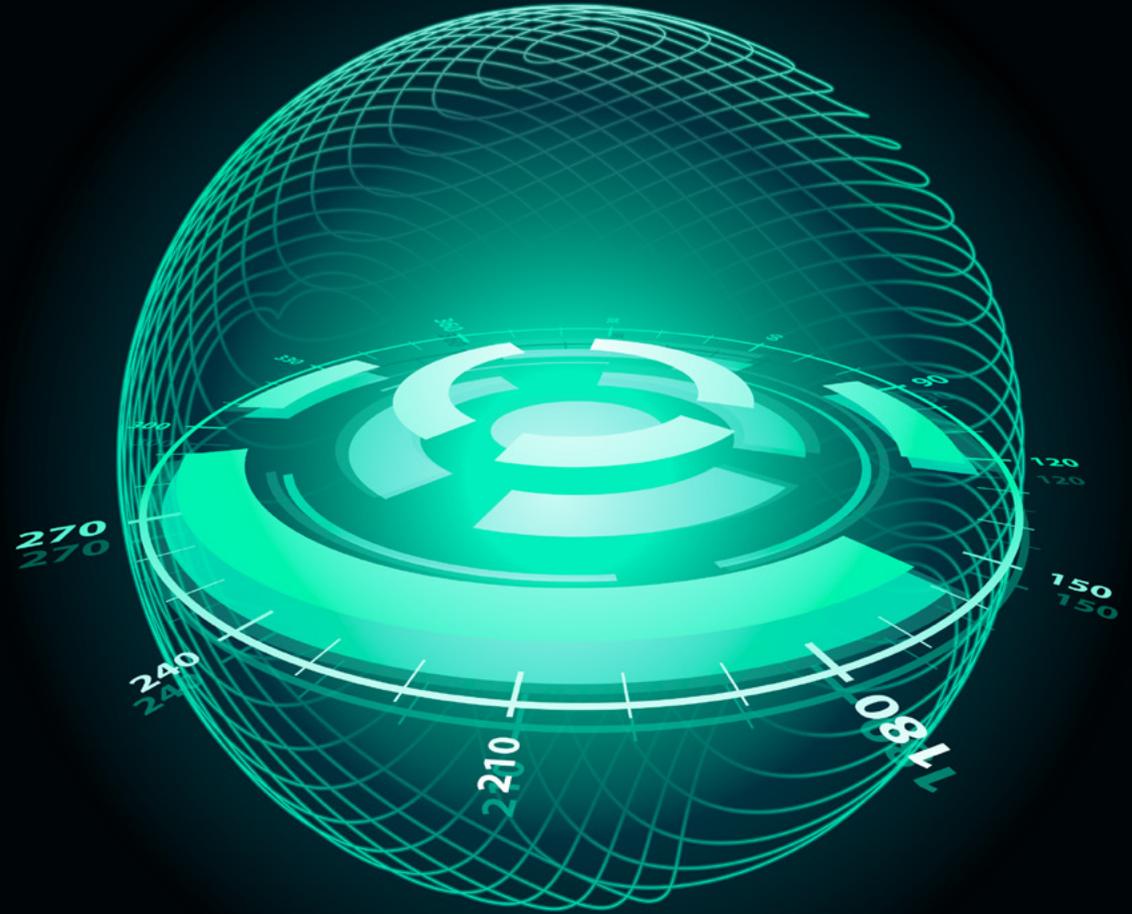




## Value-Added Tax

Closing the compliance gap



# Value-Added Tax

## Closing the compliance gap

There has recently been renewed focus by the South African Revenue Service (SARS) on value-added tax (VAT) in an effort to close the tax revenue gap. It is important to ensure that transactions are treated correctly from a VAT perspective to avoid unnecessary disputes and potential assessments for VAT, penalties and interest.

We highlight below some key SARS focus areas as well as other topical areas in the insurance industry. We have also included a recent development regarding the voluntary disclosure process and the requirement that the disclosure is indeed voluntary.

### No-claim bonuses

IFRS 17, the latest accounting standard for insurance contracts, will replace IFRS 4 for financial years beginning on or after 1 January 2023. In summary, IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts.

In readying themselves for IFRS 17 short-term insurers that have no-claim bonus features built into their insurance contracts need to give consideration to the accounting for these features. There has been much debate in the industry on how the no-claim bonus features impact the contract boundary, and whether the liability for future bonuses payable forms part of the liability for remaining coverage, or incurred claims. From a VAT perspective,

the treatment of no-claim bonuses depends on the characteristics of the underlying supply, or the event that gives rise to the payment. The VAT treatment of a no-claim bonus could take the form of a retrospective discount (credit note event) with the resultant input tax adjustment or a reduction in future premiums where VAT will be accounted for at a reduced amount.

