

Ref #:773515

Submission File

7 October 2022

South African Revenue Service
Private Bag X923
Pretoria
0001

BY E-MAIL: policycomments@sars.gov.za

Dear SARS

COMMENTS ON THE DRAFT INTERPRETATION NOTE – THE VALUE-ADDED TAX TREATMENT OF DEBT COLLECTION

1. The South African Institute of Chartered Accountants' (SAICA) VAT Committee, welcomes the opportunity to make a submission to the South African Revenue Service (SARS) on the Draft Interpretation Note (IN) that provides clarity on the VAT treatment of debt collection activities, whether undertaken by credit providers, in-house or outsourced to external debt collectors. In particular, this Draft IN examines the VAT treatment of prescribed amounts recovered by the debt collector from the debtor under the Debt Collectors Act No. 114 of 1998. It is noted that this Draft IN does not address debt collection activities outsourced to attorneys.
2. We set out below our general and specific comments in this regard.

COMMENTS – GENERAL

3. We believe this Draft IN is at odds with the industry as a whole. Various companies spend large amounts on external collection costs yet, in terms of the draft IN, the VAT charged by the collection agents will not qualify as an input VAT deduction.
4. In addition, this interpretation requires the credit providers to define internal collection costs and also not claim any VAT on these costs. Since the credit providers generally have large internal collection teams, this will require all sorts of overhead allocations etc., which is not practical.

5. Submission: The logical flaw with the interpretation in the draft IN is that the credit provider's collection activities are necessary to actually receive the cash on the original capital, interest and fees outstanding. Being able to collect cash is linked in its entirety to the provision of credit (for which the consideration is taxable and exempt supplies) and not "the collection of debt".

COMMENTS – SPECIFIC

Paragraph 4.1.1(a): Supply of debt collection services – Commission

6. Submission: We agree that the supply of debt collection services rendered by a debt collector to a credit provider in terms of an agreement or mandate given to the debt collector is a taxable supply and the agreed consideration payable to the debt collector in terms of the agreement or mandate is subject to VAT at the standard rate under section 7(1)(a) of the Value Added Tax Act, 89 of 1991.

Paragraph 4.1.1(b): Recovery of prescribed amounts under the Debt Collectors Act

7. Certain services are rendered by a debt collector to a debtor at the request of or initiation by the debtor. These services are listed as items 5 to 8 of the prescribed fees in Annexure B to the Regulations under the Debt Collectors Act (DCA) and are:
- The drawing up and furnishing, at the request of the debtor, of a settlement account;
 - Correspondence received from the debtor and attending thereto;
 - Necessary consultation with the debtor; and
 - Taxation or assessing any account or statement of costs, interest and payments claimed to be owed by a debtor.
8. These services are supplied by the debt collector directly to the debtor, being the recipient of these services. Accordingly, the debt collector is obliged to levy VAT on the fees charged for these services and should issue a tax invoice for the fees charged plus VAT to the debtor.
9. With regard to the remainder of the prescribed fees (listed in Items 1 to 4 of the prescribed fees in Annexure B to the Regulations under the DCA), the Draft IN states that, having regard to the National Credit Act (NCA) and the DCA, the prescribed amounts recovered from the debtor form part of the collection costs of the credit provider, and that the prescribed amounts allowed by the credit provider to be retained by the debt collector, is regarded as payments made by the credit provider to the debt collector in respect of fees or remuneration for debt collection services. However, the debt collector is not allowed by the credit provider to retain the amounts, but it is entitled to do so in terms of the provisions of the DCA.
10. Submission: The amounts retained by the debt collector, is to compensate the debt collector for expenses incurred by the debt collector in collecting the outstanding debts. The recovery of expenses incurred does not comprise consideration for services rendered. To determine the VAT status of the amounts of the expenses recovered from the debtor and whether there is any nexus between the amounts recovered and the debt collection services supplied to the credit provider, the terms of the agreement between the credit provider and the debt collector must be considered (see CSARS v Respublica (Pty) Ltd (1025/2017) [2018] ZASCA 109 (12 September 2018) 18 SATC 174 at paras [12] and [13]). If the agreement only provides for a fixed percentage of debts collected to be paid as consideration for the debt collection services, it cannot be considered that the credit provider “allowed” the debt collector to retain the amounts.



Paragraph 4.1.2: Recovery of debt collection costs by the credit provider

11. Submission: We agree that the enforcement of a debtor's monetary obligations under a credit agreement does not comprise the supply of any service by the credit provider to the debtor, and as such the recovery by the credit provider of expenses incurred in this regard does not comprise consideration for the supply of any service to the debtor. The recovery of collection fees incurred by the credit provider from the debtor is therefore not subject to VAT in the hands of the credit provider.

