2.3 VAT, A SELF-ASSESSED TAX.....	12
2.4 CUSTOMS, A SELF-ASSESSED TAX.....	15
2.5 SUMMARY	16
CHAPTER 3.....	18
VAT TREATMENT OF INDIRECT EXPORTS - THE OLD REGIME	18
3.1 INTRODUCTION.....	18
3.2 LEGISLATIVE FORCE BEHIND INDIRECT EXPORTS PRIOR TO MAY 2014..	18
3.3 A CATCH-22-SITUATION FOR VENDORS.....	25
3.4 SUMMARY	35
CHAPTER 4.....	37
VAT ON INDIRECT EXPORTS – THE NEW REGIME.....	37
4.1 INTRODUCTION.....	37
4.2 NEW EXPORT REGULATIONS – breath of fresh air	38
4.3 ROLES AND RESPONSIBILITIES	42

4.4	THE INFLUENCE OF THE TAX ADMINISTRATION ACT, 2011	53
4.5	CONCLUSION	54
CHAPTER 5.....		56
THE CUSTOMS MODERNISATION PROGRAMME AND IMPACT THEREOF		56
5.1	INTRODUCTION.....	56
5.2	THE CUSTOMS MODERNISATION PROGRAMME – What is it all about?	57
5.3	SOME OF THE SUCCESSES OF THE CUSTOMS MODERNISATION JOURNEY TO DATE	60
5.4	THE CUSTOMS CONTROL ACT, 2014.....	71
5.5	CONCLUSION	73

CHAPTER 1

INTRODUCTION AND PROBLEM STATEMENT

1.1 BACKGROUND

Value-added tax (VAT) was introduced in South African law on Monday, 30 September 1991 through the promulgation of the VAT Act¹. Since then, taxable supplies include supplies for which VAT is charged at either the standard-rate or zero-rate, but does not include exempt supplies.

In terms of the VAT Act, VAT on exported goods is normally charged at a standard rate (14%) or zero-rate (0%). The export of goods from the Republic of South Africa (the Republic) to any destination, including the Southern African Customs Union (SACU)² countries and the Southern African Development Community (SADC)³ countries are divided into one of two types of exports, namely, direct and indirect exports. Vendors⁴ were allowed prior to 2 May 2014 to zero-rate indirect exports transactions on condition that all the necessary requirements are met in terms of the law. In addition to the preceding requirement it was important that such exports may only be effected via sea or air freight.

The tax proposals contained in the 2012 Budget Review, which was delivered on Wednesday, 22 February 2012 by the then Minister of Finance, Pravin Gordhan, highlighted a number of VAT amendments, in particular the cross-border movements of goods. He stated that the policy, legislation and administration of VAT on indirect exports of goods by road will be reviewed in order to ensure exporters are not prejudiced and the *fiscus* continues

¹ Value-Added Tax Act No. 89 of 1991.

² An agreement that allows for the unrestricted flow of goods and services, and the sharing of customs and excise revenue between South Africa, Botswana, Namibia, Lesotho and Swaziland.

³ It is an inter-governmental organisation. Its goal is to further socio-economic cooperation and integration as well as political and security cooperation among 15 Southern African states. It complements the role of the African Union.

⁴ It is defined in section 1 of the VAT Act as any person who is or is required to be registered for VAT purposes under the VAT Act.

to be protected against potential abuse.⁵ The VAT Export Incentive Scheme (the Scheme)⁶ has been updated during May 2014 as a result of that Budget announcement⁷.

Indirect exports are regulated by the Scheme and Part One thereof refers to instances where a purchaser takes possession of goods in the Republic and thereafter exports the goods. As a general rule, the supplier of goods has to levy 14% VAT where the goods are to be exported by the purchaser. In this instance the qualifying purchaser is entitled to claim the VAT back as a refund from the VAT Refund Administrator (VRA)⁸, provided that the requirements set out in the Scheme are complied with.

Part Two of the Scheme creates an exception to the above general rule where a supplier may elect to zero-rate the supply of goods that will be exported by a qualifying purchaser. In order for this exception to apply, goods must, amongst other requirements, be exported by sea or air and the supplier must ensure that the goods are delivered at a designated commercial port, that is, a harbour or airport designated for commercial transactions. Prior to 2 May 2014, the VAT Act did not make provision to zero-rate export transactions in cases where goods are exported by road or rail by the supplier.

The new Export Regulations⁹ make provision for a vendor to elect to supply movable goods to a qualifying purchaser at a zero rate where the qualifying purchaser exports the goods by road or rail subject to certain requirements.

⁵ The Budget Speech, 22 February 2012.

⁶ Value-Added Tax Export Incentive Scheme published in Government Notice 2761 in Government *Gazette* No. 19471 of 13 November 1998.

⁷ South African Revenue Service: Tax Proposals Budget 2012 Regulation.

⁸ VAT Refund Administrator is a private company that is appointed by the Commissioner to administer the refund of tax in terms of Part One of the Export Incentive Scheme.

⁹ Published in Government Notice R.316 in Government *Gazette* No. 37580 of 2 May 2014.

1.2 PROBLEM STATEMENT

The main aim for the proposed VAT amendments was to review the policy, legislation and administration of the VAT treatment of indirect exports of goods by road and rail. This study is based on the following two objectives:

- 1.2.1 The first is to analyse the Export Regulation following the 2012 Budget announcement that the VAT treatment of indirect exports by road and rail will be reviewed.
- 1.2.2 The second is to establish whether the South African Revenue Service (SARS) has adequate resources at land border posts, taking into account the Customs Modernisation Initiative.

Gerhard Badenhorst's thinking in *TaxTalk Issue 34* (2012), is that–

*the current regulations in respect of these exports were introduced in 1998 mainly to combat round-tripping of goods which were supposedly exported, but were sold locally at great loss of VAT and Excise Duties to the fiscus. The question is whether these regulations are required at the expense of local suppliers and South Africa's foreign trade, or whether SARS officials should rather tighten up its enforcement to reduce or eliminate the round-tripping of goods.*¹⁰

Furthermore, Redge de Swart commented on the then draft Regulation as follows:

*SARS is to clarify the practical VAT implications and administration of the cross-border movement of goods. Actions will be taken to encourage trade whilst also preventing the leakage of tax collections. The VAT Amendments were raised in the Tax Proposal, Budget 2012. The Draft Export Regulation was reviewed and published for public comment. Currently it is not clear when the Draft Export Regulation will become effective, therefore, it is important for vendors to comply with current laws until it is withdrawn.*¹¹

¹⁰ Badenhorst, G (TaxTalk Issue 34). 2012. Posted by SAIT Technical. Unlocking the budget speech 2012: A closer look at VAT budget proposals.

¹¹ De Swart, R. 2012. Comment on personal and corporate tax changes.

The tax proposals¹² further made reference to the fact that VAT amendments are vital in order to ensure that exporters are not prejudiced and that the *fiscus* continues to be protected against potential abuses.

According to the VAT 404¹³, the then draft export Regulation makes reference to new documentary requirements, further circumstances under which the zero rate may be applied and a new discretion for the Commissioner to condone the late submission of a VAT refund application under specific circumstances.

Clifford Watson (Grant Thornton: 2013) stated the following:

*SARS has also proposed the Draft Export Incentive Scheme to relax the indirect export rules to also include exports via road and rail at the zero-rate. Unfortunately, this is not all good news. All the relaxations in the rules come with a number of additional and demanding requirements which should be adhered to avoid penalties and sanctions.*¹⁴

In view of the above, it is considered necessary to perform an analysis of the VAT amendments by means of exploratory research. This is to determine whether there could be any potential problems by means of practical implementation of these amendments from a VAT and customs perspective.

1.3 RESEARCH OBJECTIVES

The research objectives for this study are–

- 1.3.1 to analyse the Export Incentive Scheme following the 2012 Budget announcement that the VAT treatment of indirect exports by road and rail will be reviewed. VAT can be regarded as factual in nature and when something new is introduced in law, the question of practical implementation will remain a serious concern; and
- 1.3.2 to establish whether SARS has adequate resources at land border posts, taking into account the Customs Modernisation Initiative. The Minister emphasised that

¹² South African Revenue Service: Tax Proposals Budget 2012 Regulation.

¹³ Value-Added Tax, Guide for Vendors 2013, issued 15 March 2013.

¹⁴ Watson, C (Grant Thornton). 2013. Proposed relaxation of VAT export rules not all good news.

the envisaged amendments are to ensure that exporters are treated fairly and that the *fiscus* is protected from potential abusers.

1.4 SIGNIFICANCE OF THE RESEARCH

South Africa conducts significant trade in Africa with large volumes transported by road or rail, and VAT has become an unintended burden for exporters when indirect exports come into play. Gerhard Badenhorst indicated that the “review of the regulation is welcomed as it will certainly assist to reduce the trade barriers with neighbouring countries” (TaxTalk Issue 34:2012)¹⁵.

In view of the draft export Regulation, and having regard to the current circumstances at land border posts, a study of this nature is important in order to establish whether potential shortcomings exist which might hinder the practical implementation thereof. The amendments will have an impact on both VAT and customs laws and SARS’s readiness to accommodate the change, could be a concern to both the administration and the exporters.

1.5 ETHICAL CONSIDERATION

There were no ethical issues to consider for this study, as it is a pure tax-related study and does not have any bearing on ethical issues.

1.6 RESEARCH METHODOLOGY

The research methodology followed in this study is theoretical, exploratory and investigative in nature. The study has been conducted by utilising the following tools:

- Electronic messaging (email);
- Online university library facilities;
- Academic textbooks;
- Telephonic communications; and
- the internet.

¹⁵ Badenhorst, G (TaxTalk Issue 34). 2012. Posted by SAIT Technical. Unlocking the budget speech 2012: A closer look at VAT budget proposals.

1.7 DATA COLLECTION AND ANALYSIS

The study has been conducted by means of exploratory research relating to all relevant laws of the Republic. The research has been done by using the internet and obtaining information from the online university library facility of the University of Pretoria (the UP).

Relevant data and information have been obtained via email and telephonic discussions with the respective participants with regard to the VAT Act amendments relevant to the indirect exports transaction that is conducted by road and rail.

An analysis of all available theoretical information applicable on the research study has been done.

1.8 LIMITATION

The Draft Export Regulation was published for public comment to be submitted before or on 31 January 2013. However, while the research for the studies had been done, it was not available to the public as it had been retracted from the SARS website. Furthermore, it was finalised and implemented with effect from 2 May 2014, which was before this study has been completed.

The challenge it produced, is that the writer had to change viewpoints in the middle of the study and reconsider some of the results obtained from the initial research done.

In addition, the scope of this study excludes the following:

- 1.8.1 Comparative study of other countries' VAT legislation relevant to indirect exports by road or rail;
- 1.8.2 certain definitions in order to broaden the scope of persons who are able to obtain a VAT refund; and
- 1.8.3 the relevant changes to the procedure for claiming a VAT refund.

1.9 SUMMARY

As South Africa is striving to become more globally competitive, the changes are aimed at ensuring greater fairness in the tax system. However, it is important to note that, because something new is introduced into South African law, potential shortcomings with regard to practical implementation could be a concern in the VAT and Customs spheres.

CHAPTER 2

VAT AND CUSTOMS MEDLEY

2.1 INTRODUCTION

The VAT and Customs “legs” of SARS are impacted by direct and indirect export transactions. One of the key functions of customs is to control and facilitate all goods that are imported into or exported from the Republic. Some of these transactions do not only attract customs duties, but also VAT.

The aim of this chapter is to illustrate that a relationship exist between VAT and customs. Furthermore, this chapter will also highlight an administrative common feature between these two tax types.

2.2 RELATIONSHIP BETWEEN VAT AND CUSTOMS

One of the principles of the South African VAT system is that VAT at the standard rate is imposed when moveable goods which are supplied to or imported into the Republic. This confirms the rationale that VAT is a destination-based tax. VAT at the zero rate may be applied by a South African vendor when movable goods are exported, provided that satisfactory proof of export can be furnished. Thus, customs involvement is required when dealing with VAT transactions relevant to imports and exports. This gives rise that these two taxes are interdependent as the one cannot operate without the other when dealing with imports and exports.

Section 7(1)(b) of the VAT Act governs the imposition of VAT on cross-border import transactions and states the following:

Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax—

(b) on the importation of any goods into the Republic by any person on or after the commencement date; and calculated at the rate of 14 per cent on the value of the supply concerned or the importation, as the case may be.

In addition to section 7(1)(b), section 7(2) governs the liability of the importer regarding VAT when imported goods are brought into the Republic.

Section 13 of the VAT Act provides for the collection of VAT on the importation of goods, the determination of the value of such goods and the exemption of tax. Customs and Excise levies and collects VAT on goods imported from countries outside¹⁶ SACU. VAT becomes payable at the time those goods are entered for home consumption under the Customs and Excise Act, 1964¹⁷ and usually takes place when the goods physically enter the Republic. It is important that both sections 7(1)(b) and 13 of the VAT Act be read together and therefore, cannot be dealt with in isolation.

Section 13(6) of the VAT Act creates that distinct connection between VAT and customs and confirms that the provisions of the 1964 Act to the extent that it is not in conflict with the provisions of section 7(1)(b) and section 13 of the VAT Act, and shall apply *mutatis mutandis* as if contained in the VAT Act. Thus, the provisions in the 1964 Act relating to penalties, interest, transit and clearance of goods, for example, are also applicable to the collection of VAT on importation.

Furthermore, it can also be interpreted that where conflict exists between these two taxes, section 13(6) of the VAT Act implies that the VAT Act will take preference with regard to payment of VAT. It is important to note that the reasoning for using Customs to administer and collect the VAT payable on importation is based on the fact that they control the movement of goods into the Republic and customs officials are stationed at the borders.

Based on the above, it is evident that a distinct *nexus* has been created by law to cater for VAT and customs transactions relating to the importation of goods into the Republic. However, these findings give rise to the following question: “What is the relation between VAT and customs relating to the exportation of goods?”

¹⁶ Countries other than Botswana, Lesotho, Namibia and Swaziland.

¹⁷ Customs and Excise Act No. 91 of 1964.

The Customs and Excise Act, 1964 caters for both customs and excise matters. As indicated, the fiscal objective of this Act is to ensure that the correct duty is paid on all goods which enter the Republic for consumption.

In South Africa goods are classified according to the Harmonised Commodity and Coding System on Tariffs and Trade¹⁸. This is an international classification system under the World Customs Organisation (WCO) that has its origin in the Brussels, Belgium. The specific classification determines what the rate of duty is for a specific commodity upon its importation into the Republic and whether it attracts additional duties or levies.

The scope and purpose of the Customs and Excise Act, 1964 in relation to exports is, according to its long title, that it confirms the control of certain goods exported; and for matters incidental thereto. Thus, the control of goods leaving the Republic is considered one of the core functions of customs.

Key economic decisions are based on trade statistics and, therefore, it is imperative that SARS accurately records export performance. This is reinforced by section 117 of the Customs and Excise Act, 1964, which requires that the Commissioner should compile and tabulate statistics relating to all the imports and exports and publish those in a manner as the Minister of Finance may direct. This information is in turn used by commercial banks, the South African Reserve Bank and other similar entities in making crucial economic decisions.

