

FREE INTER-COMPANY TRANSACTIONS VATABLE: By Jonathan Hore

It is common practice among related companies to provide each other with free services and goods. The reason for this is that the management or owners of the businesses view these companies as one due to common shareholding. I want to analyse in detail the VAT implications of free intercompany transactions. But under ordinary circumstances, VAT can only be charged where a service/good is supplied at a price. I will also analyse this concept below. In this article, words importing the masculine shall be deemed to include the feminine.

VAT REQUIRES A PRICE

Those of you who may have read my article of last week may have noted that I mentioned that VAT cannot arise where goods or services are provided for free. Technically, VAT arises when a supply is made for a fee or a price and the VAT forms part of such price. This effectively excludes donations from the ambit of Vatable transactions as they are made for free. However, we need to note that the major exception to this principle relates to free transactions between or among related parties. The VAT Act states that, 'a supply made for consideration includes- (a) a supply made between related persons for no consideration.' This is the main section which makes free related party transactions subject to VAT. From the above quoted legislation, whenever related party local or cross-border transactions occurs for free or at a price which is less than the market value, then VAT would be determined at the market value. This means that if a transaction valued at P1.12m is provided among related parties for free or at a reduced price such as P600 000, VAT should be accounted or at P1.12m.

THE RELATED PARTIES

The VAT Act stipulates a number of people as related parties and these include the following:

- A company which holds at least 10% shares in another. This means that if Butter (Pty) Ltd holds 20% shares in Sugar (Pty) Ltd's, any free transaction that happens between the two is deemed to be at market value.
- A partnership and a partner to that partnership are also regarded as related parties. If Thato is a partner in a law firm with 4 partners and the other partners offer legal services to him for free, those legal services are deemed to have been rendered at market value, as if they were provided to a client.
- For individuals, a relative of that individual such as a wife or child is also included in the definition of related persons.
- A trust and a beneficiary of that trust are also related parties. This means that a service provided by the trust to the beneficiary for free must be treated as having been rendered at market value.

AFFECTED TRANSACTIONS

Below are some of the most common transactions affected by the above-mentioned deeming provision:

- **Free rent:** Most related parties offer each other free usage of office and commercial space, which means that the provider of the services should account for VAT on the market value of the space. This could be based on rates provided by a registered estate agent.
- **Free usage of assets:** If often happens that related parties do not charge each other for usage of equipment, software or any such rights. Company A may accord its subsidiary free usage of farming equipment which if rented to a third party would

fetch a price of say P224 000 per month. What that means is that despite the fact that company A would not have charged VAT on the equipment, it should account for VAT on the P 224 000, i.e. P24 000 becomes tax payable to BURS.

- **Administration services:** In a number of instances, employees of a group entity provide free services to other related parties such as accounting, administrative or other technical services. Again, this is supposed to be subjected to VAT at the market price.
- **Stock transfers:** It is common for related parties to transfer goods between each other without the movement of cash. For example, a wholesaler may move goods to a retailer which it controls for free and VAT must be charged on such transactions.
- **Imports:** The VAT Act does not define related parties as only those within the borders of Botswana, which means that the other entity could be based outside the country. This may include transactions where a holding company in the UK which transfers equipment to its Botswana subsidiary for free. The import VAT on such goods will be determined based on the market value of the goods.

CONCLUSION

To ensure that intercompany transactions comply with the VAT Act, VAT must be charged on such transactions at the market value despite the fact that no cash movement may have occurred. Non-compliance with this provision of the VAT Act may expose the related parties to penalties of a maximum of 200% plus effective compound annual interest of 19.56%. If both related parties are VAT-registered, the VAT charged by the other entity may be claimed by the recipient so there is no loss to the group at the end of the day.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax Whatsapp group, send me a text on the cell number below.