TradeTax Plus
Centre of Excellence

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Marius Jonker

Chief Executive Officer

Association of Debt Recovery Agents

Suite 202

L A K House

4 Fir Drive

Northcliffe Ext 2

2195

Email address: marius@adraonline.co.za

VALUE ADDED TAX ("VAT") OPINION

1. We refer to your Brief issued on 9 July 2018 and our letter of engagement dated 13 July 2018.

BACKGROUND

1. This opinion deals with the VAT treatment of fees charged and recoveries made by debt collectors registered in terms of the Debt Collectors Act, Act 114 of 1998 (hereinafter referred to as "the DCA").
2. Debts are collected by debt collectors in respect of credit provided in terms of the National Credit Act (hereinafter referred to as "the NCA") as well as credit facilities not regulated by the NCA. For the purposes of this opinion we shall collectively refer to the two categories of suppliers of credit providers.
3. Generally speaking a credit provider will enter into a written agreement with a debt collector in terms of which the credit provider to recover a debt owed to the credit provider gives the debt collector. The mandate provides for the debt collector to receive compensation for its services based on a fixed percentage of the capital or interest successfully recovered.
4. In certain instances the mandate provides that the debt collector for his/her own account may recover the interest. You indicated that this arrangement does not represent a cession of interest; the creditor retains its rights to the interest. If the contract between the parties is terminated or a specific instruction is withdrawn from the debt collector by the credit provider, the mandate to recover the interest portion of the debt is also withdrawn from the debt collector and all rights to interest revert to the credit provider.
5. In addition to the above contractual remuneration paid by the credit provider, the debt collector is entitled to recover from the debtor fees and disbursements in respect of the items limited to the amounts prescribed in Annexure B to the regulations promulgated in terms of the DCA (Regulation 11 amended by various subsequent regulation, the latest being Regulation No. R. 1141 of 27 October 2017).

6. Annexure B fees include a 10% receipting fee (also referred to as a collection commission). The receipting fee is calculated as 10% of each instalment (capital and/or interest) paid by the debtor. These fees are recovered from the debtor over and above the capital and interest. The debt collector recovers these fees for its account. Annexure B provides that the *quantum* of all fees excludes VAT.
7. The agreement between the credit provider and debt collector may contain clauses regulating the recovery of Annexure B fees. The credit provider and debt collector may agree that the debtor may not recover any Annexure B fees from the debtor. Where the credit provider does not preclude the recovery of Annexure B fees, the contract often contains a provision to the effect that the debt collector must, viz-a-viz the credit provider, recover Annexure B fees only once the capital and or interest is recovered in full. The credit provider however never assumes any responsibility to pay Annexure B fees to the debt collector.
8. Most of the debt recovered by the industry is consumer debt recovered from individuals who are not VAT vendors.
9. In practice a debtor would pay the debt in rescheduled instalments and may pay such instalments (including capital, interest and fees) into the debt collectors statutory trust account (registered in terms of the DCA) or directly into the creditor's bank account.
10. In practice debt collectors normally demand payment for Annexure B fees from the outset, i.e. debtors are advised upfront that the debt collector's fees are payable. The *quantum* of the fees is also reflected on correspondence with the debtors.

THE BRIEF

You requested our opinion on the following specific issues:

11. Is VAT payable by debtors on Annexure B items?
12. If the answer to the above is yes, when is output payable to SARS by the debt collector on the fees?
13. How must the debt collector account for Annexure B fees and VAT thereon (if the transaction is VAT-able) in its accounting records and to debtors?
14. If VAT is payable on Annexure B fees, who (if anybody) is entitled to the input tax credit?
15. If VAT on Annexure B were incorrectly recovered from debtors in the past, is the credit provider entitled to an input tax deduction?

16. If Annexure B fees are not subject to VAT but debt collectors recovered VAT on the fees in the past:
    a. Are the debt collectors exposed to any risk, and if so, how is the debt collector to mitigate such risk?
    b. Is the debt collector liable to the debtor for VAT incorrectly levied in the past. If so, how is this practically achieved in practice?
17. Should a credit provider be of the view that it is entitled to the benefit of input tax on VAT recovered from debtors on Annexure B fees and instruct the debt collector to provide the credit provider with data to enable the credit provider to process such VAT input claims against SARS, is the debtor collector exposed to any risk in providing such data to the credit provider?
18. Is there a need for ADRA as representative of the debt collection industry (and/or individual debt collectors) to approach SARS or any other body for any form of ruling?