As VAT is effectively a tax on expenditure in the domestic economy, the export of goods or services from the Republic does not generally attract VAT as such exports are zero-rated.

The VAT Act is not clear on the treatment between VAT and customs relevant to exports and there is no express VAT legislative force for relying on the provisions of the Customs and Excise Act, 1964. Evidently the 1964 Act is also silent with regard to the VAT involvement on the exportation of goods.

¹⁸Client Segments, Customs and Excise, Tariff (2014). www.sars.gov.za.

In an email discussion with Mr X, a senior SARS official¹⁹, he pointed out that–

In the secondary legislation, that is, the Regulations, SARS includes concepts from the Customs Act²⁰ as this regulates the movement of goods outside the country. This also makes the VAT rules more acceptable as the processes and documentation required for exporting goods is not something new but rather something that has to be done for purposes of the Customs Act.

In terms of section 3 of the South African Revenue Service Act, 1997 (the SARS Act)²¹, SARS's objective is the efficient and effective collection of revenue. Furthermore, section 4(1)(a) of the SARS Act also states that, in order for SARS to achieve its objective, SARS must secure the efficient and effective, and widest possible enforcement of national legislation listed in the Schedule²² and any other legislation²³ concerning the collection of revenue that may be assigned to SARS in terms of either legislation or an agreement between SARS and the organ of state or institution entitled to the revenue.

According to the preceding paragraph SARS must ensure the widest possible enforcement of primary legislation, such as, but not limited to the VAT Act and the Customs and Excise Act, 1964. This provision will include any regulation, for example, the new export Regulation.

The SARS Act allows for the VAT Act to extend its boundaries when dealing with export transactions. Thus, an inference may be drawn that the use of customs export procedures relating to VAT export transactions are justified in terms of section 4 of the SARS Act.

¹⁹ The real name of the official is withheld on his request. Mr X is a Senior SARS Official in the Legal and Policy Division: Indirect Taxes (further details and email address available on request).

²⁰ Referring to the Customs and Excise Act No. 91 of 1964.

²¹ South African Revenue Service Act No. 34 of 1997.

²² Section 4(1)(a)(i).

²³ Section 4(1)(a)(ii).

2.3 VAT, A SELF-ASSESSED TAX

A significant characteristic of the VAT system is that this tax is essentially self-assessed and the submission of the returns by a vendor constitutes an original self-assessment of the tax liability. The vendor himself calculates the tax to be paid or refunded by SARS.

Kriegler J, who delivered the unanimous judgment of the Constitutional Court, confirmed in *Metcash Trading Limited v Commissioner for the South African Revenue Service and Another*²⁴ that VAT, quite unlike income tax, does not give rise to a liability only once an assessment has been made. Kriegler J, further stressed that VAT is a multi-stage tax; it arises continuously. Moreover, VAT vendors or taxpayers bear the ongoing obligation to keep the requisite records, to make periodic calculations of the balance of output totals over and above deductible input totals (and any other permissible deductibles) and to pay such balances over to the *fiscus*. It is therefore a multi-stage tax system with both continuous self-assessment and predetermined periodic reporting or paying.

Furthermore, in *Engelbrecht v The State*²⁵ the Supreme Court of Appeal concurred with the above Constitutional judgment and held that–

It was clear from a reading of the VAT Act that it was essentially a system of self-assessment, in that the responsibility to calculate, deduct and pay over the correct value-added tax lies solely with the vendor and, invariably, SARS was bound to rely on the honesty and integrity of vendors to calculate and pay the correct amount of VAT, moreover, it will not be feasible or cost-effective for SARS on its own to try and verify each and every transaction by each and every vendor and it was therefore of critical importance that all relevant documentation be properly completed.

The Vendor Declaration (VAT 201) is a declaration which must be completed and submitted to SARS at the end of every tax period by a registered vendor. Various provisions in the VAT Act prescribe the applicable VAT periods, how the VAT 201 must be completed, and

²⁴ 2001 (1) BCLR 1 (CC) pages 9 to 10.

²⁵ 2011 (SCA) 74 SATC pages 161 and 163.

the time frames of completion. The VAT 201 reflects the VAT charged by a vendor on supplies (or situations where you are otherwise liable to declare output tax), and the deductible amounts relating to input tax. The difference between these amounts for a specific tax period could either result in a vendor having to pay the difference to SARS, or the vendor may be entitled to a refund of the difference. Vendors are still required to submit a VAT 201 by the due date, notwithstanding the fact that there is no payment required for the tax period.

According to the VAT 404 Guide for Vendors²⁶, the fact that there are often refunds under the VAT system and that it is a self-assessed system, makes it tempting for vendors to overstate input tax or to under-declare output tax. SARS, therefore, places great importance on identifying high risk cases, conducting regular compliance visits and promoting a high level of visibility of auditors in the field.

A vendor must indicate the supply of goods and/or services in section A of the VAT 201, “The Calculation of Output Tax and Imported Services”. A prominent feature of the VAT 201 is that zero-rated supplies relating to exported goods which have been zero-rated, must be disclosed separately from all other zero-rated supplies. This change came into effect during 2010. Vendors are required to distinguish between the value of zero-rated exports and other zero-rated supplies.

The VAT Act further indicates that the Commissioner may take action and raise assessments if returns due are not forthcoming or if dissatisfied with a return that has been submitted. Currently, section 31(1) provides for various grounds on which SARS may assess tax payable. In particular, section 31(1)(f) refers to any person who creates an impression that he is entitled to a VAT refund. This section further refers to the extent that this person would perform with regard to the submission of documentation in order to obtain an undue tax benefit or refund under the provisions of the Scheme. In essence, if the above grounds are present, the Commissioner may make an assessment of the amount of tax payable.

²⁶ VAT 404 Guide for Vendors, 5 May 2014.

On 1 October 2012, the Tax Administration Act, 2011 (Act 28 of 2011)²⁷ became South African law²⁸. The underlying principle of Act 28 of 2011 is that it further amplifies SARS's overall fiscal objective. One of the most important factors is that Act 28 of 2011 essentially applies to a broad spectrum of South African tax legislation, in particular the VAT Act. It has a direct impact on the administrative principles of the VAT Act. However, it does not apply to the provisions of the Customs and Excise Act, 1964, unless it is expressly indicated in Act 28 of 2011 that a particular provision applies in respect of customs or excise matters.

Tax legislation consists mainly of two aspects, namely tax liability (including charging provisions) and tax administration provisions. According to SARS's Short Guide to the Tax Administration Act, 2011²⁹, Act 28 of 2011 only deals with tax administration and its objective is to incorporate into one piece of legislation all administrative provisions that are generic to all the tax Acts. In addition it also aims to remove redundant administrative provisions and to harmonise the provisions as far as possible.

Section 1 of Act 28 of 2011 defines "self-assessment" as a determination of the amount of tax payable under a tax Act by a taxpayer. In section 1, paragraph (a) further implies that a self-assessment includes the submission of a return by a taxpayer which incorporates the determination of the tax; or paragraph (b) if no return is required when making a payment of tax. With a self-assessment tax, the taxpayer calculates the amount of tax that must be paid or refunded, and these amounts must be contained in that return. The return filed, therefore, is regarded as the original assessment which is effectively made by the taxpayer. For example, when a vendor files a VAT 201, the original assessment is regarded as the return that is filed. The same principle applies for employees' tax. If no return is needed but a taxpayer has to calculate what amount to pay, then the act of making payment is regarded as the original assessment.

Returns are regarded as legal and binding documents which constitute a declaration made to SARS. Thus, the duty is on the vendor to complete a return with the utmost care as he

²⁷ Tax Administration Act No. 28 of 2011.

²⁸ Proclamation No. 51 of 2012, published in *Government Gazette* 35687 on 14 September 2012.

²⁹ Short Guide to the Tax Administration Act, 2011 (Act No. 28 of 2011).

can be held liable for penalties and interest if there are errors which may lead to any shortfall in VAT paid.

2.4 CUSTOMS, A SELF-ASSESSED TAX

The earlier Customs and Excise coat of arms used to reflect *colligimus et custodimus*, which means “we collect and protect”. Customs and Excise plays an important role in the South African economy as its objective is to collect duty on goods which enter the Republic for home consumption and protect our borders and local industries. Most importantly, Customs protects the *fiscus* against potential abusers by providing the interface between the domestic and broader global economy. Customs and Excise plays a key role in facilitating legitimate trade and protecting the economy and society by clamping down on illegal and unfair trade practices.

According to Cronjé’s Customs and Excise Service,³⁰ the administration of Customs and Excise is mainly a system of self-accounting and self-assessment. Thus, it appears to require for its efficient and effective functioning, that those participating in activities regulated by the Customs and Excise Act, 1964, must exercise the necessary care in ensuring that they are *au fait* with and duly comply with the relevant provisions.

Any goods imported into or exported from the Republic, must be accurately declared to Customs. Declarations are made on various customs forms³¹, which are applicable to different customs transactions. In terms of section 1 of the 1964 Act, the definition of “bill of entry” states that it includes any SAD³² form. When dealing with exports from the Republic, one of the main forms an exporter is required to accurately complete is the Customs declaration, form SAD 500.

The rules for section 97 of the Customs and Excise Act, 1964, are general in character and place a duty on any person dealing with any customs office concerning the clearance of goods or any other official business that they must be conversant with the requirements of

³⁰ My Lexis Nexis Library, Commentary on the Customs & Excise Act, HC Cronje, March 1998.

³¹ GNR.1874 of 8 December 1995: Rules (Government Gazette No. R.16860) Arrangement of Rules, Forms.

³²Also known as the Single Administrative Document.

the administration. They also have to be able to reply to questions the Controller may ask or furnish information the Controller may require. In some instances the Controller may demand the personal attendance of a person or a principal in connection with an official matter.

Where errors are detected by Customs or false declarations are made, whether duties were payable or not, the 1964 Act provides for penalties to be introduced and even forfeiture³³ of the goods. It is important to note that different penal provisions in terms of the 1964 Act apply to different contraventions that might have been committed by the customs client. For example, the applicable penalty provision in cases of intentional transgressions, or failure to make due entry, or the completion of a false declaration would be under sections 80(1)(c), 83(a) and 84(1), respectively, depending on the circumstances. In instances of fraud, offenders may also be prosecuted. Thus, it is important for customs clients to be compliant with all relevant customs laws in order not to experience the full brunt of the law.

2.5 SUMMARY

The State not only has a fiscal, but also an economic interest in all duties levied or exempted on goods or services imported into or exported from the Republic. Evasion of duty in any form (i.e. smuggling, false invoicing or abuse of relief privileges, diversion of goods that are in transit or intended for export and then diverted for consumption in the Republic), would naturally be detrimental to the fiscal and economic interest of the State. It would also result in unfair competition. Thus, all the customs and tax laws are attempting to protect the *fiscus*.

Unlike income tax, both VAT and customs are self-assessed taxes, as parties are responsible for submitting valid and accurate declarations (Forms VAT 201 and SAD 500) without a request from SARS. Thus, the principle that was confirmed in the Engelbrecht case, *supra*, is that it is of paramount importance that, when dealing with a tax type that is self-assessed driven, the relevant documentation be completed with the utmost care and precision by the responsible person.

³³Section 88 of the Customs and Excise Act, 1964.

In essence, it is clear that no express VAT or customs legislative provision exists which marries the two tax types with regard to VAT export transactions. Therefore, the implied interpretation would suffice in this instance.

Chapter 3 focuses on the way the previous regime³⁴ handled VAT transactions in respect of indirect exports. It also illustrates the importance of why the need for change had been necessary.

³⁴Value-Added Tax Export Incentive Scheme.

CHAPTER 3

VAT TREATMENT OF INDIRECT EXPORTS - THE OLD REGIME

3.1 INTRODUCTION

The VAT treatment of an indirect export transaction remains a contentious topic to all vendors who are making supplies destined for export. In practice, when a consumer purchases goods or services from a vendor in South Africa, the price the consumer pays includes VAT. VAT is a type of indirect tax³⁵ and a direct cost to the final consumer as he cannot claim back the amount from SARS. An exception to this rule would be if an enterprise is registered as a VAT vendor. Then he/she may claim the VAT paid from SARS.

In terms of the VAT Act, VAT on exported goods is usually charged at a standard rate (14%) or a zero rate (0%). An exporter has to distinguish between two types of exports, namely, direct and indirect exports when exporting goods from the Republic to any destination. The previous regime, that is, prior to May 2014, allowed for vendors to zero rate indirect export transactions on the condition that all the necessary requirements are met in terms of the law. At the same time, it was a requirement that such goods could only be exported *via* sea or air.

This chapter illustrates the functioning of the previous Value-Added Tax Export Incentive Scheme³⁶ and highlights the reasons as to why certain provisions had to be revisited as indicated in the Tax Proposals³⁷.

3.2 LEGISLATIVE FORCE BEHIND INDIRECT EXPORTS PRIOR TO MAY 2014

VAT is levied in terms of the VAT Act and was originally levied at 10%. However, this rate was increased on 7 April 1993 to 14%. The supplier must pay the tax over to SARS, whilst the user pays VAT to the supplier when goods or services are acquired. According to Tax

³⁵ Means that the tax is not assessed directly by SARS, but indirectly through the taxation of transactions.

³⁶ Published as Notice 2761 of 1998 in Government Gazette No. 19471 of 13 November 1998.

³⁷ South African Revenue Service: Tax Proposals Budget 2012 Regulation.

Statistics 2013,³⁸ VAT was the largest source of revenue in the category of domestic taxes on goods and services³⁹ at 72.4% in 2012/13 fiscal year. In essence, VAT is a broad-based tax on the consumption of goods and services in South Africa. Therefore, any goods or services consumed outside the Republic do not attract VAT.

The VAT Act provides for two types of supplies, namely, taxable supplies and exempt supplies.

Essentially, taxable supplies encompass the following two VAT rates:

- 14% known as the standard rate; and
- 0% known as the zero rate.

Contrary to taxable supplies, exempt supplies are expressly excluded from VAT by section 12 of the VAT Act and therefore, unlike either standard-rated or zero-rated supplies, exempt supplies are not taxable activities. Consequently, a vendor making an exempt supply cannot claim a deduction of any input incurred on his purchases.

The term standard-rated supply is not defined in the VAT Act and it is commonly used in countries operating VAT systems and refers to those supplies that are taxable at the general rate under VAT.

However, when a standard-rated supply is made, VAT must be charged at the prescribed rate of 14%, as this amount constitutes the suppliers output tax. In addition, section 1 of the VAT Act defines output tax as the tax charged under section 7(1)(a) of the VAT Act by a vendor on taxable supplies of goods or services made by him in the course and furtherance of his enterprise during the relevant tax period.

On the other hand, when a zero-rated supply is made, VAT must be charged at 0% and the supplies charged at the zero rate are taxable supplies, even though charged with VAT at 0%. The supplier of zero-rated supplies is nevertheless making taxable supplies and may claim an input tax deduction for his allowable inputs.

³⁸ Tax Statistics, 2013, jointly prepared by National Treasury and SARS.

³⁹ Means VAT, Specific Excise Duties, *Ad valorem* excise duties, Fuel levy, and Universal Services Fund levy, Turnover tax on micro businesses and Environmental taxes.

