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VALUE ADDED TAX PUBLIC RULING

ACCOUNTING METHODS

LRA VAT PUBLIC RULING **ISSUE 3**

Subject	**:**	**ACCOUNTING METHODS**
ACT	**:**	**Value Added Tax Act 2001 as amended**
Section	**:**	**Sections 20, 21 and 22**
Date	**:**	**April 2011**

BACKGROUND

In terms of the provisions of the VAT Act 2001 as amended (hereinafter "the Act"), registered vendors are required to account for VAT under two methods of accounting, namely, invoice and cash methods. It is, however, important to note that, although the Act provides for accounting under both the invoice and cash methods, vendors are primarily required to report the VAT on the invoice method. It is therefore, only under special circumstances and by application to the Commissioner General that a vendor would be granted permission to account for the VAT under the cash method.

The application for change in accounting method will only be successful if the vendor can prove that at least 90% of the total value of the taxable supplies consists of services. However, care should be taken that where a vendor has been granted permission to account for the VAT under the cash method, special rules explained in detail below must be followed for the change in the vendor's accounting method. It is very important to note that a vendor cannot account for VAT using both the invoice and cash methods at the same time.

The Law and its Application

The Invoice Method

Section 20 of the Act provides a basis for accounting for VAT under the invoice method and the timing rules that are specifically important in the determination of the input tax credit allowable or refundable under the invoice method. The most important consideration is the fact that under the invoice method, VAT is accounted for as the difference between the output tax on the reported sales and the input tax allowed to the vendor on purchases. The vendor has to account for the VAT on the sales even if payment has not been received, that is, where sales have been made on credit.

Further, the input tax is allowable in the tax period in which the taxable purchases or imports are made. The vendor will only be allowed the input tax credit upon proof of valid tax invoices indicating the tax incurred by the vendor on acquiring taxable supplies in the tax period concerned. It is also important to take note that the input tax incurred by the vendor will only be refunded to the extent that it exceeds the output tax on the reported sales.

A valid tax invoice is an invoice containing the particulars as prescribed in section 24(8) of the Act, read with Schedule III thereof:

(i) the words “value added tax” invoice;

(ii) the commercial (trading) name, address, place of business, and the taxpayer’s identification number of the vendor making the supply;

(iii) the commercial name, address, place of business, and the taxpayer’s identification number of the vendor to whom the supply is made;

(iv) an individualised invoice, and the date on which the VAT invoice is issued. An individualised invoice is one which belongs to a specific vendor, that is, it is not an invoice issued to a group;

(v) description of the goods or services supplied and the date of supply;

(vii) the quantity or volume of the goods or services supplied;

(viii) where a taxable supply is made without a separate amount being identified as a payment of VAT, a statement that the consideration for the supply includes a charge of the tax and the rate at which the tax was charged; and

(ix) the total amount of the tax charged, the consideration for the supply and the consideration inclusive of tax.

Invoices from South Africa

The Kingdom of Lesotho and the Republic of South Africa have entered into an agreement for the prevention of fiscal evasion on VAT. This agreement has allowed the competent authorities of the two countries, the Lesotho Revenue Authority (LRA) and the South African Revenue Services (SARS), to enter into arrangements to ensure that the objective of preventing fiscal evasion on VAT is achieved, through, among other things, proper and legitimate documentation. Consequently, Lesotho vendors who buy goods from South Africa are required to present a valid tax invoice in terms of the South African VAT Act of 1991 as proof of the input tax incurred. In terms of that law a valid tax invoice is one which complies with the following requirements;

(a) Full tax invoice – where the consideration inclusive of VAT is greater than R3000.00 -

(i) The words “tax invoice”;

(ii) The name, address and VAT registration number of the South African supplier;

(iii) The name and address of the recipient;

(iv) The tax invoice number and date upon which the tax invoice is issued;

(v) Full and proper description of the goods – also indicating where applicable, that the goods are second-hand goods;

(vi) The quantity and volume of the goods supplied;

(vii) Either –

(1) The value of the supply, the amount of VAT and the total consideration for the supply; or

(2) Where the consideration includes VAT, the amount of VAT charged or a statement that the consideration includes VAT at the standard rate of 14 percent.