EXECUTIVE SUMMARY

19. We are of the opinion that:
    a. A persuasive argument exists for the contention that Annexure B charges represent consideration for taxable supplies and are accordingly subject to VAT. Strong arguments to the contrary however cannot be discarded lightly;
    b. Output tax is not payable on the issue of a letter of demand. Output tax becomes payable at the earliest after the completion of the taxing process or when a debtor waives his/her right to taxing;
    c. The recipient of the supply is the debtor who may or may not be entitled to the input tax credit depending on the VAT status of the debtor. In practice this normally means that output tax is payable on receipt of payment from the debtor;
    d. No tax invoices may be issued to credit providers, but any information in the format other than a tax invoice can be made available without any VAT implications; and
    e. Due to the sensitive and significant nature of the issue for the credit industry and the uncertainty with regards to the nature of Annexure B recoveries, we recommend that a Class Ruling be obtained from SARS to clarify the issue for the industry.

DETAILED BASIS FOR THE OPINION

THE LEGAL FRAMEWORK WITHIN WHICH DEBT RECOVERY OPERATES

20. To address the enquiry into the identity/ies of the potential supplier/s and recipient/s of services in the debt collection industry it is necessary to examine the statutory framework within which the relevant parties involved in the debt recovery process operate and the rights and obligation created by the relevant legislation and agreements.

THE NATIONAL CREDIT ACT

21. The NCA governs the relationship between the credit provider and the consumer.

22. Section 100 of the NCA deals with prohibited charges. It read as follows:

> (1) *A credit provider must not charge an amount to, or impose a monetary*
>
> *Liability on, the consumer in respect of-*
>
> *(a) a credit fee or charge prohibited by this Act;*
>
> (b) an amount of a fee or charge exceeding the amount that may be charged consistent with this Act;
>
> (c) an interest charge under a credit agreement exceeding the amount that may be charged consistent with this Act; or
>
> (d) any fee, charge, commission, expense or other amount payable by the credit provider to any third party in respect of a credit agreement, except as contemplated in section 102 or elsewhere in this Act. (Our underlining)

23. Section 101 of the NCA deals with the actual amounts that may be charged to consumers. The relevant sub-sections read as follows:

> (1) *A credit agreement must not require payment by the consumer of any money or other consideration, except-*
>
> *(f) default administration charges, which –*
>
> *(i) may not exceed the prescribed maximum for the category of credit agreement concerned; and*

(ii) may be imposed only if the consumer has defaulted on a payment obligation under the credit agreement, and only to the extent permitted by Part C of Chapter 6; and

*(g) collection costs, which may not exceed the prescribed maximum for the category of credit agreement concerned and may be imposed only to the extent permitted by Part C of Chapter 6. (*Our underlining*)*

24. "*Default administration charge*" is defined in section 1 of the NCA as a charge that may be imposed by a credit provider to cover administration costs incurred as a result of a consumer defaulting on an obligation under a credit agreement.

25. Part C of Chapter 6 of the NCA allows a credit provider to recover certain amounts as default administration charges from a defaulting debtor. The default administration charges contained in Part C of Chapter 6, section 132(1) of the NCA, deal with the costs associated with the repossession, attachment, etc. of goods supplied in terms of a credit agreement. It therefore does not deal with debt recovery costs.

26. As far as section 101(1)(g) debt collection costs are concerned, the NCA makes provision for the credit provider to recover debt recovery costs from the defaulting debtor. The costs may not exceed the prescribed maximum for the category of credit agreement concerned and may be imposed only to the extent permitted by Part C of Chapter 6 of the NCA.

27. Part C of Chapter 6 of the NCA does not deal with recovery of collection costs (other than collection costs associated with the repossession of goods).