In terms of the VAT Act input tax⁴⁰ is only claimed insofar as the supplies are utilised for the purpose of making taxable supplies in the course and furtherance of the enterprise. In essence, the amount of VAT payable by the vendor or refundable to the vendor is calculated by subtracting the VAT paid to suppliers (input tax) from the VAT charged on supplies made (output tax).

Example 1

ABC (Pty) Ltd, (the vendor) is a company duly registered in terms of the laws of the Republic. The vendor is a wholesaler in dried fruit and nuts (the goods) which is supplied and exported to various clients in neighboring countries, that is, Lesotho and Namibia.

For all intents and purposes it is assumed for this example that all requirements are met as required by law.

	Charge	14%	
	Excluding VAT	Tax	Credit
Input: Dried fruit & nuts	3 500	490	490
Output: Export Sale	1 000	NIL	
Local Sale	2 000	280	
Total: Output tax	280		
Less: Input Tax	(490)		
Net refund due to the vendor	210		

The provisions of section 7(1) of the VAT Act imply that every supply of goods or services by a vendor is subject to VAT at the standard rate, unless an exemption or exception applies thereto. The zero-rating provision in section 11 of the VAT Act is an exception to the charging section⁴¹.

The term “exported” as referred to in section 11(1)(a) is defined in the VAT Act in section 1, *inter alia*, as follows:

⁴⁰ It is when a vendor buys goods or services from another supplier, then VAT is charged on the purchase price.

⁴¹ Section 7(1)(a) of the VAT Act.

“exported”, in relation to any movable goods supplied by any vendor under a sale of instalment credit agreement, means –

- (a) Consigned or delivered by the vendor to the recipient at an address in an export country as evidenced by documentary proof acceptable to the Commissioner; or*
- (b) ...*
- (c) ...*
- (d) removed from the Republic by the recipient for conveyance to an export country, in accordance with the provisions of an export incentive scheme approved by the Minister.*

With reference to the term “*exported*” above, it is important to note that paragraph (a) may be classified as a direct export and paragraph (d) as an indirect export and both paragraphs apply to movable goods.

It is important to distinguish between direct and indirect exports. A vendor could export goods via road and rail and still qualify for a zero rating in the case of direct exports. However, this would mean that the vendor must physically deliver the goods by using either his own transport, or by engaging a supplier’s cartage contractor, who is contractually liable to the vendor to effect delivery of the goods on the vendor’s behalf. Furthermore, the vendor must be liable for the full cost relating to such delivery. Indirect exports provide for an election and could be classified as a standard-rated or a zero-rated supply and, it is only limited to air and sea freight. Hence, for purposes of this discussion emphasis is placed on indirect exports.

As indicated earlier, the general rule created by section 7(1) of the VAT Act implies that a supply of goods and services shall be subject to 14% VAT. Section 11(1)(a)(ii) read with paragraph (d) of the definition of “*exported*” in section 1 of the VAT Act is relevant to indirect export transactions. This section serves as an exception to the above general rule and it implies the following:

- The vendor will be allowed for a zero percent rate.
- The supply of movable goods was concluded through a sale or installment credit agreement. This forms the legal basis of the transaction.

- The moveable goods must be removed from the Republic by the recipient in accordance with the provisions of Part Two of the Scheme.
- Part Two of the Scheme requires for the goods to be delivered to harbour or airport.
- All requirements must be met in terms of section 11(3) of the VAT Act, where the vendor is required to “obtain and retain” such documentary proof substantiating the vendors’ entitlement to apply the said rate under the applicable provision.

It is important to note that the *proviso* created for in this section⁴² clearly states that–

- if the goods were supplied to a recipient in the Republic in a way other than what is required by law such supply shall be standard-rated; and
- the recipient shall be entitled to a tax refund where the goods have been removed from the Republic by the recipient in accordance with the provisions of Scheme as envisaged by paragraph (d) of the definition of “exported” in section 1.

In instances where a recipient is in a refund position, section 44(9) of the VAT Act provides that the Commissioner may make or authorise a refund of any amount of tax which has become refundable under the provisions of the Scheme referred to in paragraph (d) of the definition of “exported” in section 1. The essence of section 44(9) is to cater for those indirect exports which were standard-rated, and allows the foreign purchaser to claim back the VAT he/she paid on such a supply from the VRA.

A VAT refund is only considered where all of the following requirements are met:⁴³

- The purchaser must be a qualifying purchaser.⁴⁴
- The goods must be exported within 90 days from the date of the tax invoice.
- The VAT inclusive total of all purchases exported at one time must exceed the minimum of R250.
- The request for a refund, together with the relevant documentation, must be received by the VRA within three months of the date of export.

⁴² Section 11(1)(a)(ii)(aa) and (bb) of the VAT Act.

⁴³ Guide for Vendors, VAT404, 12 March 2012.

⁴⁴ Includes a non-resident, tourist, foreign enterprise or foreign diplomat.

- The goods must be exported through one of the 43 designated commercial ports by the qualifying purchaser or the qualifying purchaser’s cartage contractor.⁴⁵

In view of the preceding paragraph, it is important to note that the VRA is not present at all designated commercial ports. Therefore, the qualifying purchaser must apply in writing to the VRA for the refund. This would mean that additional documentation must be submitted and this places an increased administrative burden on the qualifying purchaser when he has to substantiate his claim.

Apart from the previous discussed provisions created in terms of the VAT Act, a vendor also has to take cognisance of section 11(3), which is equally an important section. This section states that –

Where a rate of zero per cent has been applied by any vendor under the provisions of this section, the vendor shall obtain and retain such documentary proof substantiating the vendor’s entitlement to apply the said rate under those provisions as is acceptable to the Commissioner.

(own underlining)

The above section is obligatory and the vendor has no choice but to comply with it. Furthermore, it is important to note that the provisions of section 11(1) and (2) of the VAT Act are subject to the obligation created in section 11(3) of the VAT Act. Thus, these sections are interrelated and cannot be applied in isolation.

Section 11(3) of the VAT Act imposes an obligation on the vendor and it can be divided into five parts, namely–

- **“Shall”** - In terms of the rules of interpretation, a statutory provision that requires exact compliance, is peremptory. However, case law has shown that the word “shall”, can also be directory in certain instances. According to Botha (2005)⁴⁶ a word with an imperative or affirmative character indicates a peremptory provision.

⁴⁵ This is a person who is registered as a vendor in terms of the VAT Act and transport is his/her main activity. This person is acting on behalf of the qualifying purchaser for consideration in money to transport and deliver the movable goods to the recipient at an export country. This includes couriers and freight forwarders.

⁴⁶ Botha C (2005) Statutory Interpretation: An introduction for students: Juta.

In *S v Takaendesa*⁴⁷ the court held that where a statute prescribes a condition precedent to doing something, that condition is usually obligatory rather than directory. A condition precedent is defined as something that must be done before an official agreement can become law. The full compliance with the relevant procedure will be a condition precedent to the completion of the transaction⁴⁸. Thus, failure to comply with the prescribed conditions of section 11(3) of the VAT Act will result in a supply being standard-rated.

- **“Obtain”** – The words “obtain” and “retain” are not defined by the VAT Act. However, the Oxford Dictionary⁴⁹ defines “obtain” as to come into the possession of, to procure; to get, acquire, to gain or secure. The Scheme sets out the time frame in which such documentation must be acquired.
- **“Retain”** is defined in terms of the Oxford Dictionary⁵⁰ as the action or fact of retaining or keeping hold of someone or something; retention. The Scheme sets out the time frame a vendor is obliged to keep the required documentation.
- **“Documentary proof”**– It is important to note that when dealing with indirect export transactions, Interpretation Note 31⁵¹ redirects you to the Scheme which sets out the documentary proof acceptable to the Commissioner.
- **“Acceptable to the Commissioner”** – The test in this instance is subjective as the documentation provided must prove to the satisfaction of the Commissioner that the goods have indeed left the Republic.

The documentary proof in the case where the standard rate (14%) was elected to be applied to an indirect export transaction consists out of the following:

- The original tax invoice.
- A copy of the qualifying purchaser’s passport or in case of a foreign enterprise a copy of the trading licence. In addition, a letter of authorisation and a copy of the persons passport who granted the authorisation letter.

⁴⁷ 1972 4 SA 72 (RA).

⁴⁸ Cambridge Dictionaries Online, British English.

⁴⁹ Oxford English Dictionary, Online University Press.

⁵⁰ *Ibid*

⁵¹ Dated 31 March 2005, Documentary proof required for the zero-rating of goods and services, Part One.

- The invoice between the qualifying purchaser and the cartage contractor.
- Proof that the qualifying purchaser declared the importation of the goods for customs purposes in the export country.

The documentary proof in the case where the zero rate (0%) was elected to be applied to an indirect export transaction consists out of the following:

- A zero-rated tax invoice.
- The contract between both parties in order to prove the legal basis for the transaction.
- All relevant export documentation as prescribed by the Customs and Excise Act, 1964. These documents differ depending on the mode of transport.
- A bill of lading⁵² to confirm the export by sea and airway bill to confirm export by air.
- The qualifying purchaser's passport or trading licence.
- Proof of payment in instances where a contractor was used.

Clearly section 11(3) of the VAT Act umbrellas the entire zero-rating provision. Thus, the vendor is obliged to obtain and keep adequate documentary proof in cases where a supply has been zero-rated by the vendor. It is clear that a myriad of documentation is required in order to satisfy the Commissioner that the provisions relating to indirect exports have been correctly applied. Consequently, if the vendor is unable to honour this obligation, the supply will ultimately be treated as a standard-rated supply as envisaged by section 64(1) of the VAT Act.

3.3 A CATCH-22-SITUATION FOR VENDORS

After May 2014 vendors were faced by the issue whether to zero-rate a supply which is destined to be exported to a foreign country or not on a daily basis. It is clear that when a vendor made a business decision to be involved in export transactions, professional advice were always required as it is beneficial for business.

⁵² It is a receipt of goods delivered to and received by a ship, signed by the person who contracts to carry them, or his agent, normally the master of the ship, and stating the terms of the contract of carriage under which the goods have been so delivered and received, Dictionary of Legal Words and Phrases, Lexis Nexis, (2014).

On the other hand, in the case where a vendor has chosen not to apply the zero rate in an export transaction, he would be facing the risk of losing business opportunities which could be detrimental for his business.

3.3.1 The provisions of the previous scheme

The Scheme in terms of the provisions of paragraph (d) of the definition of “exported” in section 1 of the VAT Act came into operation during 1998 and was specifically enacted to cater for indirect export transactions.

The Scheme is divided into two parts. Part One is relevant to a supply of goods that is not exported by the South African vendor; such supply was subject to VAT at a standard rate. Part Two on the other hand created an option where the South African vendor could choose to zero rate or standard rate a supply. In the event where a vendor elected the zero-rated option, the application of Part Two of the Scheme became relevant and such goods were only limited to be exported *via* air and sea freight.

Evidently, the qualification of vendors for a tax relief during this regime⁵³ was not all moonshine and roses as the Scheme did not only create rights but also responsibilities. For example, if the vendor has elected the zero-rated option in respect of an export supply, the following were accepted as facts:

- He accepted the responsibility to ensure that the movable goods have been delivered to any of the designated harbours or airports. According to a website article by Thornton G (2009)⁵⁴, it is indicated that the full risk rests with the supplier if he selected the zero-rated option.
- He must ensure that the person he is doing business with is a qualifying purchaser as prescribed by the Scheme.
- He further accepts that he would be responsible in obtaining and retaining all Customs export documentation as required by the Customs and Excise Act, 1964. Well-argued authority in this regard can be found in section 11(3) of the VAT Act read with the Scheme.

⁵³ VAT treatment on indirect exports pre May 2014.

⁵⁴ Thornton G, e-VATline. 2009. Zero-rated supplies = unlimited risks.

Thornton (2009)⁵⁵ added on by saying that zero-rated supplies require strict control as it is an essential part of all destination-based VAT systems. He stated that the heart of zero-rated supplies lies in the fact that the vendor would still be entitled to a full input tax credit on costs incurred to make the supplies. He went on by saying that, from a regulatory perspective, zero-rated supplies represent a high tax avoidance risk. It is therefore understandable that SARS requires VAT vendors to exercise strict control over zero-rated supplies.

The requirements created in Part Two of the Scheme are absolute. Apart from establishing that there were indeed a supply⁵⁶ during an indirect export transaction, one must also take cognisance of the qualifying words, “transported *via* air and sea” in the heading of Part Two of the Scheme. This may be construed as the departure point in order to qualify for this tax relief. Therefore it is important for exported goods to be tested against this criterion. Sea or ocean freight, as well as air freight transportation, is regarded as the more refined form of transport over road and rail, hence the inclusion thereof in the Scheme.

The special features present in air and sea transport were highlighted in a blog article written by Mr Mandaadiar H, (2013)⁵⁷. He stated that the two key factors relevant to air freight are the speed and safety features. Air freight is the front runner in comparison to any other means of transport when it comes to the speed of delivery of goods. The risks are minimal as the handling, storing, securing of freight and airport regulations and processes are very high level. He also mentioned that being the fastest and safest mode of freight does come with a price as this is the most expensive type of delivery a person can choose.

The speed and safety factors are important, however, any seller has to be careful not to overstretch his budget as there would be no profit that will defeat the purpose of running a business. Another important factor is the capacity of air freight as the cargo space on an

⁵⁵ *Ibid.*

⁵⁶ The term “supply” is widely defined in the VAT Act to include transactional performance under any sale, rental agreement, and instalment credit agreement. It also includes all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and includes any derivative of the term.

⁵⁷ Manaadiar H, (2013), Shipping and Freight resources, *Ocean Freight vs. Air Freight*, web blog.

airplane is significantly smaller. This would mean that the commodity's size is an important factor that all suppliers or buyers must consider.

According to Mandaadiar ocean freight is one of the cheapest ways of transport and therefore the exact opposite from air freight. This is why most companies would opt for this type of transport. He emphasized that cargo ships can carry really massive amounts of cargo and the fact that the shape or size of cargo is not an issue, are the biggest advantages. The fact that it overall would be at a lesser cost, is also an advantage. However, when it comes to speed and reliability, ocean freight is clearly not the front runner. Ships are incredibly slow and they have a lot of distance to cover, which can take months to deliver an item. In addition, there is always the possibility that consignments could be delayed or even damaged.

It is clear that when a supplier elected the zero-rating option in terms of Part Two of the Scheme, he directly commits himself to the realities attributable by these modes of transport. Thus, he needs to be mindful regarding the advantages and disadvantages of air and sea freight in order to achieve the best possible outcome for its business.

Furthermore, Part Two of the Scheme created a duty on suppliers, as they have to be fully conversant in both VAT and customs practices and the underlying obligation created by the relevant legislation. In the case of non-compliance, the Commissioner may, depending on the circumstances, impose penalties⁵⁸, interest⁵⁹ and additional tax.⁶⁰ This would definitely not be welcomed by a vendor as it will have a negative impact on business profits.

Thornton (2009)⁶¹ made reference to the classification of exports and highlighted that the essential difference between direct and indirect exports relates to when the risks and

⁵⁸ In terms of section 39(1)(a) of the VAT Act, a 10% penalty will be imposed on the total adjustments for the late payment of VAT. Note that this section has been repealed by the Tax Administration Act of 2011.

