

MODULE 7

TAXATION AND VALUE ADDED TAX (VAT)



In this module you will be able to understand and explain the basic concepts of VAT including the following:

- Need for VAT
- Purpose of VAT
- Principles of VAT
- Zero-rated items
- VAT exempted items
- VAT-able items
- Current VAT rate



Prior learning

The various forms of tax such as income tax and rates.

TAXATION IN SOUTH AFRICA

Before studying the specific principles of VAT, it will be useful to consider the overall context of taxation in general.

In all countries adhering to a capitalistic economy, the forces of demand and supply determine the goods and services offered by and to the citizens and business organisations. If the population demands a certain product or service, then businesses will tend to be formed to satisfy that demand. For example, several years ago there was a certain demand for cell-phones in this country, which led to the formation of MTN, Vodacom and Cell-C. The demand and supply for any product or service ultimately determines its price, and suppliers will enter the market if they feel that the expected financial returns are worthwhile.

However, the market forces cannot always be relied upon to provide certain products or services on a scale and at a price that the country needs. Market forces are also affected by economic conditions. For example if there is a shortage of money in the country, the demand for luxury goods will decline and certain suppliers might close down their businesses. This cannot be allowed to happen in the case of essential services that the country needs for its continued existence and progress.

Consider the case of the country's police force. The SA Police Services offer their services free to the population of South Africa. History has proved that there is no entrepreneur or business organisation that would be willing to use its resources in providing a service such as this for no return. It is true that commercial security companies have started up. These companies charge fees for their services, which they offer only to those consumers who might demand more than the public service offered to all South Africans and who are willing to pay more for that service.



Similar considerations apply in other areas of South African life such as education, the justice system, health services, roadworks, the defence force and government administration. In years gone by the South African government was responsible for the provision of many more services than it provides today, but as the economy of the country has developed, more and more of these services have become the responsibility of commercial organisations. Telkom and Iscor are two examples.



The Government requires income to cover these costs. The income it receives is mainly in the form of Tax. The Income Tax Act is a law passed in parliament which makes it compulsory for every person and company to pay tax on the income earned by them, according to the tax rates laid down in the Act. All employers are required

to deduct this income tax from their employees on a monthly basis and pay it over to South African Revenue Services (SARS) who collect the taxes due to the government. This is known as the PAYE (Pay-As-You-Earn) system. Those people who are self-employed are required to register as provisional taxpayers and submit provisional tax returns every six months. The Income Tax rates are based on a progressive rate structure. The higher a person's income is, the higher his tax rate. At present, persons earning less than R60 000 per year do not pay income tax. (This figure can be adjusted by the Minister of Finance at any time). Companies pay a percentage of their profits as tax.

There are several other forms of tax levied in South Africa. Customs duty is levied on imported items. Excise duty is levied on certain items, the usage of which the government wishes to restrict e.g. alcohol or cigarettes. Estate duty is levied on the value of a person's wealth when he dies. Transfer duty is levied on the purchase price of land and buildings. Value-Added Tax is yet another example.

There are also various other taxes and duties.

TASK 7.1 Why pay tax according to SARS

Fill in the missing word in the blanks marked A to K in the following extract. Select your answers from the list below.

budget; defence; dinner; economic services; expenditure; Finance; financed; Health; hospitals; job; private schools; roads; taxes;

Without the revenue fromA....., the government cannot do itsB..... The state needs your tax rands to fund social andC..... programmes, and to provide goods andD....., such as schools, universities,E....., clinics andF....., as well asG.... and security. Every year, the Minister ofH..... presents the annualI.....in parliament, which outlines the totalJ..... for the following financial year and the ways in which this expenditure will beK.....

TASK 7.2 Definitions and explanations of some forms of taxes in South Africa

Match the most appropriate statement from Column "Y" to the term in Column "X".