28. However, the regulation dealing with the recovery of the collection charges determines that:

"*The credit provider may require payment by the consumer of default administration charges in respect of each letter necessarily written in terms of Part C of Chapter 6 of the Act. Such payment may not exceed the amount payable in respect of a registered letter of demand in undefended action in terms of the Magistrates' Courts Act, 1944 in addition to any reasonable and necessary expenses incurred to deliver such letter*". (Our underlining)

THE DCA

29. The purpose of the DCA is to establish a juristic person, the Council for Debt Collectors (section 2(1) of the DCA), to provide for the exercise of control over the occupation of debt collectors so as to legalise the recovery of fees or remuneration by registered debt collectors.

30. In summary, the object of the Council is to exercise control over the occupation of debt collectors (section 2(2) of the DCA). Hence, the DCA regulates the direct relationship between the debt collector and the debtor as well as the broader debt collection industry to regulate past alleged abusive practices in the industry. The DCA does not regulate the relationship between the credit provider and the debt collector. The relationship between the credit provider and the debt collector is regulated by the mandate given by the credit provider to the debt collector.

31. Persons wishing to conduct the business of a debt collector must register as a debt collector with the Council for Debt Collectors and pay an annual subscription fee (section 13(1) of the DCA).

32. Section 19 of the DCA deals with the recovery of money by a debt collector. It reads as follows:

> *(1) A debt collector shall not recover from a debtor any amount other than –*
>
> *(a) the capital amount of a debt due and interest legally due and payable thereon for the period during which the capital amount remains unpaid; and*
>
> *(b) necessary expenses and fees prescribed by the Minister in the Gazette after consultation with the Council.*
>
> *(2) Upon receipt by a debtor and against the payment of any prescribed fee, the clerk of a magistrate's court or a cost committee of a provincial law society may tax or assess any account or statement of costs, interest and payments claimed to be owned by a debtor to a debt collector or his or her client.*
>
> *(3) The provision of subsection (2) shall not be construed as preventing the taxation or assessment of any further account or statement of costs reflecting further amounts which become payable by the debtor to the debt collector or his or client and which arise from the same cause of debt as that from which amounts reflected in an already taxed or assessed account or statement of costs arose.*

(4) A debt collector shall deliver to a debtor, upon request and against payment of a prescribed fee, a settlement account containing a complete exposition of all debits and credits in connection with a specific collection: Provided that a debtor shall be entitled to request a settlement account free of charge once in every six months. (Our underlining)

33. Our understanding is that the purpose of the introduction of the Annexure B fee schedule in the DCA was to establish a regulated environment within which debt collectors could charge and recover the regulated fees from debtors. It in no way interferes with the fees or remuneration agreed to between the debt collector and the credit provider, which is governed by the agreement between the two parties. The credit provider is in no way liable for the fees chargeable in terms of the DCA.

THE MANDATE BETWEEN THE CREDITOR AND THE DEBT COLLECTOR

34. The mandate in terms of which a debt collector acts on behalf of the credit provider forms the basis of the legal relationship between the debt collector and the credit provider and is the exclusive source of the contractual rights and obligations between the debt collector and the credit provider.
35. The basis on which the debt collector is remunerated for his/her services is regulated by the mandate. Neither the NCA nor the DCA plays any statutory or governing role in determining the basis of the remuneration that the debt collector is entitled to with regards to the relationship between the debt collector and the credit provider.

THE VAT ACT

General section of the VAT Act

36. Section 7(1)(a) of the VAT Act imposes VAT on the supply by any vendor of goods or services supplied by him in the course or furtherance of any enterprise carried on by him. The section imposes VAT at the rate of 15% on the value of the supply.
37. Section 10(2) of the VAT Act determines that the value to be placed on a supply is the amount of the consideration for the supply.

38. "*Consideration*" is defined in section 1(1) of the VAT Act as "*in relation to the supply of goods or services to any person, includes any payment made or to be made, … whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or any other person, …" (Our underlining)*

39. "*Supply*" is defined in section 1(1) of the VAT Act as "*includes performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and any derivative of "supply" shall be construed accordingly*."

40. "*Services*" is defined in section 1(1) of the VAT Act as anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage. The definition specifically excludes a supply of money.