⁵⁹ Interest is levied on the total adjustments in terms of section 39 (1)(a) at the prescribed rate as envisaged by the VAT Act. Note that this section has been repealed by the Tax Administration Act of 2011.

⁶⁰ In terms of section 60 of the VAT Act. Note that this section has been repealed by the Tax Administration Act of 2011.

⁶¹ Thornton G, e-VATline. 2009. Zero-rated supplies = unlimited risks.

rewards of ownership regarding the goods are passed. He stated that for direct exports, risks and rewards are passed only once the goods have left South Africa. Regarding indirect exports, risks and rewards are passed in South Africa. He further stated that the correct classification of direct and indirect exports is critical as the VAT risks associated with each category vary significantly.

In case a vendor made the decision not to zero-rate an export supply, such goods cannot be zero-rated and the normal standard rate will apply. This will result in an administrative nightmare for the qualifying purchaser as he would have to submit all relevant VRA documentation at the border in order to claim the VAT back on the transaction. Diane Seccombe, Mazars (2014) stated the following:

Many foreign purchasers have proved unwilling to pay the 14% VAT triggered by an indirect export of goods by road and rail, and suffer the administrative inconvenience of obtaining a VAT refund from the VRA. Fears over possible cash-flow consequences should the refund be delayed are often cited as a further reason despite proven efficiency by the VRA. This unwillingness has translated into lost sales for the supplying vendors⁶².

It is important to note that not all indirect export transactions could qualify as a zero-rated supply as envisaged by the VAT Act read together with the Scheme. This was mainly due to the choice that was available in Part Two of the Scheme as vendors could elect whether to charge 14% or 0% for an indirect export supply.

According to an email discussion with Mr X (2014),⁶³ the choice that was created by Part Two of the Scheme is very important as the supplier is the one that carries the risk. The supplier is therefore liable for the tax if unable to provide sufficient evidence that the goods were exported. He further stated that, in case there was no choice available to the supplier, it could then be argued that the law forces them to zero-rate supplies. The effect of this is

⁶² Seccombe, D (Mazars). 2014. SA TaxGuide. VAT Regulations open Africa for SA business. (This article made its first appearance in the May/June edition of Tax Talk.)

⁶³ Mr X, Senior SARS Official in the Legal and Policy Division: Indirect Taxes.

that they cannot do anything if they do not receive the required documents after the sale. The zero-rating would be based on the customer sending the supplier all the relevant customs documents after the goods have left the country. He further highlighted that this would create problems for SARS when trying to assess the supplier for goods not “exported” or for maintaining insufficient documentation.

It can be argued that the choice was purposely created by the Commissioner in order to mitigate the risk factor as there was always the possibility that the goods might not leave South Africa. Thus, an inference can be drawn that the Commissioner was aware of the inadequate customs controls which existed at land borders hence the exclusion of road and rail from the tax relief.

3.3.2 The fiscal effect in respect of 2012/2013 tax year

The purpose of the imposition of a VAT zero rate was to provide tax relief on certain merited goods and services. VAT refunds occur when a vendor’s input tax exceeds its output tax. This occurs when zero-rated supplies are made during the exportation of goods. Input tax can be claimed for purposes of making such supply but there will be no output tax to set off against the input tax. Therefore, zero-rating is regarded as the most beneficial form of VAT treatment.

The Tax Statistics⁶⁴ for the 2012/2013 fiscal year⁶⁵ state that the net VAT growth of 12,6% against the previous year resulted from a 10,0% increase in VAT payments and a 9,4% increase in import VAT. However, this was weakened by the 6% increase in VAT refunds.

The Tax Statistics, 2013⁶⁶, further makes reference to the fact that only 0,6% of vendors were in the mining and quarrying sector. They have contributed 3,1% of the total gross domestic VAT payments for the 2012/2013 fiscal year. An interesting fact is that these vendors received 23,8% of VAT refunds. The extent of mineral exports (zero-rated sales) makes the mining and quarrying sector a negative contributor to net VAT.

⁶⁴ Tax Statistics, 2013, jointly prepared by National Treasury and SARS.

⁶⁵ It refers to the financial year of government, that is, from 1 April to 31 March of the subsequent year.

⁶⁶ *Ibid.*

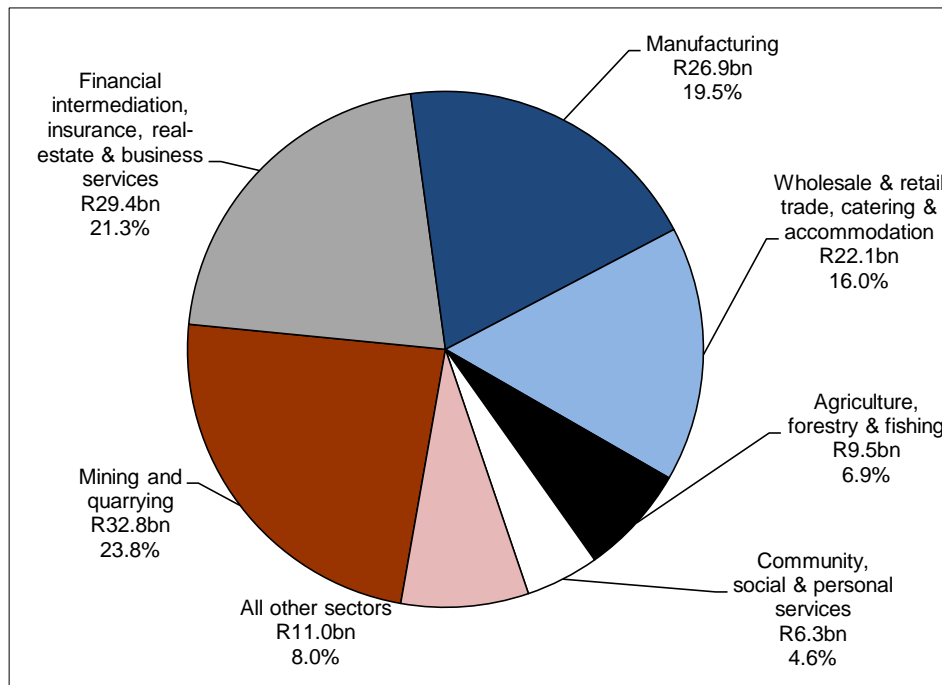


Figure 1: VAT refunds by economic activity, 2012/13 (Source: Tax Statistics 2012/2013FY jointly compiled by National Treasury and SARS).

Figure 1 indicates that the largest VAT refunds accrued to the mining and quarrying sector due to zero-rating of large volume of exports. The fiscal effect of a zero-rating transaction has far more serious consequences as revenue is minimised by the refunds. SARS has to ensure that the Government fund⁶⁷ is not depleted by unnecessary illegitimate refund transactions.

Regardless of the fact that 23,4 billion rand of refunds were paid out by SARS, VAT continued to make its appearance amongst the top three revenue taxes. This means personal income tax and corporate income tax comprising more than 80% of the total tax revenue collections. The statistics for the 2012/2013 fiscal year is testimony that continued protection is vital in order to prevent the abuse of VAT refunds.

⁶⁷ Refers to the Government fund of South Africa.

3.3.3 *Judicial decisions relating to cross-border transactions*

Case law has shown that cross-border trade transactions were not always as genuine as it was supposed to be, as the VAT system continues to be targeted by fraudsters. According to M Poverello, cross-border trade comprises of the following three distinct but inter-linked layers:⁶⁸

- An information layer which comprise out of various trade documentation, cargo and conveyance information, as well as the customs and government regulatory data that are exchanged between various supply chain entities and the customs authority. These primarily attest to the legal ownership, contract of carriage, reporting and compliance with customs and the other regulatory authority's formalities and delivery destination.
- A logistics layer relates to the collection, consolidation, sealing and conveyance of physical cargo from point of dispatch via at least two customs control points (that is export and import), to the validation *via* and delivery at the point of destination.
- A financial layer refers to the monetary exchange flow from the importer (buyer) to the exporter (seller) in accordance with the terms and conditions of the sale.

He further stated that all three layers are inter-linked and prone to risk at any point of a given transaction. It is a fallacy that Customs and Border Agencies will ever conquer cross-border crime, simply because there are too many angles to monitor, according to Mr Poverello. Additionally, in order to set up cross-border information exchange and joint enforcement operations, it is both legally and politically time-consuming. Criminal elements are not hampered by these institutions; they simply spot the loop holes and forge ahead.

In the Constitutional Court judgment *Metcash Trading Limited v C: SARS*⁶⁹, Kriegler J confirmed that a special feature of VAT relates to exports. VAT is payable only on consumption in South Africa and as a result output tax is not payable on goods sold and exported. In the arcane language of the Act, they are zero-rated in terms of section 11(1)(a) of the VAT Act. Therefore, a merchant who buys and sells goods in South Africa and also

⁶⁸ Poverello, M. (2013), What happened to the Portcullis? *A South African RFID/GPS cross-border logistics and customs solution*, web blog.

⁶⁹ 2001 (1) SA 1109 (CC) page 10.

sells some exported goods, does the periodic calculation by adding up all input taxes for deduction from the sum of output taxes. In calculating the latter, the merchant excludes no output tax on the value of the exports. No output tax is payable on the exported goods, but a full credit is given for the input tax. This exemption, which aims at promoting exports and enhancing their competitiveness in a world market, hold self-evident benefits for export-orientated vendors. Unfortunately those benefits not only attract honest exporters, but are a notorious magnet for criminals who would devise all types of schemes to exploit the system to their advantage.

In *Engelbrecht v The State*⁷⁰ the court dealt with the zero-rating of motor vehicles in terms of section 11(1)(a) of the VAT Act and the interpretation thereof. The issue before the court was whether and to what extent the Appellant had the knowledge of, and was involved in the fraudulent scheme. The Appellant worked as a sales manager for the vendor, Reeds Motors dealership. A scheme was set up to sell vehicles to a dealer, disguised as exports so that the dealer would not have to pay output VAT on the vehicles. The sales of the vehicles were zero-rated for VAT purposes by fraudulently stating that they were being exported from South Africa to Namibia. However, the sales actually took place in South Africa and should have been subjected to VAT at 14%. This resulted in SARS being defrauded of a significant amount.

The court held that the fraudulent activities were intended to defraud SARS of money in respect of VAT. It was clear from the evidence that the vehicles in question were supposed to be exported to Namibia and thus qualified to be zero-rated. However, the vehicles were never exported to the purchasers in Namibia indicated in the relevant documents. Instead, the vehicles were delivered to motor dealers in South Africa where they were taken into dealers stock locally. This arrangement was contrary to the invoices and purchase offers as the vehicles were then sold locally.

In addition, the court held that the Customs Control Area 1 (CCA1) forms had been used to facilitate this fraudulent scheme. The court further held that, in terms of section 11(1)(a) of the VAT Act, a registered vendor had the legal obligation to comply with the provisions of

⁷⁰2011 (SCA), 74 SATC 161, page 163.

the VAT Act. This would imply that the vendor was obliged to pay “output tax” in respect of all vehicles sold in South Africa. It was only when it sold its vehicles outside the country, that is, exported them, that it was exempted from paying output tax. In other words, it would be entitled to charge tax on the vehicles at the rate of 0%.

The court stated that it is clear that the VAT Act is essentially a system of self-assessment, in that the responsibility to calculate, deduct and pay over the correct value-added tax, lies solely with the vendor.

The court also stated that the appellant knowingly falsified the purchase offers and the tax invoices. The use of false CCA1 forms was clear proof that the Appellant acted unlawfully with clear intent to defraud, and his conduct met the definition of fraud; thus his convictions for fraud on all 157 counts were confirmed.

Another important reported case is the one between *SARS and another v ABSA and another*⁷¹, the question before the court was whether the bank was under duty to the Commissioner for SARS and to the Minister of Finance to avoid causing them pure economic loss by negligently opening and maintaining a bank account into which fraudulently obtained VAT refunds were paid and, shortly thereafter, withdrawn.

The facts of the case stated that during 1996 a fraudulent scheme had been devised and implemented on the Commissioner for SARS by certain persons who were of foreign origin. The fraud was planned and implemented by a South African registered Company A and its main business was general trading, importation and exportation of goods. Furthermore, a different existing Company B would pretend to supply certain high value but non-existent goods to Company A. The latter company would pretend to export the non-existent goods and the object of the fraudulent scheme was to claim a refund of VAT input tax in respect of the alleged supplies to them by Company B on the basis that Company A was allegedly exporting such goods and thus entitled to zero-rate the transaction in terms of section 11 of the VAT Act.

⁷¹ Commissioner for South African Revenue Service and another v ABSA Bank Ltd and another (2003 (2) SA 96 (WLD)) 65 SATC 220.

The scheme was fraudulent because no goods were in fact sold, no real transaction took place and, as a result there were no supplies in respect of which VAT was paid or payable in order for input tax to be claimed. Company A opened a current account with a commercial bank into which it deposited all the VAT refunds it received for the Commissioner for SARS. These were the only deposits made into the account and each deposit was followed within days by large withdrawals as cash or as cheques in favour of Company B pretending to supply goods for exports.

Van der Nest AJ, stated in his judgment that society's notion of justice demanded that a bank should not turn a blind eye to the possibility that a customer may be using an account for criminal purposes. He stated that society would not expect that a bank could stand back with impunity where large VAT refunds are received and large cash amounts withdrawn immediately, whilst to the knowledge of the bank, no genuine trading transactions had taken place on the account. The pattern of receipt of VAT refunds and the almost immediate withdrawal was a warning light that the refunds were being received and dealt with in a criminal manner.

The aforementioned case takes a different turn in respect of fraudulent VAT export transactions. However, it illustrates the level of skill and sophistication these VAT refund abusers possess. Furthermore, it is important to note that even though the Engelbrecht case relates to a direct export transaction, the principles established in this case will be equally applicable to any indirect export case. It is important to note that these cases further highlight the importance of Customs involvement during a VAT export transaction including the trade relationship between foreign countries, but most importantly, these cases also highlight the inadequacies present at land border posts.

These cases confirm the importance of South Africa's relationship with other export countries as SARS will not be able to eradicate fraud and corruption at the border posts on its own.

3.4 SUMMARY

Most of the supplies granted zero-rated status concerns the exportation of either goods or services or both. Therefore, a supply destined to be exported will have a negative impact on businesses in South Africa and the economy as a whole. Where these export supplies are

to be taxed at the normal rate, South African commodities would become uncompetitive in the international market place. Thus, the provisions of the previous Scheme created a trading barrier between South Africa and other foreign countries.

In essence, if the zero-rating provision is correctly applied to exported goods, such transaction will indeed attract VAT at a zero rate due to the destination-based principle of VAT. The effect of this is that it puts the vendor in a refund position which can be seen as an extreme risk for SARS. Therefore, it is vital that these transactions are not taken lightly, as fraudulent refund requests will erode revenue. On the other hand, it can be construed that vendors cannot zero-rate a supply as envisaged by Part Two of the Scheme where the required mode of transport is road or rail, due to the fact that Customs processes are not sufficiently monitored at land border posts.

