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BURS ORDERED TO REFUND BANK GABORONE P3.9M IN VAT CASE:

By Jonathan Hore

On 26 July 2019, the Court of Appeal ordered BURS to refund Bank of Gaborone P3 890 964.49 in VAT paid by the bank after a BURS audit on its VAT matters in 2014. The contention between the bank and the taxman centered on whether or not the supply of vehicles by the bank under its instalment credit arrangements was subject to VAT. The bank argued that such sales were indeed finance leases subject to VAT but the taxman was of the view that the bank supplied loans on which it earned interest, which is exempt from VAT. Ruling in favour of the bank, the Court of Appeal's three judges held that 'a contract cannot at the same time be a sale and a loan.' This is the first case in Botswana dealing with VAT on asset financing (finance leases) and that undoubtedly makes it a critical precedent.

The gravity of the matter

The issue of contention in the mentioned case is of paramount importance to banking industry as it impacts the VAT that they can claim when they purchase inputs for their business as such VAT claims are dependent on a ratio made up of sales subject to VAT as a proportion of total sales, i.e. a summation of taxable sales and exempt sales. This ratio is commonly known as the VAT apportionment ratio in VAT lingo. The ratio also determines VAT expenses borne by banks when they import services from non-residents such as management and consultancy fees as such VAT is determined by reference to the VAT apportionment ratio. The mentioned VAT expenses usually run into millions of dollars even for a single bank.

The finance leases

The judgment by the Court of Appeal came after BURS assessed the P3.9m arguing that the bank underpaid its VAT between 2011 and 2012 due to the perceived mistreatment of the vehicle finance leases. Aggrieved by the assessment, the bank appealed to the Board of Adjudicators, a tax court set-up by the Ministry of Finance & Economic Development to expedite the resolution of tax disputes. The case reveals that the bank's modus operandi in respect of such sales is that, upon receiving a request for financing from clients, it purchases the vehicles chosen by the clients from car dealers, claiming VAT that it is charged. The bank immediately sells the vehicles to the clients at the same price, charging VAT and adding loan arrangement fees plus interest. The bank however does not put a mark-up on the price of the vehicles, which makes the VAT incurred similar to the VAT it charges on the vehicles. The bank makes these sales under what it refers to as instalment sale agreements.

Technically, the bank therefore sells vehicles, as is acceptable practice in the banking industry. BURS was however of the view that the bank simply provided loans on which it earned interest and as a result, it incorrectly calculated its VAT

apportionment ratio by including the financed vehicle sales as subject to VAT. It therefore raised VAT assessments, which aggrieved the bank.

Courts' views

The Board of Adjudicators decided on whether or not the bank's sale arrangements were 'finance leases' subject to VAT and it ruled that they were not, thereby agreeing with BURS' arguments that the bank underpaid VAT. The Board of Adjudicators even questioned whether banks could deal in vehicles, per the Banking Act. The High Court also upheld the Board of Adjudicators' findings, ruling that the P3.9m was due to BURS. However, the Court of Appeal stated that both the Board of Adjudicators and High Court misdirected themselves by considering whether the vehicle sales qualified as 'finance lease' sales for VAT instead of considering whether the bank's standard instalment agreement was 'a taxable supply' or an 'exempt supply.' Further, the Court of Appeal observed that the High Court was not correct to hold that since the bank did not add value to the price of vehicles, the arrangement could not be held to be subject to VAT, a tax which requires that value be added. BURS was also faulted for contending that since the vehicles were immediately sold to the bank's clients on purchase, the bank at no time owned the assets and therefore it did not make sales but merely provided finance. The Court of Appeal ended up holding that the bank's arrangements were actually 'hire purchase agreements,' subject to VAT.

Landmark decision

This decision is of critical importance to the banking sector and tax fraternity as it clears the air over the treatment of instalment sale agreements, a well-established practice among banks, which has in practice, always been subjected to VAT. Further, it makes it certain that banks can include asset sales in the determination of their VAT apportionment ratio. This brings clarity as to what affects the said ratio, which is so critical in accounting for the VAT for banks, considering the magnitude of the amounts involved in such transactions.

Technicalities

However, whilst the Court of Appeal held that the bank's instalment sale agreements were correctly subject to VAT on the basis that they are 'hire purchase agreements,' it would appear that the bank's instalment arrangements were in fact 'finance leases.' The Board of Adjudicators and High Court dealt at length with whether the sales were in fact finance leases. This is so as such arrangements are internationally and per the VAT Act, referred to as finance leases. Regardless of the technicalities mentioned above, the critical issue is that the instalment sale agreements by banks have always been subject to VAT, which was confirmed by the Court of Appeal. The issue of whether they are hire purchase agreements or finance leases does not change the VAT treatment of such sale agreements. The Court of Appeal ruling comes with so much relief to the banking sector which was under scrutiny by the taxman.