Sections dealing with the time of supply

41. Section 16(3) of the VAT Act determines that a vendor must account for output tax in the tax period to which the output tax is attributable. The rules governing the tax period to which output tax is attributable are contained in section 16(4) of the VAT Act.

42. Section 16(4)(a)(i) of the VAT Act determines that in the case of a VAT vendor registered on the invoice basis, output tax is attributable to the tax period in which the taxable supply is made or deemed to be made.

43. Section 9(1) of the VAT Act determines that a supply is deemed to be made at the earlier of the issuing of any invoice or the receipt of any consideration in relation to a supply.

Sections dealing with refunds to a third person where VAT was incorrectly imposed on that third person

44. Section 21(1) of the VAT Act contains the circumstances under which a VAT vendor may make an adjustment to output tax previously accounted for.

45. Section 21(1)(b) lists as a qualifying adjustment criteria instances where the nature of the supply has been fundamentally varied or altered and the vendor has furnished a return in relation to the tax period in respect of which output tax on that supply is attributable, and has accounted for the incorrect amount of output tax on the supply in relation to the amount properly chargeable on the supply as a result of one of the qualifying criteria.

46. In our opinion incorrectly levying VAT on a supply falls within the ambit of section 21(1)(b) of the VAT Act.

47. 21(2)(b) of the VAT Act determines that where a supplier has accounted for an incorrect amount of output tax due to one or more of the qualifying criteria, the supplier must make an adjustment in calculating the VAT payable by the supplier in the tax period during which it has become apparent that the output tax is incorrect. Where the output tax properly payable is less than the amount actually declared and paid to SARS, the vendor may make an adjustment to correct the over-payment in the tax period in which it becomes apparent that the overpayment/s has/have been made. The proviso to the section determines that no deduction may be made where the excess VAT has been borne by the recipient of the goods or services and the recipient is not a VAT vendor, unless the amount of the excess VAT has been repaid by the supplier to the recipient, whether in cash or by way of a credit against any amount owing to the supplier by the recipient.

The Tax Administration Act ("the TAA")

48. Section 234(g) of the TAA determines that where a person wilfully and without just cause issues an erroneous, incomplete or false document required to be issued under a tax Act to another person, that person is guilty of an offence and, upon conviction, is subject to a fine or to imprisonment for a period not exceeding two years.

THE LAW

LEGAL MEANING OF A SERVICE

49. Because of the wide ambit of the definition of "*service*" in section 1(1) of the VAT Act (anything done or to be done), nearly any supply that is not a supply of goods is a supply of services (unless it is a supply of money).

50. In Binding General Ruling 14 (paragraph 2.11) SARS ruled that no output tax is payable on insurance recoveries from third parties as these amounts are not payment in respect of a supply of goods or services to the third party or its insurer. We submit that it follows logically that had the payment related to an identifiable service, the payment would have been subject to VAT irrespective of being in the nature of a recovery.

LEGAL NATURE OF A SUPPLY

51. The leading South African case dealing with the nature of a supply is *Shell's Annandale Farm (Pty) Ltd v Commissioner, SARS 2000 (3) SA 564 (C), 2000 (7) JTLR 203*. The issue before the court was whether VAT was payable on the expropriation of land. The court held that the term "*supply*" connotes some positive act on the part of the supplier and that the process of expropriation involves no act on the part of the person whose land has been expropriated. The court added that if SARS were correct that the term "*supply*" could be interpreted to include circumstances where the vendor has not acted, there would be a genuine ambiguity in the definition of supply.

52. The definition of "*supply*" in section 1(1) of the VAT Act was subsequently amended to include the words "*whether voluntary, compulsory or by operation of law*".

53. The New Zealand High Court interpreted "*supply*" as meaning "*to furnish with or provide*" (*Databank Systems Limited v C of IR (1987) 9 NZTC 6,213 at 6,223 (HC)*). This approach is compatible with the approach followed in the Shell's Annandale Case, i.e. that it connotes some action by the supplier.

54. The Australian Goods and Services Tax Ruling 2006/9 deals in depth with interpretation of the term "*supply*". Of particular interest is the approach followed by the Australian Tax Authorities with regards to the identification of the recipient of a supply.