One of the purposes of the introduction of the customs modernisation programme is the revamp of all customs controls, processes and procedures at all ports of entry. Furthermore, the intention is that those customs processes and procedures applicable at airports and harbours be implemented at land border posts as well.

It is evident that indirect export transactions during the previous regime encompassed a lot of advantages and disadvantages. Hence, it can be argued that, from a SARS enforcement perspective, customs involvement is crucial to ensure that exported goods actually leave the Republic in order to avoid that the vendor has a second bite at the cherry, which will ultimately put local markets under pressure.

The Scheme came into effect in 1998 and was replaced after 16 years in 2014 by the new Export Regulation. This development can be regarded as a breath of fresh air for cross-border traders, notwithstanding the fact that it still mirrors some provisions of the previous Scheme to a certain extent. In Chapter 4 the impact of the new Export Regulation will be discussed.

CHAPTER 4

VAT ON INDIRECT EXPORTS – THE NEW REGIME

4.1 INTRODUCTION

The tax proposals⁷² contained in the 2012 Budget Review delivered on Wednesday, 22 February 2012 by the then Minister of Finance, Pravin Gordhan, highlighted a number of proposed VAT amendments, in particular the cross-border movements of goods. He stated that the policy, legislation and administration of VAT on indirect exports of goods by road will be reviewed in order to ensure exporters are not prejudiced and that the *fiscus* continues to be protected against potential abuse.

Theron stated in a website article, *Fast VAT Facts*, that SARS acknowledged the important role that VAT will play in the future of South Africa and have invested heavily in human and technology based infrastructure to ensure that the tax base is not eroded by abuse or non-compliance.⁷³

The purpose of this Chapter is to provide a study of the VAT amendments relating to indirect export transactions relevant to road and rail. The aim is to identify any possible problem areas which may arise during practical implementation. In addition, it is important to note that the amendment came into effect on 2 May 2014. Therefore, limited literature has been published on this topic.

⁷² South African Revenue Service: Tax Proposals Budget 2012 Regulation.

⁷³ Theron, C. (2012) Moneywebtax, *Fast VAT Facts*.

4.2 NEW EXPORT REGULATIONS – BREATH OF FRESH AIR

Indirect exports are regulated by the Export Regulations⁷⁴ which came into effect on 2 May 2014. These Export Regulations substitute the Export Incentive Scheme⁷⁵ (the Scheme) in its entirety and are aimed to give effect to the following three E's:

- To “**enhance**” the processes and procedures relating to indirect exports;
- to “**encourage**” future trade with South African businesses; and
- to “**ensure**” compliance and continuous protection of the *fiscus*.

A SARS official stated in an email discussion⁷⁶ that–

the change to allow indirect exports by road and rail to be zero-rated was largely to facilitate trade with neighbouring African countries. Our model for exporting goods was aligned to the Customs modernisation programme which provides us with some certainty that once goods are declared for export, they are indeed exported and hence a low risk.

All VAT regulations are secondary legislation and are intended to expand on the legislative concepts and principles established in primary legislation. Under the new Export Regulations some significant changes have been made, but some provisions of the previous scheme are still mirrored to a certain extent.

The wording of the definition of “exported” in terms of paragraph (d) of section 1 of the VAT Act has been amended⁷⁷ in order to incorporate the Export Regulations. The definition is pretty much the same as the previous definition, but now provides that any movable goods supplied by any vendor is to be removed from South Africa by the recipient or the recipient’s agent for the conveyance to an export country in accordance with the new Export Regulations.

⁷⁴ Export Regulation published as Notice R.316 of 2014 in Government Gazette No. 37580 of 2 May 2014.

⁷⁵ Value-Added Tax Export Incentive Scheme published in Notice 2761 of 1998 in Government Gazette No. 19471 of 13 November 1998.

⁷⁶ Mr X. 2014. Senior SARS official in Legal and Policy: Indirect Taxes, email, 31 July 2014 (further details and email address available on request).

⁷⁷ Section 104 (1)(b) of the Revenue Laws Amendment Act No. 35 of 2007.

The Export Regulations consist out of the following three main parts:

Part One

This Part deals with the procedures which must be followed by a qualifying purchaser when the supplier has charged VAT at the standard rate on the supply of movable goods which will be exported from the Republic by the qualifying purchaser's cartage contractor. The qualifying purchaser is subsequently entitled to a refund of tax from the VRA subject to certain limitations or conditions contained in Part One.

Part Two

This Part deals with the procedures for the supplier who elects to supply movable goods at the zero rate and is split into the following:

- Section A deals mainly with the procedures for goods that are initially delivered to one of the designated harbours or airports or are supplied by means of a pipeline or an electrical transmission line in the Republic before being exported; and
- Section B deals mainly with the procedures for goods that are exported by road or rail through a designated commercial port.

Part Three

This Part deals with the various time periods within which movable goods must be exported from the Republic, the party responsible for exporting the goods, as well as the time periods within which the required documentary proof must be obtained by the supplier to substantiate the application of the zero rate.

It is important to note that for purposes of this study emphasis will be given to Section B of Part Two and to Part Three of the Export Regulations.

Furthermore, it is apparent from Section B of Part Two of the current Export Regulations that no choice is created within that specific provision. If the vendor chooses to export goods under these provisions he submits himself to the requirements set out in Section B of Part Two of the Export Regulations.

The Export Regulations in Section B of Part Two make reference to various role players⁷⁸ in an indirect export transaction. The Regulations allow for vendors to zero-rate a supply of movable goods to a qualifying purchaser, where the movable goods are exported by road or rail to an export country⁷⁹. In addition, it also highlights the responsibilities of the respective role players in such a transaction, so although this is seen as a major breakthrough in the industry, the industry also needs to realise that a number of legislative requirements need to be complied with.

When movable goods are exported from South Africa *via* road or rail, the following key role players will be present:

- The vendor;
- the agent;
- the cartage contractor; and
- the qualifying purchaser.

The legal basis for an indirect export transaction is the creation of a legal relationship, that is, an order or a contractual agreement between the foreign purchaser and the local vendor or supplier. The foreign purchaser thus orders from the South African vendor or supplier of movable goods. These goods are not intended for home consumption and are to be exported from South Africa to the foreign purchaser's country. The vendor on the other hand accepts the order from the foreign purchaser and through this arrangement a supply is established. Thus, the transactions require at least two parties.

Another important factor is that the provisions set out in the Export Regulations are subject to the VAT methodology applied to the term "supply". In terms of the definition of "supply" in section 1 of the VAT Act, a supply constitutes any performance of a sale, rental or instalment credit agreement.

⁷⁸ Paragraphs 12(3), (4), (5) and (6) of the Export Regulations.

⁷⁹ Any country other than the Republic and includes any place which is not situated in the Republic.

In the case of *Shell's Annandale Farm (Pty) Ltd v Commissioner for the South African Revenue Service*⁸⁰ Judge Davis held that some form of act is required for there to be a "supply". Therefore, if there is no supply in an export transaction, the application of the Export Regulations will become irrelevant.

Paragraph 12(1) of the Export Regulations caters for road or rail exports and creates a *nexus* between VAT and Customs. It states that the export documentation as prescribed by Customs and Excise Act, 1964 shall apply to Section B of Part Two of the Export Regulations. This confirms the previous discussion in Chapter 2 of this document, that VAT rules are more acceptable to Customs export laws.

Furthermore, the peremptory provision created in paragraph 12(2)(a) of the Export Regulations states that goods destined to be exported *via* road or rail must be consigned or delivered by the vendor to the agent's premises. This requirement supersedes any contractual obligation between the vendor and his foreign client with regard to delivery.

Important words that have been observed in paragraph 12(2)(a)(i) of the Export Regulations are "consigned or delivered". These words also appear in the definition of the term "exported" in section 1 of the VAT Act⁸¹ and are relevant to direct exports.

Furthermore, the terms "consigned or delivered" are not defined in terms of the VAT Act, but the Commissioner has deemed it appropriate to explain the term in Interpretation Note No. 30⁸² to mean –

- *the delivery of movable goods by a cartage contractor contracted by the vendor to deliver the movable goods on the vendor's behalf to the recipient at an address in an export country, where the cartage contractor –*
 - *is engaged by and contractually liable to the vendor to effect delivery of the movable goods; and*

⁸⁰ 62 SATC 97.

⁸¹As amended by section 104(1)(a) of the Revenue Laws Amendment Act No. 35 of 2007.

⁸²Issue 3 dated 5 May 2014.

- *invoices the vendor and the vendor is liable for the full cost relating to such delivery; or*
- *physically delivered by the vendor to the recipient at an address in the export country including the export of the movable goods in the vendor's baggage or by means of the vendor's own transport.*

It can be argued that the phrase “consigned or delivered” in the Export Regulations denote the same meaning as provided for in Interpretation Note No. 30, based on the fact that the vendor must physically deliver the goods by using either its own transport or by engaging a supplier's cartage contractor, who is contractually liable to the vendor to effect delivery of the goods on the vendor's behalf. This means that the vendor must be liable for the full cost relating to such delivery.

Alternatively, the vendor can also ensure that the goods are delivered to the agent's premises. This implies that the vendor may appoint someone to deliver the goods on his behalf. In essence, the intention of the legislature is to ensure that the goods are indeed exported to an address in an export country.

4.3 ROLES AND RESPONSIBILITIES

The Export Regulation makes reference to various roles players in export VAT transactions and equally also mentions the applicable responsibility. It is paramount that each role player complies with the law, as failure to do so might bear serious repercussions. Each role player will now be discussed in detail.

4.3.1 The vendor

The role and responsibilities relevant to vendors in terms of paragraph (3) of the Export Regulation are constringent and should not be taken lightly. Vendors are not only required to obtain and retain VAT and Customs documentation relevant to the transaction, but they are also obliged to verify the authenticity of the relationship created between the foreign purchaser and the agent who was appointed by the qualifying purchaser.

Furthermore, a vendor must also establish whether the agent is a registered customs client. This requirement ties in with the Customs export requirement which states that natural or juristic persons located in South Africa may register as a registered agent to act on behalf

of the foreign principal at land borders⁸³. It is important to note that a registered agent is the same at the clearing agent. However, the latter may also become a registered agent.

The consequences of any non-compliance by a vendor will result in the supply being subject to tax at a standard rate. Generally, in practice the zero-rated supplies shall be deemed to be inclusive of VAT at a standard as envisaged by section 64(1) of the VAT Act. Consequently, the Commissioner will make an output tax adjustment in terms of section 7(1)(a) of the VAT Act regarding the amount involved. This adjustment will only be applied to the relevant VAT periods concerned.

In addition, a vendor also runs the risk of a percentage-based penalty⁸⁴ and interest⁸⁵ being imposed and in worst cases even understatement penalties⁸⁶.

Diane Seccombe (Mazars 2014) holds the following view:

It cannot be over-emphasised that parties wishing to make use of this new opportunity to zero rate the indirect export of goods by road or rail, must carefully study the regulations and ensure they are completely familiar with all the obligations, documentation and time limits prescribed. Should a supplying vendor elect to zero rate the supply of goods as permitted and all the requirements set out in the regulations are not fulfilled timeously, the supplying vendor will be deemed to have made a standard rated supply in respect of the export and have to account to SARS for output VAT calculated as the VAT fraction (14/114) multiplied by the cost of goods supplied. It is highly unlikely that the foreign purchaser will be amendable to compensating any supplying vendor for the output VAT liability triggered by non-compliance with the regulations⁸⁷.

⁸³ Registration at land borders, Customs Modernisation (n.d.).

⁸⁴ Section 213 of the Act 28 of 2011 read with section 39 of the VAT Act.

⁸⁵ Chapter 12 of the Act 28 of 2011.

⁸⁶ Section 222 of the Act 28 of 2011.

⁸⁷ Seccombe, D (Mazars). 2014. New VAT Regulations open Africa for SA business.

It is important to note that because VAT is based on a self-assessment tax system which allows the vendor to determine its liability for or refund of tax, any non-compliance relevant to indirect exports will only be discovered by the Commissioner during the audit phase, unless the vendor comes forward before any audits are conducted. Based on the aforementioned discussion, it is evident that the administrative burden on vendors has certainly increased. However, this part of the law will be dealt with in terms of the Tax Administration Act No. 28 of 2011 later on in this Chapter.

4.3.2 The agent

The obligatory duties created in respect of agents are equally important and onerous. According to paragraph (4)(a) the agent is appointed by the qualifying purchaser for the collection, consolidation and exportation of the goods supplied to the foreign purchaser by one or more suppliers. In terms of Section B of Part Two of the Export Regulations the definition of an agent means a registered vendor who is–

- located in South Africa, registered in terms of the Customs and Excise Act, 1964 and was appointed by the foreign purchaser or foreign principal;
- responsible to collect, consolidate and deliver movable goods to the foreign purchaser in an export country; and
- licensed as a remover in bond in accordance with the Customs and Excise Act, 1964.

The above definition is in line with the requirements that were implemented in the third release during 2012 as part of the Customs Modernisation Programme and now requires registration at land borders.

The Export Regulations further impose the following obligatory duties on the agent:

- An agreement must be entered into by the agent and foreign purchaser in order to be appointed as the South African representative for customs purposes. This agreement would create the existence of a foreign principal and agent relationship.
- In addition, the agent is required to act as a representative in respect of all supplies made to that foreign purchaser by respective vendors. Thus, the appointed agent will be an agent for business activities relating to customs and similarly to VAT related activities.

- The agent needs to orchestrate the entire export process as required in terms of the law including obtaining and retaining relevant customs documentation in order to prove that the movable goods have left the country.
- The agent needs to ensure that the movable goods are exported from the Republic within 90 days from the earlier of the time an invoice is issued by the vendor or the time any payment of consideration is received by the vendor. The agent thus needs to obtain the required documentation within the prescribed time period.

4.3.3 The cartage contractor

For purposes of Section B of Part Two of the Export Regulations a cartage contractor is a person whose activities include the transportation of goods, and includes couriers and freight forwarders. The cartage contractor must ensure that he is a licensed remover of goods in bond as envisaged by section 64B of the Customs and Excise Act, 1964. It is important to note that the cartage contractor may be an agent and may be contractually bound to either the –

- vendor;
- qualifying purchaser; or
- qualifying purchasers' agent.

The cartage contractor must move the goods from the vendors premises to the agent's premises, deliver the movable goods to the warehouse⁸⁸, be licensed as a remover of goods in bond and obtain and retain proof of delivery of the movable goods to the warehouse.

On the flip side of the coin, the cartage contractor which is may be the agent may be contractually bound, either to the qualifying purchaser or its agent who is liable for the exportation of the movable goods from the agent's premises to the qualifying purchaser in an export country. The cartage contractor must–

- deliver the movable goods to the qualifying purchaser via one of the designated border posts listed in the definition of "designated commercial port";
- be licensed as a remover of goods in bond;

⁸⁸ Means a warehouse other than a customs and excise warehouse.

- obtain proof of export from the Republic to the export country; and
- obtain proof of import of the goods into the export country or proof of delivery of the movable goods to the qualifying purchaser or the qualifying purchaser's agent in the export country.

