PAY VAT ON FORFEITED DEPOSITS: By Jonathan Hore

Some business operators require customers to pay a deposit as a way of securing a sale. I am sure most of us are not strangers to this practice. Some of the most common transactions that would come to mind is when one is making a hotel booking or buying an asset. However, a quandary always arise from these business operators when it comes to the tax treatment of the deposits when a customer fails to complete the payments, especially for businesses that operate under a 'no refund' policy. In such cases the forfeited deposits will undoubtedly trigger VAT in the hands of the business operator. In this article, words importing the masculine shall be deemed to include the feminine.

The deposit

Basically, a deposit relates to any upfront payment made before the actual sale is effected or completed. The deposit payment is generally required by the seller to secure a sale or in a way, to safeguard the chances of the sale to follow through. In some cases, the deposit may be refundable if the buyer notifies the seller that he intends to cancel the transaction. In some instances, the deposit is ultimately non-refundable regardless of whether or not the buyer proceeds to complete the sale or transaction. Now, allow me to irradiate what the law says about forfeited deposits.

Enter VAT!

VAT is triggered in the period of forfeiture of any deposit by a VAT registrant. But hold on, Isn't VAT triggered by the earlier of receipt of payment or issuance of an invoice? Doesn't this mean VAT should be accounted for when the customer pays the deposit? Well, as convincing as this may seem, it is practically an unfitting principle to apply.
It is important to understand that VAT is levied on the value of a supply. In terms of the VAT Act such value is technically referred to as a 'consideration'. The Act specifically states that a consideration does not include, 'a deposit, other than a deposit on a returnable container, whether refundable or not, given in connection with a supply of goods or services, unless and until the supplier applies the deposit as consideration for the supply or such deposit is forfeited.'

Per the above, the quoted provision of the VAT Act makes it axiomatic that a deposit is not considered as a value of supply unless it is applied to the consideration for the supply i.e., the purchase price. Consequently, a refundable deposit cannot be taken into consideration when determining VAT. Further to note is the alternative qualifying factor, the Act further states that a deposit can also be considered as a consideration for VAT purposes when 'such deposit is forfeited.' Technically, VAT is triggered at that point when a deposit is either applied to the purchase price or when forfeited.

For example, if a customer pays a 20% deposit on 10 September 2021 when booking for a future date say, 25 December 2021, no VAT arises in September 2021. If the customer shows up and pays the balance, VAT on the full booking fee should be accounted for on that future date. Alternatively, if the same customer fails to show up and the hotel eventually forfeits the deposit on say 25 January 2021, VAT on the 20% deposit should be accounted for on that day as if the forfeiture is an actual sale.

Conclusion

It is important to note that a deposit triggers VAT as per the above quoted legislation. However, it is also necessary to state that upon forfeiture of the deposit, no tax invoice must be issued as no real sale occurs but the Act deems that the VAT registrant makes a taxable

sale. In other words, the sale must be recorded through some accounting journals or entry signifying the forfeiture of the deposit. Lastly, a deposit which has not yet been applied towards the consideration of a taxable good or service remains free from VAT, unless and until it is forfeited.

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 or to know about our 9 Tax e-books, send me a text on the cell number below.