55. Proposition 15 of the Ruling deals with the proposition that one set of activities may constitute the making of two or more supplies. In this regard paragraph 217 to 221 of the Ruling reads a follows:

> "*217. Examining the levels of contractual or reciprocal relationships between the entities in a tripartite arrangement may reveal two or more supplies being made based upon the one set of activities.*

217A. This proposition is illustrated by Federal Commissioner of Taxation v. Secretary to the Department of Transport (Vic) (Department of Transport), where the activity undertaken by the taxi operator of transporting the eligible passenger resulted in two supplies being made:

(i) the supply of transport to the passenger; and

(ii) the supply to the Department of the service of transporting the eligible passenger.

Redrow has also been referred to as authority for the proposition that 'one set of acts can constitute two different supplies' or 'a single course of conduct by one party may constitute two or more supplies to different persons'. In Redrow, both Redrow and the prospective purchaser contracted for the estate agent's services. The agent's activities resulted in the agent making a supply of services to both Redrow and the prospective purchaser."

56. Paragraphs 221A to 221E of the Ruling deal with instances where a third party can be regarded as the recipient of a supply where the third party is responsible for the payment of the consideration for the supply of goods or services notwithstanding the contractual arrangement among the contracting parties. The relevant paragraphs read as follows:

"Factors that may point to a supply being made to a payer where there is a supply to a third party

221A. While there was no indication on the facts in Department of Transport that there was a binding obligation between the Department and the taxi operator for the latter to provide transport to the eligible passenger, the Full Federal Court concluded that there was a supply of the service of transport of the eligible passenger by the taxi operator to the Department. In practice, whether such a supply can be identified for a particular arrangement will require careful consideration of all the relevant facts and circumstances.

221B. The Commissioner considers that the following factors, in combination, may point to a supply being made by the supplier to the payer under a tripartite arrangement that involves a supply by the supplier to the customer, even where there is no binding obligation between the payer and the supplier for the supplier to make a supply to the customer:

(a) there is a pre-existing framework or agreement between the payer and the supplier which contemplates that the parties act in a particular manner in respect of supplies by the supplier to particular third parties or a class of third parties;

(b) the pre-existing framework or agreement:

(i) identifies a mechanism by which the particular third parties or the class of third parties are to be identified such that the supplies made to them come within the scope of the framework or agreement; and

(ii) specifies that the payer is under an obligation to pay the supplier if there is a relevant supply by the supplier to a third party and also sets out a mechanism by which such payment is authorised;

(c) the framework or agreement and the mechanism for authorising the payment are in existence before the supply by the supplier to the third party (that is, the supplier knows in advance that the payer is obliged to pay some or all of the consideration in the event of the supply to the third party);

(d) the supplier makes the supply to the third party in conformity with the pre-existing framework or agreement between the parties; and

(e) the obligation of the payer to make payment pursuant to the pre-existing framework or agreement is not an administrative arrangement to pay on behalf of the third party for a liability owed by the third party to the supplier. Rather, once the supply becomes a supply to which the framework or agreement applies, the framework or agreement establishes a liability owed by the payer (not the third party) to the supplier in the event that there is a supply by the supplier to the third party.

Pre-existing framework or agreement and requirement for supplier to act in a particular manner

221C. The pre-existing framework or agreement can take various forms, including licence conditions (as occurred in Department of Transport). The pre-existing framework or agreement must set out the terms and conditions governing the parties and require the supplier to act in a particular manner with respect to supplies to third parties. Those requirements may include a binding obligation to make a supply to a third party, complying with licence conditions which are binding on the supplier or a requirement to charge a lower amount to the third party.