4.3.4 The qualifying purchaser

The Export Regulations require the foreign purchaser to order or to enter into an agreement with the vendor regarding the supply of movable goods to be exported from South Africa to an export country. The foreign purchaser must also register as an exporter as prescribed by the Customs and Excise Act, 1964.

The purchaser must appoint an agent, who will act as its South African representative for Customs purposes. The foreign purchaser and the South African supplier must enter into an agreement in order to satisfy the requirements.

Lastly, the Export Regulations require that payment must be made by the foreign purchaser to the vendor in respect of the supply of the movable goods. The prescribed rules relating to payment in respect of the supply is set out in paragraph (8) of the Export Regulations.

4.3.5 Extensions and exceptions

Over and above the obligations that have been created in paragraph 12 of the Export Regulations, both vendor⁸⁹ and agent⁹⁰ must also comply with the additional requirements set out in paragraphs 15 and 16 of the Export Regulations. Paragraph 15 relates to the export time periods, whereas paragraph 16 relates to the time period to obtain specific required documentation.

The general rule⁹¹ regarding the time frames relating to exports indicates that goods must be exported from the Republic either within a period of 90 days or when the invoice was issued or on receipt of payment, whichever comes first⁹². The exceptions to the general rule

⁸⁹ Paragraph 12(3)(d) of the Export Regulations

⁹⁰ Paragraph 12(4)(d) of the Export Regulations.

⁹¹ Paragraph 15(1) of the Export Regulations.

⁹² Paragraph 15 (1)(a) of the Export Regulations.

are discussed in paragraph 15(2) of the Export Regulations. It provides for an extended export period which consists of the following:

- Supply of movable goods which requires an advance payment must be exported within 30 days.
- Precious metals must be exported via air within 30 days.
- In cases where the time of supply is regulated and the goods are subject to repair, improvement, erection, manufacture assembly and alteration, 90 days are granted for such goods to be exported and it is determined from the date of completion of the said process.
- The supply relating to a hunted animal trophy must be exported within seven months and the date for exportation is determined from the date the invoice is issued or when any payment of consideration is received by the vendor.
- Any bulk containers used to transport bulk liquid, powders or gases must be exported within six months. The time period is determined from the date of completion of the manufacturing or reconditioning of the tank container.

In cases where vendors relied on the above provisions, they must obtain and retain proof to substantiate the application of the exception. It is clear that the above exceptions to the general rule distinguish between various time frames which range from a month to three months, six months and seven months, depending on the movable items that is being exported and the circumstances.

The Export Regulations allow vendors a second bite at the cherry in case they run out of time. However, a vendor must satisfy the Commissioner that any delay was not due to circumstances beyond his control or due to exceptional commercial interruptions or difficulties. The term “circumstances beyond the control” in terms of the Export Regulations is defined⁹³ as the following, which is in itself vague and ambiguous:

- a natural or human-made disaster;
- a civil disturbance or disruption in services; or
- a serious illness of or accident concerning the qualifying purchaser.

⁹³ The Export Regulations, *Definitions*.

It is clear that the entitlement for extension is not straightforward in terms of paragraph 15(2)(f)(i) to (iii) of the Export Regulation, which sets out the procedure in the case where a vendor wishes to extend the export time period. This provision further provides that the Commissioner may extend the period in which goods must leave the Republic, whether it is the initial 90 days period or the amount of days catered for in paragraph 15(2)(a) to (e).

An important observation is that the Export Regulations and the VAT Act are both silent on the aforementioned terms, which results in the entire definition being open to interpretation.

According to Mr X (2014),⁹⁴ the concept of serious illness or accident must be interpreted to both incidents and must be serious enough to prevent a person from complying with the requirements as set out in the Export Regulations.

In case this definition is applied in practice it might cause interpretation difficulties. Clear guidance in this regard would eliminate unnecessary ambiguousness. In general, it is through practical application where shortcomings are discovered. The application of this section definitely creates a grey area. Will this be left for the courts to decide?

The vendor is required to submit an application in writing to the Commissioner by requesting a binding private ruling⁹⁵ or binding class ruling⁹⁶, confirming the extension of the 90 days or other extended period referred to above.

This additional concession that is created by the Export Regulations⁹⁷ cannot be regarded as a “get out of jail free card”, as such an application must contain the circumstances that would be regarded as being circumstances beyond the vendor’s control or as exceptional

⁹⁴ Mr X, Senior SARS Official in the Legal and Policy Division: Indirect Taxes (further details and email address available on request).

⁹⁵ Means a written statement issued by the Commissioner to a specific person regarding the interpretation or application of the VAT Act.

⁹⁶ Means a written statement issued by the Commissioner to a class of vendors or persons regarding the interpretation or application of the VAT Act.

⁹⁷ Paragraph 15(f)(i).

commercial delays or difficulties⁹⁸. The Export Regulations further provides for an explanation with regard to the aforementioned occurrences.

Exceptional commercial delays or difficulties mean⁹⁹ –

- the foreign purchaser was unable to secure transport for the export of the movable goods. It is important to note that this must not be as a result of financial difficulties that are experienced by the foreign purchaser;
- where the terms of an order or contract have been changed by the recipient; or
- specific requirements imposed by the export country relating to a specific type of goods.

It has to be an exceptional commercial delay or an exceptional difficulty which resulted in the non-compliance of the law. In essence, whether it is a commercial delay or difficulty, it has to contain an element of rareness. When looking at the grammatical meaning, “exceptional” is defined in terms of the Oxford Dictionary¹⁰⁰ as out of the ordinary course, unusual, special. Words which are synonymous to the word “exceptional” are uncommon, abnormal, atypical, extraordinary, out of the ordinary, out of the way, rare, singular, unprecedented, unexpected, surprising, strange, odd, queer, bizarre, freakish, anomalous, peculiar, inconsistent, deviant, divergent, aberrant, unheard of and out of the common¹⁰¹.

In the case of *Mazibuko and another v S*¹⁰² the term “exceptional” formed the centre point of the judgment. Rall AJ held that in order to give a meaning to the phrase "exceptional circumstances" it is essential to ascribe a meaning to "exceptional", and a good starting point is the dictionary meaning or meanings of the word. He also stated that he is in agreement with the approach that was adopted by Comrie J in the Mohammed case¹⁰³ where it was decided that “exceptional” has two shades or degrees of meaning. It can either mean unusual or different, or markedly unusual or especially different. He stated that Comrie J places the emphasis on the degree of deviation from the usual and the enquiry will vary

⁹⁸ Paragraph 15(f)(iii)

⁹⁹ Paragraph 15(f)(iii)(aa) to (cc) of the Export Regulations.

¹⁰⁰ Oxford English Dictionary, Online University Press, accessed on 19 August 2014

¹⁰¹ www.oxforddictionaries.com (British and World English), accessed on 23 July 2014.

¹⁰² (8774/09) [2009] ZAKZPHC 61.

¹⁰³ S v Mohammed 1999 (2) SACR 507 (c).

from case to case. Rall AJ further stated that “exceptional” can firstly denote the rarity of something, that is, the infrequency with which something occurs, for example “*it is exceptional to find a nocturnal animal walking around during the day*”. Secondly, it can denote the extent or degree to which a quality or characteristic is present, as in the example of Comrie J “*the more talented a musician is, the more unusual or rare that musician would be*”. Rall J held that the two meanings are however interlinked. Despite this, Rall AJ in the end applied the meaning as it was given in the case of *Director of Public Prosecutions v Nkalweni 2009(2) SACC 343 (Tk)* as “unique, unusual, rare and peculiar” to the matter before him.

In essence, when applying the principle that was established in *Mazibuko and another v S*, unique or rare circumstances have to exist. It may be argued that it would be a tedious exercise to satisfy the Commissioner that unusual commercial delays or unusual difficulties exists. Thus, it is important that vendors should not find themselves on the wrong side of the law.

A vendor and qualifying purchasers have to remain mindful of the different time periods relating to the exportation of the respective items including the time period to obtain the relevant documentary proof. This in itself increases the administrative burden on vendors as it is crucial to comply with and very easy to fall into the trap of omission.

It may be argued that these terms are not self-explanatory and straightforward to apply, in the case of a dispute as it might give rise to an unforeseeable interpretation conundrum. Thus, moving forward, it would be helpful if the Commissioner can provide clear guidance to vendors in this regard.

4.3.6 Mode of transport – road and rail

The transport system in South Africa is regarded as the backbone of the economy. In particular, the road freight industry is a key provider of transport in South Africa and is regarded as a fast and flexible link in supply chain management logistics.

The performance of South Africa’s logistics industry is very dependent on its transport infrastructure, logistics services provision, cross-border trade facilitation and telecommunications system. It has been reported that the rail network in South Africa

accounts for 80% of the total network in Africa.¹⁰⁴ The road network on the other hand covers an area of approximately 535 000km of proclaimed roads.¹⁰⁵ Thus, it makes the transport infrastructure arguably the most important component in the industry and is a critical ingredient for economic growth, development and wealth creation. Transport infrastructure investments are key determinants of performance in the transport sector.

During the previous regime, the Scheme¹⁰⁶ did not make provision to zero rate an indirect export transaction where the mode of transport was road or rail. Only direct export transactions made provision for road and rail as the mode of transport. However, this was subject to the supply of goods being standard-rated.

The new Export Regulations broadened the scope of the previous regime to the extent that a supply of goods which are destined to be exported can now be zero-rated notwithstanding the fact that it is transported *via* road or rail.

South Africa is regarded as the gateway into Africa, which implies that much higher volumes of exports are transported *via* inland border posts to African countries further north and it is believed that these exports will increase as a result of the latest Export Regulations. For example, a qualifying purchaser can now do business in South Africa without paying VAT on an indirect export transaction. In addition, the qualifying purchaser can still qualify for the zero rate if the mode of transport is road or rail freight. The good news is that under such circumstances the qualifying purchaser no longer has to submit refund claims at the VRA, which means no more transport delays or cash flow in-house problems. However, it is paramount that they comply with all the necessary requirements prescribed in terms of the Export Regulations.

It can be argued that road and rail transport are more common modes of transport in South Africa. Each mode of transport contains its own advantages and disadvantages, which are

¹⁰⁴ CSIR (2013) 10th Annual State of Logistics Survey for South Africa.

¹⁰⁵ *Ibid.*

¹⁰⁶ Value-Added Tax Export Incentive Scheme published as Notice 2761 of 1998 in Government Gazette No. 19471 of 13 November 1998.

unavoidable factors to consider by the supplier. Thus, a closer look will be given to these transport modes.

Road freight transport is considered to be more flexible and versatile than other modes due to the vast networks of roads. The door-to-door service of road transport allows consignments to be conveyed directly from the supplier to the purchaser. The vehicle carrying capacity is adaptable, notwithstanding the fact that it is relatively small compared to other modes of transport and it can be readily increased.

With regard to freight protection, road freight carriage offers the client reliable service with little damage or loss in transit. A high frequency can be maintained as a result of the small carrying capacity and high speed of road vehicles as opposed to rail transport which cannot offer such frequent service.

Furthermore, while road transport hauliers carry far higher tonnages of freight, the average line-haul distance is shorter than that for rail. This is due to the fact that the greater portion of road freight is of a local and short-haul delivery nature. The rail balance of ton-kilometres is much higher as most of it is exporting coal and ores while road freight handles a higher percentage of general freight traffic.

Rail transport on the other hand provides for terminal-to-terminal services rather than point-to-point services for clients. This would result in another transport mode to be used in order to gain access to the rail service. Almost any type of commodity can be conveyed by rail. Large volumes of bulk loads can be carried in single trains over long distances, which can reduce air pollution and ease the traffic burden on the roads. Theoretically, trains can be scheduled more reliably than road and sea transport. The accident safety record of rail transport, especially with the transport of hazardous goods, is favourable. Rail transport is cost- and energy-efficient over long distances, contrary to road transport, which has a high energy consumption and high environmental impact due to noise and air pollution. Another important highlight regarding rail transport is that it costs less, relative to weight, than air and road freight transport over long hauls.

Evidently, the logistics industry benefits from growth in the domestic economy as well as growth in international trade. This makes the entire system intertwined. The function of each

role player in the supply chain has an enormous impact on the success rate of the other. In simple terms, if there are no means or infrastructure available to make the exportation of goods possible, it will defeat the entire purpose. Thus, the logistics industry, customs operations and transport infrastructure may be regarded as the most pivotal role players in the supply chain in order to make South Africa globally as well as regionally competitive.

4.4 THE INFLUENCE OF THE TAX ADMINISTRATION ACT, 2011

The commencement of the Tax Administration Act No.28 of 2001 (Act 28 of 2011) on 1 October 2012 gave rise to a revolution in the administration of all taxes in the Republic.

The provisions of Act 28 of 2011 have a direct impact on the general administration of several other pieces of South African taxation legislation, in particular the VAT Act. It is important to note that Act 28 of 2011 does not apply to the Customs and Excise Act, 1964, except to the extent where Act 28 of 2011 expressly provides for a provision to apply to certain customs and excise matters.

With the implementation of the Act 28 of 2011, certain administrative provisions previously contained in the VAT Act, were replaced by similar provisions contained in the Act 28 of 2011, for example the penal provisions.

However, where an administrative provision applies only to one tax type, then the administrative provision is contained in the individual tax Acts such as the VAT Act. A vendor must adhere to the administrative requirements that are contained in the Act 28 of 2011 and the VAT Act.

The fact that Act 28 of 2011 regulates the administration of all the tax Acts, requires that a specific tax Act must then be read together with Act 28 of 2011. If any administrative provision in a tax Act is catered for and Act 28 of 2011 is silent in this regard, then the specific administrative provision in the tax Act must apply and *vice versa*.

Furthermore, in the case where a tax Act uses a term that is defined in that specific tax Act, then that meaning must be applied. This rule also applies when there is an inconsistency, however, in such instances Act 28 of 2011 shall prevail.

Vendors should be mindful to comply with all the requirements as envisaged by the new Export Regulations. The new Act 28 of 2011 provides for two types of administrative penalties in terms of Chapter 15 thereof, namely, fixed-amount and percentage-based penalties which concern the non-compliance with administrative obligations. Furthermore, Act 28 of 2011 replaced section 60 of the VAT Act relevant to additional tax with the understatement penalty in terms of Chapter 16 thereof.

Due to the fact the VAT is a self-assessment tax; Act 28 of 2011 makes provision for checks and balances in order to establish compliance from vendors. There are two forms of mechanisms followed by SARS namely verifications and audits. Verification is a less intensive process than audits, even though it involves the evaluation of the accuracy of reporting relevant material. Relevant material that might be used will be the supporting documents relating to the input tax deducted or output tax declared.

The scope of the verification is generally limited to a single VAT period and will probably be the latest period. An audit is generally a detailed check on the correctness of VAT returns submitted and payments made by a vendor. This is due to the fact that VAT is a self-assessment tax system which allows the vendor to determine its liability or refund of tax. An audit generally involves an examination of multiple periods, and relevant material may be obtained from third parties including vendors and is a check and balance tool for the Commissioner.

In essence, Act 28 of 2011 imposes a variety of new legislative requirements on SARS and modernises and harmonises the common administrative elements of all the different tax laws. It may also be regarded as the administrative umbrella of all tax legislation and as such, plays a major role to simplify law and enhances clarity in the tax sphere. In addition, vendors will have to acquaint themselves with all VAT laws and applicable Regulations and has to be mindful to consider Act 28 of 2011 at all times.

