VAT News 2 - June 1995

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HOW THE VAT SYSTEM WORKS

The VAT system is what is known as a "self-assessment" type of tax, which means that you, the vendor have to know enough about the tax to levy the tax, subtract the correct amount of input tax and pay over the difference to the Receiver of Revenue (or claim a refund). While this places a load on your shoulders it is the best practical way to levy a tax on the consumption of goods and services. The alternative would be to have a tax collector stationed at every business – that would be expensive and impractical.

The system relies on you the vendor. It depends on you being supplied with information and the system is backed up by periodic audits by Inland Revenue.

INFORMATION AND THE NEW GUIDE FOR VENDORS

The main source of information is the Guide for Vendors (VAT 404) while the information on the back of the VAT return and newsletters such as this should also be kept in mind. The Guide for Vendors is being reprinted and will be sent to you shortly. Upon receipt thereof please discard the previous Guide issued in 1991 as well as the update issued in 1992.

VAT AUDITS

The audits serve a dual purpose – they help to keep vendors informed and they reduce tax evasion. If the VAT auditors need to call on you they will telephone you and make an appointment. Many of these visits will be information visits – in fact Inland Revenue would dearly like to pay a courtesy call on each and every vendor. On such a visit the auditors will examine your record keeping and accounting system and will tell you if there are things which you are not doing correctly. You can assist by ensuring that all your VAT records are available.

VAT audits will also occur for a number of different reasons, for example – a large refund may have been claimed by you or by another vendor who has dealt with you – there may have been a sudden change in the ratio of your purchases to your sales – a customer may have complained about you adding VAT to a price advertised or quoted. Most of the reasons for the Inspection may be quite innocuous, but Inland Revenue must carry out routine audits to ensure that the VAT system is being correctly applied.

WHAT ARE THE COMMON ERRORS VAT INSPECTORS FIND?

The following are errors commonly made by vendors -

OUTPUT TAX

- Tax is erroneously not levied on indemnity payments under a contract of insurance (see paragraph 8.2 of the Guide for Vendors).
- Tax is not levied on goods taken for own use.
- VAT is not levied on fringe benefits (see paragraph 8.4 of the Guide).
- Tax is not levied on assets sold or traded in.
- Proof of export has not been obtained where the zero rate has been applied to goods exported.

INPUT TAX

- Input tax deductions are claimed without the vendor being in possession of a valid tax invoice.
- Input tax is claimed on goods and services acquired for the purpose of entertainment (e.g. staff refreshments) where the vendor is not entitled to such deduction.
- Input tax is claimed on the purchase or rental of a motor car, station wagon, combi or double cab vehicle.
- Input tax is not claimed on the cash value of goods bought under an installment credit agreement, but on the monthly payments (which include interest which is an exempt financial service and therefore not deductible).
- Input tax deductions are claimed on subscriptions to social, sporting or recreational clubs, rugby or theatre tickets.

- Vendors sometimes forget to claim input tax deductions on taxable supplies made to them where direct bank transfers are made (e.g. burglar alarm rental).
- Vendors claim notional input tax deductions in respect of second-hand goods but don't maintain proper second-hand goods registers (information required – name and address of supplier, description and quantity or volume of goods, date of purchase and purchase price).
- Adjustments have not been made for debit or credit notes or prompt settlement discounts granted by suppliers.

WHY TAX INVOICES ARE IMPORTANT

A number of vendors who wrote to VATNEWS wanted to know why Inland Revenue insists on tax invoices. The most effective VAT systems in the world are what is known as "invoice based subtractive" systems. The VAT payable to the Receiver of Revenue is calculated by subtracting the tax you pay to your suppliers from the tax you charge your customers. The tax invoice is proof of the tax you have paid to your suppliers and it provides an audit trail to assist Inland Revenue in detecting tax evasion.

WHAT INFORMATION MUST TAX INVOICES CONTAIN?

There are two types of tax invoices and in certain situations tax invoices are not required.

FULL TAX INVOICE

This is required where the consideration (price and tax) exceeds R500. For it to be valid it **must** contain the following information:

1. The words "tax invoice".
2. The name, address and VAT registration number of the supplier.
3. The name and address of the recipient.
4. An individual serial number and date of issue.
5. A description of the goods or services supplied.
6. The quantity or volume supplied.
7. Either – the VAT exclusive price, the VAT and the inclusive price, or - the VAT inclusive price with a statement that VAT is included and the rate of VAT charged.

ABRIDGED TAX INVOICE

Required where the consideration exceeds R20 but not R500. It must contain the information referred to above, but the name and address of the recipient and quantity or volume supplied (points 3 and 6) may be omitted.

TAX INVOICE NOT REQUIRED

Purchases not exceeding R20 do not require tax invoices, but should be recorded in your accounting system, e.g. in a petty cash journal. Where the transaction consists of a number of regular supplies (e.g. the rental of a delivery vehicle or premises) a tax invoice will not be required, provided:

- You are in possession of a written contract.
- The contract contains the name, address and VAT registration number of the supplier and confirms that the supply is subject to VAT at the standard rate.
- You retain proof of payment, e.g. bank statements (electronic transfers), or paid cheques.

INPUT TAX DEDUCTIONS

CAPITAL GOODS AND SERVICES / OTHER GOODS AND SERVICES

The input tax deduction for capital goods and services must be inserted in block 14 of the VAT 201 return. This relates to items treated as capital expenditure for accounting and income tax purposes.

The input tax deduction for other goods and services is made in block 15.

This distinction is necessary for our audit purposes and where capital purchases are included in block 15, unnecessary VAT audits are likely to occur.

VAT RETURNS AND POSTAL DELAYS

Many vendors have difficulties with postal delays and Inland Revenue is investigating ways of overcoming this problem – e.g. allowing you to pay VAT at your bank or making electronic transfers. We are as keen as you are to resolve this matter, but in the meantime please submit your returns early enough to reach us by the due date.

N.B. If you pay by bank transfer your bank account will be debited on the last business day of the month no matter how early your return is received.