221D. If the 'requirement' to act in a particular manner is optional then it is unlikely that a supply would be made to the payer. This situation may arise where the pre-existing framework or agreement allows, but does not require, the supplier to act in a particular manner and the payer makes a payment because the supplier has satisfied eligibility criteria for the payment. In these circumstances there may instead be a third party payment. [Proposition 14: a third party may pay for a supply but not be the recipient of the supply,

Pre-existing framework or agreement allows for identification of third parties and sets out authorisation process

221E. The pre-existing framework or agreement must:

- *be capable of allowing the supplier to identify the third parties (or classes of third parties) and the supplies that come within the scope of the framework and must be in existence before the relevant supply is made; and*
- *set out the authorisation process, in advance of the supply, by which the obligation arises for the payer to make payment.*

However, if there is no pre-existing framework or agreement which identifies the classes of third parties and which triggers the payer's obligation to make a payment to the supplier in the event of the relevant supplies being made to those third parties, the mere act of payment, in the absence of anything else, would not give rise to a supply to the payer. There may instead be a third party payment. [Proposition 14: a third party may pay for a supply but not be the recipient of the supply, paragraphs 177 to 216 of this Ruling.]"

57. In paragraph 5.1.2 of Interpretation Note 70 SARS confirmed that, although the definition of "*consideration*" in section 1(1) of the VAT Act is very wide and includes any payment which is in respect of, in response to or for the inducement of the supply of goods or services, there must be a sufficient nexus between the supply and the payment for the supply to constitute consideration ad envisaged in the VAT Act.

58. In CIR v NZ Refining Co Ltd (1997) 18 NZTC 13 @ 187 the court held that to constitute consideration for a supply a payment must be made for that supply and an element of reciprocity is required. Inland Revenue, New Zealand and the New Zealand courts have emphasised the need for legally enforceable reciprocal obligations between the payer and payee in order for a consideration to be linked to a supply. It has been said that payments that relate to a supply but is not for that supply, will not be consideration (Tax Information Bulletin Vol 14 No 10).

59. With regards to the requirement in the definition of "*consideration*" in section 1(1) of the VAT Act that the consideration may be paid by the vendor or any other person, where the vendor making the payment in fact acquires goods or services, although the goods are not provided or the services performed to him in a contractual sense, he may be the recipient of the supply for VAT purposes. In this regard SARS previously issued a ruling to the Association of Law Societies that where a third party is obliged to pay the costs of an attorney who received instructions from a client, the third party is entitled to the tax invoice of the attorney in order to claim an input tax credit in respect of the costs paid by him (SARS ruling No. 322). The ruling has since been withdrawn as part of the general withdrawal of rulings issued prior to the introduction of the Tax Administration Act. The principles forming the basis of the ruling has however not changed.

LEGAL MEANING OF ISSUED

60. The term "*issued*" is not defined in the VAT Act. Where a term is not specifically defined in an Act, the normal grammatical/dictionary meaning of the term must be used. The context in which the word or term is used must also be considered.

61. The ordinary meaning of "*issued*" connotes a situation involving two parties, one of whom issues something that is received by the other. Further, the term "*issue*" requires a positive deliberate act on the part of the person who has issued the item in question (see Inland Revenue New Zealand's Tax Information Bulletin Vol. 19 No. 7 p 9) (source – Juta's Value Added Tax).

LEGAL MEANING OF AN OBLIGATION TO MAKE PAYMENT

62. For an obligation to be classified as an obligation to make payment as envisaged in the VAT Act, the obligation to make payment must be enforceable. Inland Revenue, New Zealand stated that the obligation means a present legal obligation (TIB Vol. 19 No 7 @ p9).

63. Where a contract is subject to a suspensive condition, the operation of the obligation flowing from the contract is suspended until the occurrence of a future uncertain event (see RH Christie The Law of Contract in South Africa). As such a contract only notifies a contingent obligation to make payment, it does not constitute an invoice.

APPLICATION OF THE PRINCIPLES

ENQUIRY 1 - IS VAT PAYABLE BY DEBTORS ON ANNEXURE B ITEMS?

64. It is common cause that a debt collector conducts an enterprise for VAT purposes in the course of which he/she supplies debt-collecting services.

65. As such any fees charged by a debt collector to a credit provider would constitute consideration for a taxable supply made by the debt collector to the credit provider and would accordingly be subject to VAT.

66. For the Annexure B amounts recovered from the debtors to be consideration for a supply of a service, the service that is being supplied must be identified and there must be a close link (nexus) between the services supplied and the recoveries made.