Paragraph 4.2.1: Input tax on debt collection costs incurred by the credit provider

12. The Supreme Court of Appeal in the case of *Consol Glass (Pty) Ltd v The Commissioner for the South African Revenue Service* (1010/2019) [2020] ZASCA 175 (18 December 2020) 83 SATC 186 at par [14] provided guidelines with regard to the entitlement of a vendor to deduct input tax. The Court stated that one must firstly determine for what purpose did the vendor acquire the services, and secondly, whether the vendor acquired the services in the course of making taxable supplies. The Court stated that the relationship between the purpose for which the services were acquired and the use to which these services were put lies at the heart of the matter.
13. If one applies these guidelines, a credit provider acquires the debt collection services for the purpose of collecting the outstanding debt in relation to the supplies made by the vendor concerned. Where a vendor supplies goods or services on credit, the collection of the amounts owing in relation to such supplies forms an integral part of the taxable enterprise of the supplier in terms of which the goods or services are supplied. There is therefore a direct functional link between the taxable supply of goods or services, and the collection of the consideration for the supplies made. If the amounts owing by debtors are not collected, the business will fail. The provision of credit is not a supply which is separate and distinct from the supply of the goods or services, but it enables the taxable supply of goods or services.
14. Where a credit provider provides credit as regulated by the NCA, the credit provider derives taxable initiation fees, taxable service fees and exempt interest as consideration. The provision of credit comprises a single activity which is partly taxable and partly exempt, as confirmed by the *Commissioner for the South African Revenue v Service Tourvest Financial Services (Pty) Ltd* [2021] ZASCA 61; 2021 (5) SA 86 (SCA) at para 16. The outstanding debt comprise of taxable fees, interest and the capital amount advanced and the NCA provides under section 126(3) that payments made by a debtor should firstly be appropriated to unpaid interest charges, secondly to fees or charges and lastly to the principal debt, as these charges retain their nature. Accordingly, the debt collection fees are deductible to the extent that the credit provider makes taxable supplies and should therefore be apportioned accordingly.
15. The debt collection fees incurred by a supplier of goods or services on credit or by a credit provider from part of the general overhead costs of the business. These expenses are properly incurred for the business as a whole (see *Commissioner for the South African Revenue Service v De Beers Consolidated Mines Ltd* (503/2011) [2012] ZASCA 103 (1 June 2012) 74 SATC 330 at para 39).

16. **Submission:** We therefore do not agree that the debt collection costs are incurred for a purpose wholly other than for consumption or use in the course of making taxable supplies. The debt collection costs comprise overhead costs which are necessary for any enterprise and is therefore deductible to the extent that the supplier makes taxable supplies.

17. When a debt becomes irrecoverable, the vendor is entitled to make a deduction of the output tax previously accounted for on the taxable supply of the goods or services supplied, and in the case of the provision of credit, the VAT accounted for on the taxable fees included in the amount written off as irrecoverable. The amount is deductible in terms of s 16(3)(a)(v) of the VAT Act.

18. When an amount previously written off as irrecoverable is subsequently recovered, the VAT amount previously deducted under s 22(1) is, to the extent that it is recovered, deemed in terms of s 22(2) to be tax charged in relation to a taxable supply made during the tax period in which the debt is wholly or partly recovered.

19. **Submission:** The draft IN should include the VAT treatment of irrecoverable debts. That is, a debt previously written off as irrecoverable will only be recovered as a direct consequence of the debt collection services acquired by the vendor concerned, or the in-house debt collection procedures applied. There is, therefore, a direct nexus between the debt collection costs incurred and a taxable supply made by the vendor on the recovery of the debt.

Paragraph 4.2.2: Input tax on expenses relating to debt collection services supplied by the debt collector

20. **Submission:** We agree that the debt collector is entitled to deduct the total amount of VAT incurred on expenses in relation to the supply of debt collection services to the credit provider and the supply of services rendered to debtors, on the basis that all these services are taxable supplies.

Paragraph 4.2.3: Input tax: Prescribed amounts and other debt collection costs paid by the debtor

21. The prescribed debt collection amounts recovered by the debt collector in terms of the DCA do not comprise consideration for any services rendered by the debt collector to the debtor. Accordingly, the debtor is not entitled to make any VAT deduction in relation to such amounts recovered.

22. **Submission:** Where the debt collector renders services to the debtor for which a prescribed fee is charged (see comments under paragraph 4.1.1(b) above), the debt collector is obliged to levy VAT on such fees and to issue a tax invoice to the debtor for the fees charged. The VAT on such services may qualify for an input tax deduction in the hands of the debtor if the services are acquired by the debtor for the purpose of use or consumption in its taxable enterprise.



Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely

Leon Oosthuizen
Chairman: VAT Committee

Dr Sharon Smulders
Project Director: Tax Advocacy

The South African Institute of Chartered Accountants