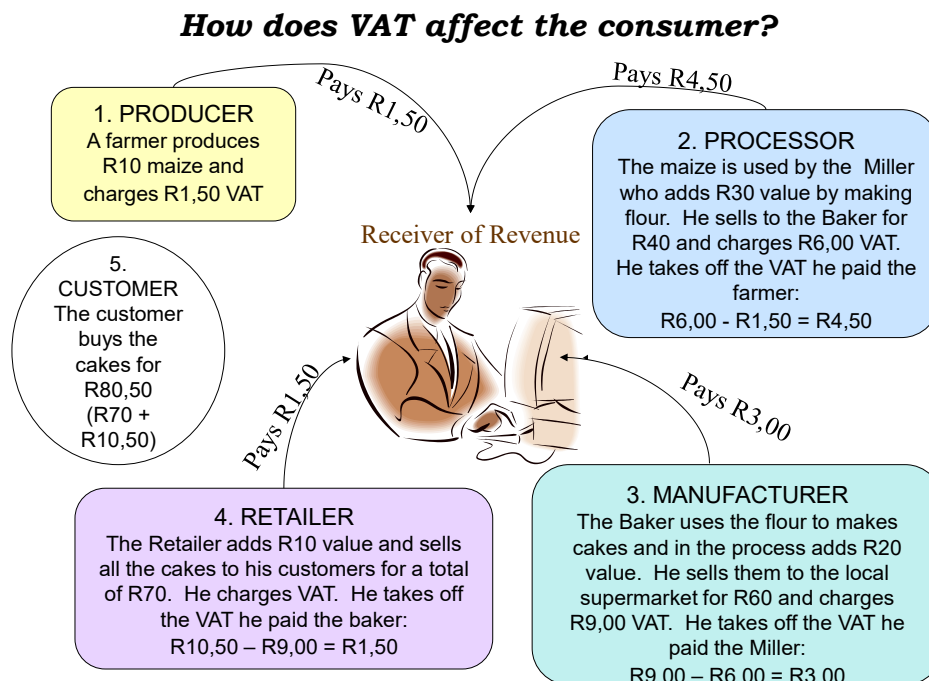
COLUMN "X"		COLUMN "Y"	
1.	Income Tax	A	This tax was introduced in October 2001. It forms part of the income tax system and includes in taxable income capital gains made on the disposal of assets.
2.	Capital Gains Tax (CGT)	B	This tax is payable on the value of property disposed of by a resident by means of a donation.
3.	Value Added Tax (VAT)	C	This tax is the government's main source of income and is levied in terms of the Income Tax Act, 1962. This tax is levied on a South African residents' worldwide income.
4.	Excise duty	D	All employers are required to deduct this income tax from their employees on a monthly basis and pay it over to South African Revenue Services (SARS) who collect the taxes due to the government.
5.	Transfer duty	E	It is the government's second biggest source of income. VAT is also levied on the importation of goods and services into South Africa. It is levied at the standard rate of 15%, but certain supplies are subject to a rate of zero or are exempt from VAT.
6.	Estate duty	F	This levy is a compulsory levy scheme for the funding of education and training. SARS administers its collection. The rate is 1% of a payroll and is payable by employers who are registered with SARS for employees' tax purposes.

7.	Unemployment Insurance Fund (UIF)	G	This duty is levied as a specific duty on tobacco and liquor, some cosmetics, televisions, audio equipment and motor cars. Relief from duty is available where excisable products are exported.
8.	Skills Development Levy (SDL)	H	This fund provides short-term relief to workers when they become unemployed or are unable to work because of maternity or adoption leave, or illness.
9.	Donations Tax	I	For the purposes of this duty, an estate consists of all property of the deceased - including deemed property, such as life-insurance policies and payments from pension funds. The duty, at a rate of 20%, is calculated on the dutiable amount of the estate
10.	Pay As You Earn (PAYE)	J	This duty is payable by individuals when they acquire property at progressive marginal rates between 0% and 8%. When property is acquired by a person other than an individual, such as a company or trust, transfer duty is payable at a rate of 8%.

THE GENERAL PRINCIPLES OF VALUE-ADDED TAX

VAT is the most pervasive of all the taxes levied in South Africa as it applies equally to all persons. No person, irrespective of how little he earns, is exempted from paying VAT. Many people may argue that VAT is the fairest system of taxation.