67. In this regard there are two schools of thought. The one school of thought is that all the activities carried on by a debt collector are collectively aimed at the furtherance of its core business and activity, debt collecting (the reason for its existence). For these services the debt collector is remunerated from two sources; by the credit provider and by the debtor. In terms of this school of though the debt industry and its governing structures must be viewed as a single activity where rights and obligations are created via statutory and contractual relationships.

68. In this regard, when a debtor applies for credit from a credit provider, the debtor accepts all the consequences of becoming a consumer of debt. This includes that the creditor may take action to recover the debt or appoint another person to do so. In both instances the debtor agrees to compensate the party/ies executing the debt recovery for their services. As such all activities carried on by a debt collector must be regarded as being carried on in the course of supplying debt collecting services within the credit industry while payment for such services could potentially come from various sources (debt collection commission payable by the credit provider and general debt collection fees payable by the debtor who assumes responsibility for such fees in terms of the regulatory environment within which the debtor contracts to take up debt).

69. If regard is had to the manner in which the credit industry operates and is regulated, and the inter-connectedness of the parties involved in the credit as well at the role of each party in the overall credit supply chain, we are of the opinion that a persuasive argument exists for the contention that all activities conducted by a debt collector in the pursuit of collecting a debt fall within the ambit of the supply of a service as envisaged in the definition of "*service*" in section 1(1) of the VAT Act.

70. We are therefore of the opinion that a persuasive argument exists for the contention that all the activities conducted by a debt collector constitute taxable services as envisaged in the VAT Act and that any consideration received (including Annexure B fees) for the performance of such services are subject to VAT.

71. The second school of though is that all activities carried on by the debt collectors are aimed at collecting the debt in terms of the mandate from the credit provider. Any recovery of costs from the debtor does not relate to a supply of any service to the debtor (or any other person) and as such cannot be consideration for a supply for VAT purposes. As such, such recoveries are not subject to VAT. This school of though finds strong support amongst certain VAT specialists in South Africa, and should not be discarded lightly.

ENQUIRY 2 - WHEN IS VAT PAYABLE TO SARS ON THE DEBT COLLECTION FEES REFERRED TO IN ANNEXURE B?

72. Output tax is payable in the tax period in which the earlier of the issuing of an invoice or the receipt of any part of the consideration for the supply of a service occurs.

73. An invoice for VAT purposes is any document notifying an obligation to make payment. The obligation must be enforceable, i.e. unconditional. A letter of demand sent to a debtor by a debt collector requesting payment and indicating that the debtor will/may be held liable for certain cost charges by the debt collector does not constitute an invoice as envisaged in the VAT Act as the liability to pay the fees is not unconditional at that point in time. The debtor has the right to respond to the letter of demand proving that the debt has already been paid or various other responses. If the debt collector seeks to recover Annexure B charges from the debtor, the debtor has the right to request a taxing process, in terms of which the costs levied may be reduced or denied by the competent officer of the court.

74. Based on the above we are of the opinion that the time of supply cannot be earlier than the date that the taxing process has been completed or the debtor waives his/her right to taxing. If any document notifying an obligation to make payment is issued after that date for the agreed costs, VAT will be triggered at that point in time. Any documents issued before the date of taxing or waiver of a debtor's right to taxing can be ignored. Such documents also will not become invoices after the taxing process. New documents need to be issued to constitute an invoice as envisaged in the VAT Act.

75. In practice this will generally mean that output tax would be payable in the tax period that the Annexure B charges are actually received.

ENQUIRY 3 - ACCOUNTING FOR VAT IN THE DEBT COLLECTOR'S ACCOUNTS

76. The debt collector must account for the amount excluding VAT (the amounts reflected in Annexure B) as income and the VAT on the amount as tax/VAT due to SARS.

ENQUIRY 4 - WHO IS ENTITLED TO THE INPUT TAX CREDIT?

77. Only the recipient of a supply may claim input tax in respect of the supply of goods or services. The recipient of a supply is defined in section 1(1) of the VAT Act as the person to whom the supply is made.

78. It is common cause that the debt collector acts on a mandate received from the credit provider. Without the mandate by the credit provider the debt collector will not be making any supplies of debt collecting services. This however does not as a matter of consequence mean that all services supplied by a debt collector are supplied to the credit provider.