The accounting for no-claim bonuses under IFRS 17 and their VAT treatment may therefore appear different. The evaluation of the accounting for no-claim bonuses for purposes of IFRS 17 also offers an opportunity for insurers to review their current insurance contract wordings to ensure that the VAT treatment is consistent with the requirements of Value-Added Tax Guide for Short-Term Insurance published by SARS.

### Management of superannuation schemes

Long-term insurers would generally not levy VAT on the insurance premium payable by the insured. Currently, long-term insurers must account for VAT on the management of a superannuation scheme either on the consideration embedded in the insurance premium or the cost of making such supply, whichever is greater (section 10(22A)). However, Binding General Ruling 34 (Issue 2) (BGR 34) allows the insurer, who does not charge a specific consideration for the management service, to use the cost of making the supply to determine the value of the

consideration on which VAT must be accounted. BGR 34 also provides the method for calculating such cost.

In terms of a proposed amendment, section 10(22A) will be deleted which means that BGR 34 will no longer be applicable. This will have the effect that, where there is no fee embedded in the premium charged by the long-term insurer, a portion of the premium will be subject to 15% VAT to the extent that it is attributable to the management service. Should a long-term insurer wish to embed a fee in the premium charged, such fee should be specified in the insurance contract. Where the fee is not specified, section 10(22) requires a vendor to attribute that portion of the consideration received (being a consolidated charge for more than one supply) to the making of taxable supplies as is properly attributable to it.

The deletion of section 10(22A) means that if there is a fee/commission embedded in the premium, the long-term insurer needs to make a reasonable apportionment of what part is subject to VAT and what part is exempt from VAT, now with reference to section 10(22) of the VAT Act (with affect from 1 April 2021). In view of the proposed amendment, long-term insurers should review their contracts and consider the manner in which the reasonable apportionment can be made.



### Apportionment method

The stated policy of SARS is not to make VAT apportionment rulings effective retrospectively to prior financial years. As a result, a vendor must apply in the current financial year should it wish to apply an alternative apportionment method.

During 2019, the Tax Court considered an application for a retrospective apportionment ruling (VAT Case 2063). The taxpayer apportioned the VAT on its expenses but did not have prior written approval for the apportionment method it applied. The taxpayer applied in its 2017 financial year to SARS for approval to apply an appropriate apportionment method retrospectively to 1 February 2014. SARS issued a binding private ruling to the taxpayer in which it approved the application of a transaction count-based method. The ruling was made effective from 1 March 2016, being the commencement of the financial year in which the taxpayer applied for the ruling and not 1 February 2014 as per the vendor's request.

The Tax Court found in favour of SARS on the basis that the standard turnover-based method as set out in Binding General Ruling 16 was the only ratio applicable to the taxpayer. Proviso (iii) to section 17(1) of the VAT Act expressly precluded SARS from issuing a ruling that had effect prior to 1 March 2016.

This judgement is, however, being taken on appeal on the basis that there is an alternative interpretation of proviso (iii), that is, if read with sub-paragraph (aa), a ruling may not be applied for retrospectively beyond the start of that particular financial year, only in instances where the vendor already had an approved method.

Even short-term insurers need to consider the impact of non-taxable income in the form of investment income (e.g. interest and dividends) and foreign reinsurance claim receipts.

As the standard turnover-based method is rarely representative of the extent to which a vendor utilises its expenses in order to make taxable supplies, the failure to apply for a ruling application may result in a vendor having to apply an inappropriate apportionment method which is contrary to the principles for claiming input tax.

### Voluntary disclosures

In order for a voluntary disclosure application to be valid, the disclosure must be "voluntary". In the *Purveyors South Africa Mine Services (Pty) Ltd v CSARS* (Purveyors case), the High Court found that an application cannot be "voluntary" if SARS has prior knowledge of the default. In this specific instance, Purveyors queried its liability to pay customs VAT with SARS via email and telephonic discussions, during which SARS confirmed that Purveyors is required to pay customs VAT and that the default is subject to penalties and interest. Although it is unclear at this stage whether the High Court judgement will be appealed, prior interactions with SARS (e.g. ruling application) must be carefully considered as these could negatively impact a later request for relief under the Voluntary Disclosure Programme.

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