(b) Abridged tax invoice – where the consideration inclusive of VAT is 3000.00 or less –

(i) The words “tax invoice”;

(ii) The name, address and VAT registration number of the South African supplier;

(iii) The tax invoice number and date upon which the tax invoice is issued;

(iv) A description of the goods – also indicating where applicable, that the goods are second-hand goods;

(v) Either –

(1) The value of the supply, the amount of VAT and the total consideration for the supply; or

(2) Where the consideration includes VAT, the amount of VAT charged or a statement that the consideration includes VAT at the standard rate of 14 percent.

Example 1: Relevant Invoices and Calculation of VAT – the Invoice Method

Mr Motlatsi, a registered businessman in Lesotho, made both cash and credit sales during February 2010 and has issued tax invoices for both types of sales. The sales are M1140 and M2280 respectively. He expects payment for the credit sales in March. In the same month, he has purchased goods on credit from suppliers in South Africa for R1938 and Swaziland for E570 and the suppliers have invoiced him accordingly with payment to be made in March. Note that all figures are inclusive of VAT of 14%. The VAT on Swaziland goods is import VAT, and is explained below.

Calculation of VAT for February 2010-07-08

Sales: Cash	*M1 140*	
Credit	*M2 280*	*M3 420*
Output VAT (total M3 420 divided by 1.14)		*M 420*
Purchases: South Africa	*M1 938*	
Swaziland	*M 570*	*M2 508*
Input VAT (total M2 508 divided by 1.14)		*M 308*
VAT Payable (Out – Input)		***M 112***

From the above example it should be noted that all invoice are taken into account, both cash and credit sales and purchase. Further note that both sales and purchases took place in the same month

In terms of the agreement between Lesotho and RSA Mr Motlatsi should request duplicate invoices from the suppliers, or duly certify a copy. One will be left with the LRA officials at the border and this is used to claim back the VAT from SARS by the LRA. The other one is retained for accounting and purposes of substantiating the input tax.

With respect to the Swaziland purchases the suppliers should zero-rate, as is generally the case with exports. It is important that Mr Motlatsi ensures that this is done since there is no agreement between Lesotho and Swaziland that ensures that Lesotho can claim back the tax from Swaziland. At the border Mr Motlatsi will pay import VAT and the documentation will then be used for purposes of calculating the input tax when making the tax return. If Mr Motlatsi fails to ensure that the goods are zero-rated in Swaziland it means he will pay VAT in both Swaziland and Lesotho, but will only be able to claim the tax paid on importation, thus making his goods more expensive.

The Cash Method

A vendor whose taxable supplies are at least 90% services, may apply for permission to account for VAT on the cash method. In terms of the provisions of section 21 of the Act, a vendor who has permission to file under the cash method is required to report the output tax on the sales in the period in which the payment for the sales or any other consideration is received. Similarly, input tax credit is only allowable to the vendor under the cash method in the period in which payment or part payment has been received in respect of the taxable sales made in that period. However, for the claim of the input tax credit to be allowable, a vendor must be in possession of a valid tax invoice.

Example 2: Relevant Invoices – the Cash Method

Mr. Motsoalle, a registered service provider in Maseru who has applied for and consequently been granted permission to use the cash method, during the month of February 2010 makes some purchases for the business on credit worth M100 000.00. In March he renders services for M50 000.00 in cash to his customers and he also makes a part payment of M25 000.00 to his suppliers for the procurement of goods and services he made in February 2010.