79. In this regard we are of the opinion that regard should be had to the rights and obligations created by the various statutory bodies and legislation to determine who the potential recipient/s are of the various categories of supplies made in the debt recovery process.

80. In our opinion, having regard to the various governing statutes, the rights and obligations between the debt collector and the debtor are enshrined in the Debt Collectors Act, while the rights and obligations between the credit provider and the debtor are enshrined in the credit agreement between the credit provider and the debtor. Furthermore, the contractual rights and obligations between the debt collector and the credit provider are enshrined in the agreement/mandate between the debt collector and the credit provider.

81. Each of the above legal arrangements operates independently with regards to the compensation that the debt collector will receive for his/her services, unless the parties specifically contract to the contrary.

82. In our opinion the nature of the legal arrangements as set out above leads to the only logical conclusion that in the process of debt recovering more than one supply is made notwithstanding the fact that the debt collection process commences with a single mandate from the credit supplier to the debt collector. In this regard we are of the opinion that the Australian proposition that one set of activities may constitute the making of two or more supplies apply in the present circumstances. We are further of the opinion that the Australian proposition that a third party can be regarded as the recipient of a supply where the third party is responsible for the payment of the consideration for the supply of goods or services notwithstanding the contractual arrangements among the contracting parties finds application in the present circumstances. In fact, the factors listed in the Australian Ruling dealing with factors that may point to a supply being made to a payer where there is a supply to a third party, all apply perfectly to the present circumstances.

83. We are of the opinion that the ruling issued by SARS to the Association of Law Societies further supports the above contentions. In our opinion this is indicative that SARS would apply the above rules in interpreting the VAT Act with regards to the debt collection industry.

84. We are accordingly of the opinion that a persuasive argument exists for the contention that the recipient (as defined in section 1(1) of the VAT Act) of the supply linked to the consideration provided for in Annexure B is the debtor, not the credit provider.

ENQUIRY 5 - TREATMENT IF FEES ARE NOT SUBJECT TO VAT

85. As concluded above we are of the opinion that a persuasive argument exists for the contention that the Annexure B fees are subject to VAT.

86. If the Annexure B recoveries are however not subject to VAT, there is no obligation in terms of the VAT Act or the TAA on the debt collectors to refund any VAT incorrectly previously recovered from debtors. The debt collectors will however only be allowed to recover the amount of the excess output tax paid to SARS in the past from SARS once the VAT recovered from the debtors has been refunded to the debtors (via actual cash refunds or passing of a credits against the debtors' account).

87. A further consequence of Annexure B fees not being subject to VAT is that it will create a pool of non-taxable supplies in the hands of the debt collectors. This will have the impact that debt collectors will be required to introduce apportionment mythologies in their businesses, which in practice is administratively challenging (apportionment is the method by which an organisation determines the level of input tax credits that may be claimed in an organisation making both taxable and non-taxable supplies).

ENQUIRY 6 - SUPPLYING OF VAT INFORMATION TO THE CREDITOR

88. The basis of claiming input tax is being in possession of a tax invoice. As no supply has been made to the credit providers with regards to Annexure B fees, the debt collectors may not issue tax invoices to the credit providers. To do so would be a criminal offence in terms of the Tax Administration Act subject to potential penalty and jail time.

89. Providing other information to the credit providers (for example the amount of charges recovered from a debtor) in a form other than a tax invoice has no VAT implications and can be done at will.

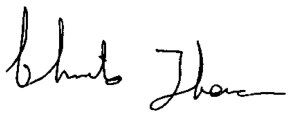
ENQUIRY 7 - NEED FOR A RULING

90. In our opinion the above conclusions accurately represent the interpretation of the VAT law and principles. Due to the sensitivities involved in the industry, we advise that a Binding Class Ruling be obtained to clarify the issue. In this regard it would be ideal to involve the credit industry, but this may be challenging due to conflicting agendas.

91. We trust that the above adequately addresses your enquiry. If anything is unclear though, please do not hesitate to contact us.

Kindest regards

Yours sincerely



Christo Theron

Founder: TradeTaxPlus – Centre of Excellence