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Forfeited deposits trigger VAT & Income Tax

Generally, if clients fail to conclude business deals, a non-refundable deposit becomes handy to hedge against financial loss and, in some cases, to compensate for incidental expenses and missed opportunities. However, in as much as this might be a good business strategy, it is imperative that taxpayers understand that forfeited deposits actually trigger tax. Keep on reading and allow us to help you understand how forfeited deposits may trigger Value Added Tax (VAT) and Income Tax (IT). In this article, words importing the masculine shall be deemed to include the feminine.

Enter deposit!

As alluded to above, some business operators require their customers to make an upfront payment of a deposit before the actual sale is settled. This practice is mostly common amongst operators providing a credit facility. Accordingly, a deposit helps vendors to secure a sale or minimise the chances for defaulters. It is key to note that some business enterprises may refund deposits when a customer fails to follow through with the sale whereas, some operate under a no refund policy. Technically, the latter ends up utilising the deposits for business use.

Enter VAT

Basically, VAT is triggered at the earlier of either issuance of an invoice or receipt of any payment. In this regard, it is crucial that we first clarify that a payment can only be made as compensation for a supply of goods or services. This technically means that 'any payment' received as a consequence of a supply of taxable goods or services triggers VAT. Therefore, in order for a deposit to trigger VAT, it should fit in the ambit of a payment for a supply. This is technically referred to as 'consideration' in terms of the VAT laws.

In verbatim, the VAT Act states that a consideration i.e., a payment for supply of goods or services, does not include, 'a deposit, whether refundable or not, given in connection with a supply of goods or services, unless such deposit is forfeited.' Based on the quoted VAT law, it is apparent that a deposit is also considered as a payment for a supply when it is forfeited. Accordingly, its undebatable that deposits only trigger VAT at the time of forfeiture. In other words, VAT is triggered at the time the seller obtains legal ownership over the deposits.

Enter Income Tax

The Income Tax Act generally levies Income Tax (IT) whenever a person earns taxable income. Whilst it is commonly accepted that deposits are not really income earned, section 28 states otherwise. Specifically, the said section prescribes that, 'the gross income of any person for any tax year insofar as it is derived from a business shall be the gross amount, whether in cash or otherwise, accrued or deemed to have accrued therefrom during that tax year… the market value of any benefit, whether or not convertible into cash, accruing in the course of business.' Therefore, a forfeited deposit is a 'benefit,' which arises from a 'business,' and is thus subject to income tax. The tax is triggered by the mere fact that the seller derives a monetary benefit from his business activities through the deposit forfeiture.

Conclusion

Well folks, we hope that was insightful. As us the two Yours Truly say goodbye, remember to pay to Caesar what belongs to him. If you want to consult, join our free Tax WhatsApp group or to know about our 9 Tax e-books, send a text to +267 7181 5836 or email us on jhore@aupracontax.co.bw. You can read more tax articles on our website, www.aupracontax.co.bw under the 'Tax articles' tab.