VAT is charged on the supply of goods or services by a vendor (i.e. a supplier). The general rule is that a vendor charges the consumer a standard rate of 15% VAT (this %'s is controlled by the government and can be adjusted by the Minister of Finance at any time) on the price of articles or services charged by him. The vendor deducts the value of VAT paid by him to his suppliers. The vendor is required to pay over the difference to SARS every month. This represents tax on the 'value added' by his business. As we shall appreciate below, the system is not so simple but it is effective in the manner in which SARS is able to collect all the tax revenues due.



VAT is charged on goods as well as services. For example, the fees charged by an advertising business or an accountant are subject to VAT. VAT is charged on any activity carried out regularly or continuously by businesses, traders, manufacturers, professional persons or clubs.

Although it is not necessary for you to do VAT calculations in Grade 10, the following tasks will assist you in a better understanding of the concepts.

REGISTRATION AND PAYMENT PROCEDURES

It is compulsory for all businesses with sales (turnover) in excess of R1 000 000 per year to register as a vendor. Registered vendors are then issued with the necessary forms which must be submitted to SARS every second month together with the amount payable.

A business with sales less than R1 000 000 may apply for voluntary registration that means that they can deduct their input taxes from the output taxes in paying over the required amount. Businesses which are not registered as vendors are simply required to pay over the full 15% on cost prices to their suppliers, who will pay over the VAT to SARS.

No business earning less than R50 000 is allowed to register as a vendor.

In assessing the sales value, SARS will consider the owner and not specific businesses. For example, if you own one business with sales of R800 000 and another business with sales of R220 000, you will have to register as a vendor because your combined turnover exceeds R1 000 000.

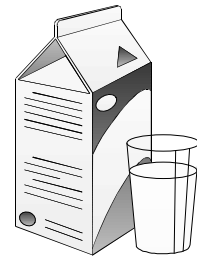
As a businessman, one of your concerns might be that if you sell on credit and have to wait for payments from your debtors, you might face a liquidity problem if you have to pay VAT in the month in which the sales transaction occurs. It is for this reason that the VAT regulations make provisions in the calculations to avoid this problem.

ZERO-RATED ITEMS

0%

As a general rule, all taxable supplies are subjected to the standard rate of 15% (VAT-able items). However certain items are zero-rated which means they are subject to a tax rate of 0%.

Zero-rated items comprise goods or services that normally would be subjected to VAT, but which because of their nature, cause hardship to indigent consumers would arise if 15% VAT were to be levied. These items are brown bread, maize products, rice, lentils, dried beans, legumes, fruit, vegetables, milk, milk powders and blends, cooking oil, eggs, canned pilchards and paraffin. Petrol and diesel fuel are also zero-rated but they are subject to fuel levies which are included in the pump price. However, this % can be adjusted at any time by the Minister of Finance.



VAT EXEMPTED ITEMS

VAT-exempted goods and services are those items that, by law, are not subject to VAT. VAT may not be charged on these items at all. Examples are: interest rates, export services, childcare services, educational services, services provided by associations not for gain.

Supplies on which VAT is not levied include:

- Private sales of personal or domestic items
- Hobbies or any private recreational pursuit (unless this becomes a business)
- Salaries and wages

This may seem similar to zero-rated items but it is not. Remember, zero rated items could be charged VAT at any stage the Minister of Finance decides to increase the % above 0. Whereas VAT-exempted items cannot have VAT added to the price at all.

EVASION AND AVOIDANCE OF TAX

It is every person's prerogative to avoid the payment of tax as much as possible. For example, if you wish to pay as little VAT as possible, then you may reduce your purchases. If you wish to pay less income tax, then you can transfer your savings into tax-free investments such as endowment funds or government bonds. This is called tax avoidance.

However, it is illegal to evade tax. If you have earned income which is taxable, it is a legal requirement to declare this income on your tax returns and the appropriate tax will be levied by SARS. If you fraudulently

submit incorrect tax returns, you will be guilty of tax evasion which is a criminal offence punishable by fines or imprisonment.