For the month of February 2010, there will be no output tax to be accounted for nor any input tax credit claim by Mr. Motsoalle since there were no sales. It is important to note that since during the course of February Mr. Motsoalle did not make any payments for the goods, he is not in a position to make any input tax credit claim. This is so even if Mr. Motsoalle is at the time in possession of a valid tax invoice showing the VAT due on the goods. Under the cash method, it is only when Mr. Motsoalle has made full or part payment for the goods that he will be entitled to make a claim for the input tax credit in the period the payment was made. Thus, Mr. Motsoalle will only be able to file for a claim for the input tax credit in March 2010 against the M25 000.00 that he would have paid to his suppliers. Similarly he will have to account for the output tax in the period of March 2010 for the goods he sold for the M50 000.00 during the course of this month.

Thus in March, he will account for the tax as follows;

Cash sales	*M50 000.00*		
Part payment	*M25 000.00*		
VAT payable	*M25 000.00 *14/114*	=	***M3 250***

Change in Accounting Method

Where a vendor has been granted permission to account for VAT on the cash method, as opposed to the invoice method, or required by the CG to revert to the invoice method from the cash method, the vendor must follow specific rules for the calculation of the output tax. The input tax claimable for the period before a change in accounting method must be authorised.

If a vendor changes from the invoice method to the cash method or from the cash method to the invoice method, the vendor is required, in terms of section 22(1) and (3) of the Act, to determine the liability in the first tax period in which permission for a change in accounting method has been granted.

The tax liability for a current tax period is determined as a result of an adjustment resultant from the first tax period before a change in accounting method and includes the tax liability as calculated in the current period under the new method of accounting. Thus, the current tax liability reportable under the new accounting method would be a total on the tax liability as determined under the old method of accounting (that is, the invoice method) and the tax liability under the new method of accounting (that is, the cash method). Vendors are required to submit a list of debtors and creditors in support of the adjustments made in the calculation of the tax liability under the old method of accounting (that is, the invoice method).

For illustration purposes, it may be noted that if a vendor changes from the invoice method to the cash method and the creditors balance is more than the debtors balance, VAT on the difference will be payable by the vendor (see Example 3 below). However, in the case where the vendor changes from the invoice method to the cash method and the creditors balance is less than the debtors balance, VAT on the difference will be a refund due to the vendor (see Example 4 below).

Example 3: Effecting Change in Method – From Invoice to Cash Method

A vendor has applied and been granted permission to change from the invoice method to the cash method. At the end of March 2010 he is now required to report the tax on the cash method. During the course of February, whilst under the invoice method he purchased goods from his suppliers for M12 624.00 and during the same month, he sold goods to his customers for M25 000.00 but received only M6 660.00 and the balance of M18 340 .00 still owed to him (all amounts being inclusive of VAT).

The vendor will therefore make an adjustment in April 2010 as follows:

Debtors balance	*M12 624.00*
Less creditors balance	*<u>M18 340.00</u>*
VAT payable	*M5 716.00 *14/114 = M702.00*

Example4: Effecting Change in Method – From Cash to Invoice Method

Debtors balance	*M47 860.00*
Less creditors balance	*<u>M 18 740.00</u>*
Difference	*M29 120.00 *14/114*
VAT refundable	*M 3 576.00*

Disclaimer

This ruling provides the general interpretation of the legislation. It has no binding legal force and does not affect a taxpayer's right of objection and appeal to the Commissioner General, the Revenue Tribunal or the Courts of Law. This ruling shall not affect the taxpayer's right to argue for a different interpretation, where necessary, in any appeal process, as stipulated in the revenue laws.

Bank Reconciliation

Reconciliation Date	**4/30/2010**

Opening Balances

Calculated Bank Statement Balance	7,982.87
Outstanding Items:	
Withdrawals	-4,229.34
Deposits	2,340.00
Cashbook Balance	6,093.53

Current Month Transactions

Withdrawals	-15,762.88
Deposits	14,700.00

Closing Balances

Cashbook Balance	5,030.65
Outstanding Items:	
Withdrawals	-1,042.00
Deposits	2,650.00
Calculated Bank Statement Balance	3,422.65

Actual Bank Statement Balance	**3,422.65**

Unreconciled Difference