4.5 CONCLUSION

The Scheme came into effect in 1998, four years after the dawn of democracy, and 16 years later the Export Regulations replaced the Scheme. This is indicative of the fact that South Africa is a country of growth, improvement and change.

Now that road and rail is catered for in terms of indirect export transactions, it can be regarded as a bitter-sweet transformation, bitter due to the administrative burden that is placed on vendors, and sweet as it is a magnet for foreign traders who wish to do business with South Africa. Overall, the effect of the Export Regulations can be perceived as the tool which opened the flood gates for foreign traders in South Africa and therefore creates endless business opportunities for vendors which will ultimately boost the country's economy.

By virtue of the fact that something new is introduced into our law, most creases will be ironed out as time progresses. Shortcomings are only realised during practical application, and it is through disputes that it is realised that there is always room for improvement.

Manifestly, vendors must have checks and balances in place when dealing with cross-border transactions. Therefore, the stringent responsibilities which are imposed on various role players are all mechanisms in an attempt to protect the *fiscus*, this is unfortunately a necessary evil.

CHAPTER 5

THE CUSTOMS MODERNISATION PROGRAMME AND IMPACT THEREOF

5.1 INTRODUCTION

The Customs and Excise Act, 1964¹⁰⁷ came into operation on 1 January 1965 and caters for both customs and excise matters. Customs in South Africa plays an integral role in the facilitation of movement of goods and persons entering or exiting the borders of the Republic and the core functions are to–

- enforce customs as well as related trade laws;
- collect duties and taxes;
- ensure the social welfare of the citizens of South Africa by controlling the import and export of prohibited and restricted goods;
- ensure timely clearance of goods and facilitate the speedy movement of travellers through South African borders; and
- support our integration into the global economy in a way that benefits all South Africans.

The approximately 3000 staff members in customs are involved in either trade facilitation activities¹⁰⁸ or border control and enforcement functions, which incorporate members of the Detective Dog Unit. Customs officers are involved in a variety of different core activities, *inter alia*–

- facilitating legitimate trade and travel while ensuring compliance;
- controlling and accounting for all imports and exports; and
- collecting all revenue due to the State.

¹⁰⁷ No.91 of 1964.

¹⁰⁸ For example: documentary and physical inspection of cargo; registration and licensing; processing and auditing.

In an article written by Van Rooyen¹⁰⁹ (2012), he stated that SARS has made numerous changes to its operations over the last two years. The key changes which have had a positive impact on cross-border trade are as follows:

- Electronic submission of supplementary documents.
- The new customs clearance codes.
- The electronic release system.
- The measures to enhance the flow of trucks through South Africa's borders. In line with this change is the review of the VAT treatment¹¹⁰ or indirect export of goods by road and rail to ensure that exporters are not prejudiced and that the *fiscus* continues to be protected against potential abusers.

Various changes and new developments have been implemented in the customs sphere. One of the contributing factors were when the then Minister of Finance, Mr Gordhan, in his budget speech¹¹¹ indicated that road and rail will be included when dealing with indirect exports for VAT purposes. This amendment had a direct impact on customs resources and processes at land border posts. Trade barriers are lessened and this change is expected to attract foreign customers and increase exports. Road freight is the most common form of transport, taking into account the geographical position of South Africa which makes it easily accessible to other sub-Saharan countries and it is thus also expected that the traffic at the land border posts will increase.

The purpose of this Chapter is to illustrate whether SARS has adequate resources at land border posts in order to give effect to the new inclusion. In addition, a closer look will be given at the Customs Modernisation Programme and the contribution thereof to the customs sphere.

5.2 THE CUSTOMS MODERNISATION PROGRAMME – WHAT IS IT ALL ABOUT?

The SARS Customs Modernisation Programme was officially launched during 2009 to make it easier and more convenient for traders to comply with their obligations.

¹⁰⁹ Van Rooyen, R. (2012). (TaxTalk). *Changes impacting cross-border trade*.

¹¹⁰ The new Export Regulations which came into effect in May 2014.

¹¹¹ South African Revenue Service: Tax Proposals Budget 2012 Regulation.

The Customs Modernisation Programme involves the use of a modern, electronic and integrated technological platform together with redesigned basic processes to give effect to several benefits for traders and for SARS. Not only do these benefits include greater ease of movement of goods across borders and cost savings for traders, but it also allows increased efficiency for SARS.

Special provisions were created in terms of section 119A¹¹² of the Customs and Excise Act, 1964 in order to cater for the Customs Modernisation Programme. This section enables SARS to implement its strategic objectives relevant to the Customs Modernisation Programme. Section 119A of the Customs and Excise Act, 1964 empowers the Commissioner to make rules for the purposes of modernising customs or excise administration where –

- a provisions for the implementation of any part of a modernisation program are urgently required; and
- it is not possible to timeously effect the necessary amendments to any relevant section of the Act.

In terms of section 119A of the Customs and Excise Act, 1964, the Commissioner may adapt any existing power, duty or function as envisaged by the Act for purposes of establishing alternative or revised administrative policies and procedures that will give effect to the modernisation program. In addition, the provisions¹¹³ further state that the Commissioner may also include any requirement, process or procedure relating to the following activities:

- any electronic communication;
- the processing of travellers;
- the clearance of goods;
- the import, export or handling of goods;
- the licensing and the operation of licensed premises;
- the control over the movement of any person, ship, vehicle or goods;
- the manufacture of goods;
- the administration of any international agreement.

¹¹² Inserted by section 32 of Act No.18 of 2009.

¹¹³ Section 119A 1(ii) of the Customs and Excise Act, 1964.

- any other activity regulated by this Act.

In the event new implementations are made in order to give effect to the Customs Modernisation Programme, section 119A shall apply, and thus, it must adhere to the rules and powers set out in the particular section. In reality, all the new implementations and improvements in the Customs sphere to date are justified by the provisions the section.

Traditionally, border or customs control is exercised to ensure the collection of taxes on imported and exported goods. This is simply to combat cross-border crime and generally to protect a country's sovereignty and people and to enforce its laws. Whilst there is a need for an effective customs control system, the international trend is to modernise customs systems in order to minimise their disruptive effect on legitimate trade and tourism as much as possible. This is to be achieved through simple, predictable and efficient customs systems and by optimising available technology that would neither compromise the traditional objectives of customs control nor disrupt the flow of goods and people between countries.

During 2008, the need for modernising and transforming Customs became more urgent than ever. Trade volumes had doubled over the previous 10 years, while staff numbers had, in fact, decreased.¹¹⁴ Systems and processes were still largely paper-based, leading to many validation errors and wasting staff resources on low value-adding activities. Lack of adequate customs presence at ports of entry, corruption, lengthy inspection turnaround times, non-adherence to legislation and poor trader awareness were also identified as other areas of concern.

According to an article by Poverello,¹¹⁵ the inefficiency of road freight transport is one of the primary factors that hamper the economy of sub-Saharan Africa. He stated that long delays experienced at border posts are the single biggest contributor towards the slow average movement of freight. Cross-border operations are complicated by the conflicting security

¹¹⁴ The Customs Modernisation Programme, The Journey, undated document.

¹¹⁵ Poverello, M. (2013), What happened to the Portcullis? *A South African RFID/GPS cross-border logistics and customs solution*, web blog.

objectives of customs and border authorities *versus* efficiency objectives of transport operators. He said that in theory the efficiency of cross-border operations can be improved based on the availability of more accurate and complete information. This can only be achieved if different role players can exchange data between currently isolated systems.

Basically, the new customs processes focus on the introduction of a proper automated risk management system. Without risk management, customs officials would be bound to physically check each and every consignment entering or leaving the Republic. The Customs Risk Engine is intended to provide the basis around which import or export transactions may warrant scrutiny or detailed checking by customs. In this way, non-risk related shipments will receive a green light for release and onward movement to their destination.

The Customs Modernisation Programme is aimed at addressing these and other areas through the upgrading of business processes and systems, improved risk detection capability and enhanced human capacity through training and performance measures.

5.3 SOME OF THE SUCCESSES OF THE CUSTOMS MODERNISATION JOURNEY TO DATE

The Customs Modernisation Programme has been broken down into various releases due to the size of the project. The following implementations to date have completely changed the way trade is conducted in South Africa:

5.3.1 *The new declaration method*

The introduction of release one in November 2010 which relate to the declaration method was the first major milestone for SARS as it presented a new system of goods clearance by customs procedure. This resulted in the replacement of “purpose codes” with “customs procedure codes”. This change was required to allow SARS and customs stakeholders to embrace a new standard as provided for in the Revised Kyoto Convention,¹¹⁶ which

¹¹⁶ The expression commonly used to refer to the International Convention on the Simplification and Harmonization of Customs Procedures adopted by the Customs Co-operation Council in Kyoto in 1973. (SARS website Glossary).

establishes set minimum standards on customs clearance simplification and harmonisation¹¹⁷.

This new procedure codes declaration method encompasses all import, export and transit trade which have yielded positive results according to SARS. The new procedure-based declaration method introduced a comprehensive level of detail regarding the purpose of the movement into, through and out of South Africa. In addition, it provides Customs with more detailed information in relation to onward processing of goods, while enabling better and proper acquittal of declarations. For example, at header level of declaration the customs clearance requires a declarant to indicate a "Procedure Category Code" and it consists of the following:

Procedure Category Code (PCC)	Description of the PCC
A	Home use (including goods intended for "home use" for which there is a relief of duties and taxes.
B	National and International Transit Procedure.
C	Transshipment Procedure.
D	Temporary Admission Procedure.
E	Customs Warehousing Procedure.
F	Stores Procedure.
G	Tax Free Shop Procedure.
H	Export Procedure.
I	Temporary Export and Re-importation in the Same State Procedure.
J	Inward Processing Procedure.
K	Home Processing Procedure.
L	Outward Processing Procedure.

¹¹⁷ The expression commonly used to refer to the International Convention on the Harmonized Commodity Description and Coding System, adopted by the Customs Co-operation Council in 1988. (SARS website Glossary).

The mentioned PCC identifies the customs procedure under which the declarant wishes to clear goods. This new system has had the effect of decreasing unnecessary administrative tasks and increasing the tracking and tracing ability of declarations throughout their lifecycle and across the supply chain.¹¹⁸

5.3.2 Improved turn-around times

It has been noted that the average time for processing a declaration could be anything from a few seconds in the case where there are no stops through the risk engine, to less than 30 minutes. In the past cargo could take anything between a few hours to a day or two to move through the ports, especially if an inspection was still required. For example, customs traders using Kopfontein border post would first have to submit their declaration at Zeerust customs office where it would be manually processed before the truck could go to the border post which is some distance away. This process has now been simplified and the average turn-around time has reduced significantly to 28 minutes as everything can be done electronically.

5.3.3 Tracking and tracing through Service Manager

The biggest changes under Customs Modernisation were made in Release Two, introduced in June 2011. These changes were aimed at offering trade the benefits of greater ease of movement of goods, faster turn-around times and cost savings as well as increased efficiency for SARS. This phase resulted in an opportunity for SARS to leverage its IT capability for the mutual benefit of both Customs and tax environments.

Among the IT tools that were introduced into SARS's operating environment is the enterprise case management and workflow solution called Service Manager, which was initially developed and implemented in the tax environment with great success. Service Manager is a business workflow solution developed in-house that enables SARS employees to utilise it in and record their day-to-day activities. It directly interfaces Customs and other tax systems and provides a seamless interface for the SARS user. In the past, staff had to access various

¹¹⁸ This is the continuous linking of activities that take place for the systematic movement of goods from place of origin to the place of final destination.

systems to resolve a query and today all information is available at a single point. Service Manager routes medium and high risk transactions or cases to various work pools for further scrutiny, assessment or inspection until the matter is finalised. In this way, customs assessment and audit officers and border control inspectors have immediate access to the underlying data of a trade transaction, including digitised images of any supporting documents (transport document, supplier's invoice, packing list, worksheet, regulatory permits and certificates, etc.) related to the transaction concerned.

For example, SARS can now get statistics on the average time taken for trucks to move through the various ports, the average number of trucks per hour and per day at individual ports. Through system-generated statistics, SARS is now able to see that Lebombo is, in fact, the busiest land border from a commercial perspective with an average of over 600 trucks per day and not Beit Bridge with an average of over 400 trucks per day.

5.3.4 *Electronic release messaging*

The elimination of paper clearance documents is a significant departure from traditional SACU processing where all member countries have relied on the Single Administrative Document (SAD) to facilitate intra-SACU clearance. With the bulk of clearances expected to be electronic, SARS will now only print a Customs Notification (CN1), which will specify the status and outcome for each clearance. The trader will use the CN1 in support of customs clearance in Botswana. SARS will no longer stamp and authorise hard copies of SAD 500 clearance documents. However, it is important to note that there is nothing that stops a trader from printing the SAD 500 for cross-border purposes; it is only SARS that no longer will attest to these. Regarding SARS VAT requirements, arrangements will be made for traders to submit the CN1 for purposes of VAT returns.

5.3.5 *From manual to electronic*

The shift from manual to electronic processing at land borders has meant greater control for SARS and speedier turn-around times for trade. In January 2012, 95% of trade at borders

were using Electronic Data Interchange (EDI)¹¹⁹ for exports and at the end of July it increased to 98%. With regard to imports 49% traders were using EDI in January 2012 and in July 2012 this amount increased to 86%¹²⁰. EDI, or electronic data interchange, is essentially a "paperless" trading system. It involves the electronic transfer of data, by established message standards, from one computer application to another.

Growth in world trade means businesses are increasingly developing better ways of managing the movement of raw materials, stock and finished goods. EDI organises the flow of information from one end of the supply chain to the other.

The benefits of using EDI are as follows:

- It is a fully automated process that needs little or no intervention by either party.
- Declarations can be accepted round-the-clock.
- Quicker retrieval of cargo through the reduction of clearance times.
- A reduction in manual administrative processes resulting in fewer errors and no duplication.
- Harmonised business relationships with other bodies such as Transnet Port Terminals, Transnet Rail Terminals, airlines and container depots.

In terms of Government Notice R.814 dated 31 July 2009, SARS is legally mandated to enforce the use of EDI for the submission of certain cargo and goods declarations and reports.

5.3.6 Improved risk management

SARS operates on the principle of risk management. Therefore all work and associated activities are defined according to the outcome of transactions processed via the core tax systems and the enterprise automated risk engine. How the risk engine operates is that it would identify high-risk transactions based on previous transactional information and the profile of the trader or taxpayer.

¹¹⁹ Means the transfer of structured data, by agreed message standards, from one computer application to another by electronic means without human intervention.

¹²⁰ Customs Modernisation Programme, *The Journey*. page 11.

All declarations, including Vouchers of Correction (VOC) are now verified by the Customs Risk Engine (CRE). Cargo at land borders is treated consistently from a risk analysis perspective and officers have no control over which declarations will be stopped for inspection. Subsequent to inspection all risk assessment results are captured into the risk engine which interprets the results and uses it to inform future analysis.

