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TAXATION | BASIC

Video Transcription: Value-Added Tax

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Hi, my name is Riley and, in this video, I will be introducing the basic principles of Value Added Tax or VAT.

VAT is an example of an indirect tax. South Africa has both direct and indirect systems of taxation. Direct taxes, for example income tax, are levied on taxpayers whereas indirect taxes, such as VAT, are levied on transactions.

The South African Revenue Service, or SARS, is the authority that actually collects the taxes. So what is VAT? VAT is a tax levied on transactions that is collected by businesses on behalf of SARS. Businesses that collect VAT are referred to as VAT vendors and currently all businesses generating taxable supplies of R1m or more per annum have to register as VAT vendors. Taxable supplies, simply put, is turnover on which VAT is levied, but I will explain this in more detail later.

So, VAT is essentially made up of two components, namely output tax and input tax. The VAT payable by the VAT vendor to SARS at the end of a tax period is calculated as output tax less input tax. So what is output tax? Output VAT is levied, imposed or charged at a rate of 14% (or 0%) on the value of the supply of goods or services by a vendor in the course or furtherance of any enterprise carried on by him. Woah! There are many technical terms in this explanation of output tax. Before we can truly understand output tax, we will need to know what each of these technical terms mean.

Taxation, like many professional disciplines, has a language that you need to become familiar with, understand and be able to apply. This language has been developed by legislation and law and it is important to use these technical terms when talking or writing answers, in test or exam question on VAT as these are the defined terms in the legislation being the VAT Act.

Let's look at each of the technical terms, individually:
The term "supply" covers a wide range of activities carried out by businesses and includes regular sale arrangements, for example selling inventory, rental agreements, instalment credit agreements, transfers of ownership or deemed supplies. The word "deemed" means that even though it might not be a supply, SARS is telling us to treat it as a supply. If an activity is considered to be the supply of goods or services, these supplies can be either taxable or non-taxable. Taxable supplies will have output VAT levied at either a standard-rate (currently 14%) or a zero-rate (0%). This means that if a vendor's supply is standard-rated, the amount of output VAT levied (or charged) by the vendor is calculated by multiplying the value of the supply by 14% (the standard rate).

Some examples of standard-rated supplies are normal sales, commercial rent and some services within South Africa. If a vendor's supply is zero-rated, the output VAT on the supply is zero. It is important to note that there is still output VAT on zero-rated supplies, but that the amount of output VAT is zero. This is important as it means that the vendor can claim a VAT input which we'll discuss later. Some examples of zero-rated supplies include exports, international travel, the sale of a going concern business, basic foods, fuel and services to non-residents.

Non-taxable supplies, also called "exempt supplies" are supplies of goods or services where no VAT is charged. Because no VAT is charged on the supply, no input tax can be claimed back. Some examples of exempt supplies include financial services, residential accommodation, education and road and rail transport. Goods are corporeal (in other words, tangible) moveable items (i.e. a moveable object that you can touch), fixed property (such as buildings or land) and electricity which is specifically included. Certain items that are corporeal moveable items, such as money, are excluded from this definition of goods.

When applying tax principles and sections, there are often exclusions to the general rule. In other words, situations where the general principle does not apply. It is important to get into the habit of checking the exclusions before you apply the general rule in any tax situation.

If the supply is not considered goods, then it is a service. A service is anything done or to be done, including the granting, in other words, officially give, assignment, in other words, transfer, cession, in other words, to give up or surrender of a right. For example, the sale of intellectual property or shares do not meet the definition of goods, as they are not corporeal moveable items, so the transaction is a supply of services.

A vendor needs to be registered. Who should register? A person (a natural person or a legal entity) must be conducting an enterprise. An enterprise is similar to a business, but is specifically defined in the VAT Act. You have to register as a vendor if you have reason to believe that your taxable supplies will exceed R1 million for the period or has already exceeded that amount. You can voluntarily register if your taxable supplies exceed R50 000.

The tax period refers to the period over which the vendor has to pay VAT to SARS. For example, a tax period of one month means VAT is paid over to SARS every month. There are different tax periods, and vendor categories that link to those periods. For example, one month (category C vendors, who are vendors with turnover greater than R30 million, or vendors who want to be in this category), two months (category A or B vendors, which is the standard tax period allocated when registering) and six months (category D vendors, farmers and micro-businesses).

An enterprise, which is similar to a business, is any continuous or regular activity that occurs in or partly in South Africa. It does not matter whether the enterprise has a profit motive, but a consideration must be charged.

Consideration refers to any payment that is made or will be made. Consideration does not have to be cash. It could be an asset that you are receiving in exchange for the supply you are making. We need to know how to value consideration, because this is the amount we use to calculate the output VAT. The amount of the consideration is the cash being received. If the consideration is not money, then it is the open market value of the supply. Consideration does not include a deposit, where the deposit is not a part payment, and will be repaid. The term consideration is the amount that includes VAT. If the amount quoted excludes VAT, we refer to that as the value of the supply.

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Okay, so now we have covered the technical terminology for output tax. Output VAT is only one side of the calculation of VAT payable to SARS. The other side is input VAT. Input VAT is the VAT claimed back from SARS and is deducted from the output VAT before calculating the final VAT amount payable to SARS.

So what is input tax? Input tax is defined as VAT charged by a vendor to another vendor on the taxable supplies to them. In other words, a VAT vendor makes a supply to us (for example, sells us furniture) and charges output VAT. As the VAT vendor purchasing the supply (i.e. furniture) the amount of input VAT that we can claim equals the output VAT charged to us.

Where both taxable supplies (i.e. standard-rated and zero-rated supplies) and non-taxable supplies (i.e. exempt supplies) are made, the input VAT for goods and services used to make these supplies must be apportioned (shared in the ratio) as you can now only claim input VAT on taxable supplies. For example, assume a block of flats is purchased and some flats are used for residential accommodation and the rest for business. Residential accommodation is exempt for VAT purposes, so only the amount paid for the business portion of the block of flats will be allowed to be claimed as an input.

The input VAT that can be claimed back on imported goods is the amount of VAT imposed on the import. For example, when you purchase goods overseas, customs duty and VAT are paid to release the goods from customs when they come into the country. The amount of VAT paid is equal to the input VAT you can claim back.

In order to claim input tax, there needs to be a valid tax invoice. So what if we purchase from a non-vendor? Well, we cannot claim any input VAT as there is no valid tax invoice as the seller is not registered as a VAT vendor. The exception to this rule is when we buy second-hand goods from a non-vendor. We can claim input VAT equal to the tax fraction ($^{14}/_{114}$) of the cost of these second-hand goods acquired from the non-vendor. What are second-hand goods? They are goods that were previously owned and used. The amount of the input VAT claimable is the tax fraction multiplied by the lesser of the cost or market value of the item being sold.

Finally, what is meant by the time of the supply? The general rule for time of supply is the earlier of the invoice date issued or any payment of the consideration. This concept determines the tax period in which the VAT must be charged or claimed. We must pay output VAT over to SARS, or claim input VAT from SARS, in the tax period.

This video has hopefully given you a better idea of what output and input VAT is. Thanks for watching.