Tax evasion is a potential problem that every government tries to combat. It must be remembered that the government needs a certain amount of tax revenue in order to cover its expenses. If the government is unable to combat tax evasion, a consequence will be that tax rates will be increased which means that the honest taxpayers are disadvantaged even further. In recent years, South Africa has experienced declining tax rates for a variety of reasons, one of which is the increased efficiency in collecting taxes.

TASK 7.3 Taxable items, Zero rated and Exempt items

Study the following 6 items (of goods or services) and tick off those which you consider to be:

- Liable for 14% VAT
- Zero rated (0%) VAT
- Exempt from VAT

Thereafter you must write down a further 6 items (goods and services) – 2 items that are 14% taxable; 2 items that are 0% taxable and the last 2 items being VAT exempt.

	Goods / services	15% VAT	0% VAT	VAT Exempt
1.	Brown bread			
2.	Salary of hotel manager			
3.	Tinned sardines			
4.	Petrol			
5.	School fund payable to public school			
6.	Purchase of a personal computer			
7.				
8.				
9.				
10.				
11.				
12.				

TASK 7.4 Presentation of Government revenue and expenditure

Compile a wall-chart or PowerPoint presentation to reflect:

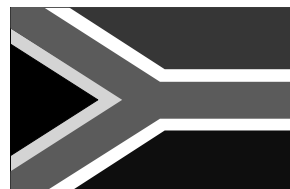
- The sources of tax revenue received by the government
- The areas in which the government spends the tax revenue.

TASK 7.5 Debate on whether income tax should be abolished

Hold a debate in your class. The motion is: 'The country will benefit as a whole if income tax is abolished'. Team A is to propose the motion. Team B is to oppose the motion.

TASK 7.6 Group discussion on taxation

- Why taxes are a necessary evil?
- Types of taxes levied by the SA government.
- What is VAT and how it is calculated?
- Why is VAT a tax that is fair to all citizens?
- Why are some goods are zero-rated?
- The difference between tax avoidance and tax evasion.



TASK 7.7 Group discussion on taxation

Undertake this task as a role-play. One person enacts the part of tennis coach who makes a lot of money in charging fees for tennis lessons. He has a flashy car and he holidays overseas. He accepts only cash, not cheques, and he does not issue receipts. He brags that he does not pay taxes and SARS cannot catch him for tax evasion. He charges VAT on his fees, but he is not registered as a vendor. Another person acts the

part of his neighbour who earns a fixed salary from his employer (PAYE is deducted each month) and struggles to cover his costs each month.

The role-play is intended to communicate:

- The difference between tax evasion and tax avoidance
- The lack of ethics on the part of the tax evader
- The effect on honest taxpayers if tax evasion is allowed to exist.

You may change the circumstances and you may introduce other characters, e.g. a SARS inspector (or St Peter at the Pearly Gates!)

It is not a requirement of your Grade 10 syllabus that you should be proficient in calculating or processing VAT on the required forms or in the journals and ledger. That task will be left for future years.

TASK 7.8 Ethical & Internal control issues relating to VAT

For a general understanding of ethics in business, fraud and internal control, you may refer to Modules 13 and 14. Answer the following questions:

- 7.8.1 Briefly explain how VAT is collected in South Africa.
- 7.8.2 South African Revenue Service (SARS) needs to set up a division to check that all the amounts owed by businesses for VAT are in fact paid over to SARS. Do you agree with this statement? Explain.
- 7.8.3 How is the honest citizen in South Africa affected by disreputable businesses that do not pay over the correct amount of VAT due to SARS?
- 7.8.4 If you were a SARS official tasked with checking that the correct amount of VAT has been paid over, what would you want to check? Provide at least three points.

CHECKLIST

Skills	Yes – proficient	Requires more attention	Complete
Understand the reasons for taxation in the country.			
Understand the basic principles of Value Added Tax.			
Understand who needs to register as a VAT vendor.			
Understand the difference between standard VAT, zero-rated and tax exempted items.			
Understand the difference between tax evasion and tax avoidance.			