5.3.7 Electronic manifests

The introduction of electronic manifests *via* the Automated Cargo Management (ACM) system for sea and air in 2011 and for road in 2012, allows SARS to match manifests with declarations. This change enables SARS to ascertain the total risk related to a particular consignment.

All road carriers are now required to submit their road manifests electronically, *via* EDI, to the Customs ACM system. SARS will not electronically match the manifest against the declaration. However, SARS will monitor compliance and data quality of electronic manifests for a period of time before initiating real-time matching and acquittal. This practice will invoke a significant responsibility on both trader and road remover to ensure that they both provide credible data to customs otherwise delays will occur. Upon arrival of the cargo at the border, the driver presents a printout of the electronic manifest. The manifest number is "checked in" by a customs official. In seconds it brings up all associated goods declarations linked to the manifest number on the system. In addition, the customs officer is also able to determine the overall risk status of the vehicle. Where no risks are present, a status notification (CN1) is printed for each goods declaration and a gate pass (CN2) is handed to the driver permitting him to exit the customs controlled area.

The future real-time matching will comprise a combined risk assessment of both manifest and declaration information that will result in a single risk outcome. Such risk assessment will include both fiscal and security compliance features thereby bringing SARS in line with international supply chain security standards. Going forward, risk assessment will accommodate "all-of-government" requirements ensuring that all regulatory measures and associated risks are administered in a single instance obviating the need for successive, time-consuming inspections and costly delays.

5.3.8 Mobile inspection solution by iPods

Following the Service Manager roll-out, the need for a hand-held device was identified. This means that all the functions of SARS's Service Manager are now available at an inspector's fingertips. Wi-Fi technology was made available at the port to ensure wireless integration between the Service Manager and iPod devices. The idea is that inspectors receive their instructions on the iPod, capture the results and make recommendations which then go to the finalisation or adjustment inspector.

In addition a customs officer has access to the underlying clearance data which will allow him/her to activate the camera function and capture visuals of any suspect cargo. This significantly improves the efficiency for this time-intensive activity where the officer can initiate a status update electronically at the inspection site. As a result, inspectors no longer have to move back and forth to and from the office, and their next job can be assigned to them on the spot. On the other hand, the declarant would not have to wait for the outcome of the manual inspection report and release note. This is expected to substantially reduce the time spent on physical inspections and minimise human error.

5.3.9 Taking back control at border posts

Greater sterility of the Customs Control Area has been enforced by introducing reflective wear and mandatory identification of any authorised persons. The loitering of any unauthorised persons has been eliminated. In addition, strict health and safety rules are now being applied.

5.3.10 Increase in foreign trader registration

The registration of foreign or BLNS traders increased substantially in 2012 since the abolishment of the general registration code 70707070¹²¹. All importers and exporters, local and foreign are now required to register and declare their registration details on their Customs declarations. This is a huge benefit for SARS from an auditing perspective, as

¹²¹ This code was introduced by SARS some years ago as a general code which importers or exporters could use temporarily until they received formal registration.

SARS will now have a record of many of the “unknown” foreign entities that were using the general registration code in the past. Foreign traders are only allowed to do business with Customs *via* a South African-based “registered agent”. According to SARS, during the first six months of 2012, 6074 “foreign” or BLNS traders registered with them, compared to just 77 during the whole of 2011.

5.3.11 *Electronic submission of supporting documents through E@syscan*

SARS customs is becoming a paperless administration as traders can now submit documents from the comfort of their offices. The intention of this new feature is to reduce the administrative burden and processing times and eliminate the need for messengers to deliver documents to SARS offices. This breakthrough was already tried and tested at seaports and airports across South Africa. Customs clients are no longer required to carry around hardcopy clearance supporting documentation for example, invoices, worksheets and packing lists. These are now only required should SARS indicate *via* electronic message that a consignment requires further scrutiny.

Customs brokers and clients using EDI will in most cases have the SARS e@syScan¹²² facility available on their computer systems, which makes it relatively simple and easy to scan, package and submit to SARS. In the event that a customs client is unable to perform this electronically, he may visit any of the four Customs Hubs¹²³ across the country. There he will be allowed to scan and upload the necessary supporting documents at SARS. Alternatively, these can also be delivered to the border post for manual processing and finalisation of a customs intervention. Supporting documents are linked to a unique case number which SARS utilises to notify to the customs client in the event of a risk.

5.3.12 *Improving the way customs officers work*

Service Manager has improved the way Customs officers receive and view data, the way they navigate through the system, the way their work is allocated, the way they are measured and the way their work is reported.

¹²² This is an Adobe-based document scan and upload application, which enables traders and brokers to scan and package supporting trade documents to SARS electronically.

¹²³ SARS Customs offices in Alberton, Cape Town, Durban, and Doringkloof.

5.3.13 Preferred trader programme

Part of SARS's segmentation approach involves customs redefining its Accreditation Programme to provide greater benefits for those clients who demonstrate greater compliance. The Preferred Trader¹²⁴ is the first phase of the journey towards the internationally accepted Authorised Economic Operator (AEO) programme, which is a response to the need to improve trade facilitation, whilst securing international supply chains and improving compliance.

During 2010 SARS piloted a preferred trader initiative with about 150 importers and exporters that required the client to perform a self-assessment of their business systems and compliance with Customs requirements. Upon validation of their compliance by Customs Audit, these traders will receive customised services and benefits in relation to their standing. Thus, this program is appropriate to clients who *inter alia* maintain a high quality internal operational processes and computer systems with an appropriate record of compliance and has its own unique set of benefits. Rule 64E.14¹²⁵ lists the benefits conferred by the Commissioner to accredited clients¹²⁶.

Amongst the benefits listed are:

- The appointment of a Customs Relationship Manager.
- Possible reduction in security.
- Fewer documentary and physical inspections.
- Priority in processing tariff and value determinations.
- The use of non-intrusive inspection techniques for cargo examination.

¹²⁴A person registered under the provisions of the Act who has been granted accreditation status in terms of the provisions of Section 64E and the Rules thereto on the second level of accreditation.

¹²⁵ GNR.1874 of 8 December 1995: Rules (Government Gazette No. R.16860) Arrangement of Rules, Forms.

¹²⁶ Means person registered under the provisions of the Act who has been granted accreditation Status in terms of the provisions of Section 64E of the Customs and Excise Act, 1964 and the Rules thereto.

5.3.14 Greater optimisation of customs resources and greater control

With regard to clearance processing SARS has centralised its back end processing of clearances where goods declarations are now processed off-site at one of the four Customs Hubs¹²⁷. Clearance processes are no longer performed at customs branches as all goods declarations, whether electronically submitted or manually captured, are routed to a central pool for validation, verification and assessment in case where the declarations are flagged by the risk engine. All clearances at land borders will, once successfully processed, receive a "proceed-to-border" message implying that the road carrier may commence delivery to the border.

A key feature of the new clearance process is the availability of Customs Status Codes. These codes are initiated by the customs system at specified points in the process to alert the declarant of the status of his/her transaction. These statuses also indicate the follow-up required from the declarant to bring the transaction to a state of finality.

5.3.15 Progress towards customs-2-customs Information exchange with other countries

SARS has been in consultation with various trading partners concerning information exchange, notably the IBSA countries, that is, India, Brazil, South Africa and Swaziland. During January 2012 a World Customs Organisation (WCO) workshop was held in Pretoria for SACU member states and representatives from the United Nations (UN), Southern African Development Community (SADC), Common Market for Eastern and Southern Africa (COMESA), and Mozambique Customs on the Globally Networked Customs (GNC) concept and IT connectivity. The GNC concept aims to realise connectivity, data exchange, and cooperative work amongst the world's customs administrations. GNC is set to play a very important role in promoting trade facilitation, enhancing trade efficiency and safeguarding trade security. It will also greatly influence international rules and the development of the customs end-to-end operational process.

¹²⁷ *Ibid* 16.

5.3.16 Straight from the horse's mouth¹²⁸

According to a SARS newsletter, SARS can boast with positive feedback from Customs clients. Some Customs clients have expressed their satisfaction regarding the current changes. Dave Logan, CEO of South Africa Association of Freight Forwarders stated that “This programme has definitely had a positive impact on trade facilitation both into and out of South Africa by accelerating the pace of the clearance of legal freight electronically via our ocean ports, airports, and more recently through the land borders.”

Rodney Cresswell of Rohlig-Grindrod in Komatipoort said their entire office was very excited about the changes:

Everything is going electronic which is great as you can find out exactly where your entry is in the system. At the same time, once your document is in the system, you don't know who will release it, which I think is fantastic as it closes the door on corruption.

“Vehicles are moving through the border much quicker,” said Leticia Schutte of Clear Fanatics Import & Export in Komatipoort following the Lebombo implementation. She further said:

The system saves time and now there are very few queues of trucks with a much better flow across the border. I think Customs Modernisation is very good for trade because of the faster turnaround times which will mean fewer demurrage costs and ultimately better business for trade.

Lin Botha (Sediba Clearing in Beit Bridge) said that as a clearing agent in the area she had always had a lot to say about bribery and corruption. “Service Manager is a dream come true for us”. She also praised SARS for all the time spent engaging with them and dealing with queries during the implementation.

Graham Clark from Zimbabwe, a truck driver who travels through the Beit Bridge border post regularly, was delighted by the speedier process:

¹²⁸ Customs Connect, Issue No. 2, December 2011.

The best case scenario in the past when it came to travelling through the border was about one and a half hours on the South African side. On Monday after the new process was introduced, it took just 30 minutes.”

The above-mentioned feedback from various customs clients is testimony of the hard work and commitment that went into this initiative thus far.

5.4 THE CUSTOMS CONTROL ACT, 2014

The Customs and Excise Act, 1964 has been re-written in its entirety and will be superseded and replaced by the Customs Control Act No. 31 of 2014 (Customs Control Act) upon implementation. The introduction of the Customs Control Act is yet another major development in the customs domain. The aim of the Customs Control Act is to replace the provisions of the Customs and Excise Act relating to customs control of all means of transport, goods and persons entering or leaving South Africa.

The provisions of the Customs and Excise Act, 1964 dealing with customs and excise duties will be contained in two separate pieces of legislation, namely the Customs Duty Act No. 30 of 2014 and the Excise Duty Act, 1964 (The latter is currently contained in the Customs and Excise Amendment Act No. 32 of 2014.).

In March 2014, the South African Parliament approved the adoption of the Customs and Excise Amendment Act,¹²⁹ the Customs Duty Act¹³⁰ and the Customs Control Act¹³¹. The Customs Control Act was promulgated on 23 July 2014 to provide customs control of all vessels, aircrafts, trains, vehicles, goods and persons entering leaving South Africa. The Customs Control Act is in accordance with current international treaties, trends and best practices and gives effect to South Africa’s international obligations in this regard.

¹²⁹ No.32 of 2014.

¹³⁰ No. 30 of 2014.

¹³¹ No. 31 of 2014.

The main objective of the Customs Control Act is to establish systems and procedures for customs control of all modes of transport, goods and persons entering or leaving South Africa, whether by land, sea or air. Therefore, it is important to note that the main points of control are land border posts, seaports and airports. The thinking behind this control is two-fold:

- Firstly, it has a *fiscal* objective in order to ensure that any taxes imposed by other legislation on imported or exported goods are collected; and
- Secondly, the compliance with other laws governing imports and exports are to be taken into account.

The Customs Control Act determines the procedural requirements that must be complied with when goods are imported or exported from South Africa. SARS's Chief Legal and Policy Officer, JJ Louw, urged the adoption of the new system of customs control, saying the authorities required more comprehensive information regarding incoming cargo in order to eradicate fraud and illegal imports. He stated that the new system would lay a solid and predictable framework for a modernised system of customs control that balances the need for trade facilitation with the need to prevent imports of illicit goods.¹³²

The Customs Control Act provides for goods to be cleared by means of the customs procedure codes. This is a new declaration method that was recently implemented to give effect to the Customs Modernisation Programme goals. The customs procedure codes allow for goods to be dealt with in a specific way and does not create any options to an importer or exporter as it must be utilised only in circumstances permitted by the Customs Control Act.

The Customs Control Act further caters for a specific tax status¹³³ on goods when the goods are cleared for home use or for customs procedure. A tax due status refers to any tax that may have been imposed on goods of the relevant class or kind and must be paid upon clearance of goods for home use. On the other hand a tax free status is basically self-explanatory as no taxes are payable on such goods. However, its status will continue for as

¹³² Ensor L. 2014. Customs bill gets escape clause to go back to old system.

¹³³ means tax due or tax free.

long goods remain under that customs procedure. For example, when goods are cleared for warehousing purposes it will carry no tax liability until cleared for home consumption.

The Customs Control Act further facilitates the implementation of other legislation relating to prohibiting, restricting or regulating the import and export of certain goods and for that reason direct powers are assigned to Customs to detain and deal with goods which fits the aforementioned category.

The Customs Control Act also includes dispute resolution procedures for administrative appeals and outside court settlements. With regard to court cases the Customs Control Act allows for additional punitive powers for the courts in criminal proceedings, jurisdictional matters and the “name and shame” publication of the names of offenders. Offences are categorised as serious and less serious offences.

It also provides for a system of administrative penalties that may be imposed by Customs for breaches of the Act. The Customs Control Act distinguishes between prosecutable and non-prosecutable breaches. In the case of the latter a fixed amount of penalties may be imposed. In the case of the prosecution avoidance penalties may be paid by offenders who want to avoid criminal prosecution. This provision mirrors the administrative penalty provision in terms of section 91 of the Customs and Excise Act, which was also regarded as an alternative option to prosecution.

The Customs Control Act further provides for instances where a person may voluntary disclose a faulty duty determination and that, in such cases, the Commissioner would not institute criminal proceedings or impose administrative penalties.

It is important to note that provision is made for transitional provisions and the repeal of current customs legislation. The Customs Control Act is a form of a modernised legislation and an important tool which is intended to contribute to the common good of the customs sphere.

5.5 CONCLUSION

Modernisation of SARS’s systems and processes has given SARS a platform and capacity to extend its reach to a much wider tax base and as such, gives it the capacity to broaden

and grow compliance across the entire citizenry. The Customs Modernisation Programme includes various facets and due to the size of the project it is understandable that implementation is spread over years.

It may be argued that the main change under the Customs Modernisation Programme was the introduction of Release Two, which gave rise to an automated workflow driven system, called Service Manager. This cutting edge technology marries all tax types and when a vendor exports movable goods from the Republic, customs officers will be in a position to view the entire tax transaction. This was not the case in the past. In addition, new processes minimises human intervention, which is in actual fact good news to SARS as it eliminates or decreases the probability of fraud.

The outcome of the Customs Modernisation Programme brought new life to the customs operational processes as it gives rise to time efficiency, effective management which definitely makes businesses in South Africa more attractive on a global platform.

In essence, it is evident that SARS is geared up and ready to face any challenges at land border posts. The VAT amendments with regard to zero-rated export transactions relevant to road and rail will definitely be well received at border posts due to this enormous change the Customs Modernisation Programme brought about.

As the saying goes, “To improve is to change; to be perfect is to change often.” — Winston Churchill¹³⁴.

[Total words: 24001]

¹³⁴http://refspace.com/quotes/Winston_Churchill/ accessed on 10 July 2014.

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