

FACT SHEET #11 - CLASSIFICATION OF VAT

CLASSIFICATION OF VAT

What is the issue?

Questions have been raised about the classification of VAT – whether receivable or payable – as a financial instrument or something else, for example, a statutory receivable. The question arises for the classification of VAT on transaction date and subsequently, as well as whether the accounting answer differs between VAT vendors on the invoice (accrual) or payments (cash) basis of VAT.

The following scenario is used to illustrate the issue...

An entity sells goods to another party. The transaction value is R100, and includes R10 VAT. R50 is received 30 days after invoice date.

Initial recognition

Invoice (accrual) basis

Dr Receivable (goods)	R90	
Dr Receivable (VAT)	R10 [Financial instrument or statutory receivable?]	
Cr Revenue		R90
Cr VAT control (payable to SARS)		R10 [Financial liability or something else?]

Payments (cash) basis

Dr Receivable (goods)	R90	
Dr Receivable (VAT)	R10 [Financial instrument or statutory receivable?]	
Cr Revenue		R90
Cr VAT accrual (only liable to SARS once received)		R10 [Financial liability or something else?]

Receipt of cash

Entry 1 – Record receipt of cash and reduction of receivable

Dr Bank	R50	
Cr Receivable		R45
Cr Receivable (VAT)		R5

Entry 2 – Recognise liability due to SARS [Only applicable to VAT vendors on the payments basis]

Dr VAT accrual	R5	
Cr VAT control		R5 [Financial liability or something else?]

Application to liabilities

Although the example illustrated above relates to receivables, the same questions arise for the purchase of goods and/or services.

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What do the Standards say?	
What Standards could apply?	<p>VAT is received or paid in cash between the customer/supplier and the VAT vendor, and VAT is settled between the VAT vendor and SARS. As a result, the following Standards of GRAP could be applicable:</p> <p><u>Receivables</u></p> <p>GRAP 104 on <i>Financial Instruments</i></p> <p>GRAP 108 on <i>Statutory Receivables</i></p> <p><u>Payables</u></p> <p>GRAP 104 on <i>Financial Instruments</i></p> <p>GRAP 19 on <i>Provisions, Contingent Liabilities and Contingent Assets</i> [there is no specific Standard that deals with statutory payables]</p>
What is the definition of a financial asset?	<p>A financial asset is:</p> <ul style="list-style-type: none"> (a) cash; (b) a residual interest of another entity; or (c) a contractual right to: <ul style="list-style-type: none"> (i) receive cash or another financial asset from another entity; or (ii) exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity. <p style="text-align: right;">Paragraph 2.1, and AG2.1</p>
What is the definition of a financial liability?	<p>A financial liability is any liability that is a contractual obligation to:</p> <ul style="list-style-type: none"> (a) deliver cash or another financial asset to another entity; or (b) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity. <p style="text-align: right;">Paragraph 2.1 and 3.5-3.8</p>
What is the definition of a statutory receivable?	<p>Statutory receivables are receivables that:</p> <ul style="list-style-type: none"> (a) arise from legislation, supporting regulations, or similar means; and (b) require settlement by another entity in cash or another financial asset. <p style="text-align: right;">GRAP 108.05</p>
What is the definition of a legal obligation?	<p>A legal obligation is an obligation that derives from:</p> <ul style="list-style-type: none"> (a) a contract (through its explicit or implicit terms); (b) legislation; or (c) other operation of law. <p style="text-align: right;">GRAP 19.17</p>
How do you know which Standard to apply?	
The theory	<p>The distinguishing factor between applying GRAP 104 or another Standard is whether the arrangement is contractual or not.</p> <p>Arrangements are contracts when there are willing parties to the arrangement, the parties have rights and obligations (they need not be equal), and the rights and obligations are enforceable.</p> <p>If the arrangement is contractual, GRAP 104 is applied. Other arrangements are accounted using GRAP 108, GRAP 19 or another applicable Standard.</p>

This Fact Sheet explains the Secretariat's views on the classification of VAT based on the principles in GRAP 104 on Financial Instruments (2019) and GRAP 108 on Statutory Receivables. This Fact Sheet accompanies, and is not a replacement for, the complete text of GRAP 104 and GRAP 108. This Fact Sheet has not been reviewed, approved or otherwise acted on by the ASB.

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	The sections that follow explain the classification of receivables at initial recognition and subsequently. A similar classification process is applicable to liabilities, although the Standards of GRAP applied differ between assets and liabilities.
Classification on initial recognition	
Classification of the asset	<p>If an entity enters into an arrangement between another party to provide goods and/or services in return for cash (or on credit), then this would be a contractual arrangement.</p> <p>If the entity is a VAT vendor, it is required to levy VAT on the goods and/or services provided in terms of the VAT Act. The collection of VAT by the vendor from the customer is as a result of the contractual arrangement to provide goods and services in return for consideration. As the transaction arises from a contract, the entire transaction – including the VAT component – is classified as a contractual receivable.</p> <p>VAT due to SARS by the VAT vendor is a deemed debt to SARS that results in a deemed debtor-creditor relationship.</p>
Classification of the liability	In broad terms, the liability to pay VAT to SARS arises from legislation. As a result, it is a “statutory” arrangement. The nature of the liability(ies) that arises on initial recognition and subsequently depends on whether the VAT vendor is on the accrual or payments basis.
Is the classification of the liability different for VAT vendors on the accrual or payments basis of accounting?	<p>The nature of the liability is different for vendors on the accrual or payments basis. The nature of the liability(ies) is different because obligation to pay SARS arises at a different point:</p> <ul style="list-style-type: none"> • Accrual basis - VAT is payable to SARS on transaction date. • Payments basis – VAT is payable to SARS when cash is received. <p>For VAT due to be paid to SARS, the liability is recognised as a statutory liability using GRAP 19.</p> <p>For the VAT still to be collected– the “VAT accrual account” – no payable exists to SARS. As the credit in the VAT accrual account is not yet a liability to SARS, an entity should formulate an accounting policy using GRAP 3 on <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>. It may be appropriate to use GRAP 19 in formulating the accounting policy.</p>
Classification after initial recognition	
Does the classification of the asset or liability change after initial recognition?	Both the VAT accrual account and the VAT control account are statutory arrangements. However, the nature of the liabilities are different – the VAT accrual represents VAT still to be collected in cash, while the VAT control represents the liability to SARS.
Application to the payments for goods and services (payables) and input VAT	
Are the same principles applied for the sale and purchase of goods and/or services (and related debtors and creditors)?	The same principles are applied to both the sale and purchase of goods and services and related assets and liabilities.

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Presentation in the financial statements	
<p>Can VAT receivable from and payable to SARS be “set off” in the financial statements, or should they be presented separately?</p>	<p>VAT receivable from or payable to SARS is not a financial instrument, and should be treated as a statutory receivable or payable. The amount of VAT receivable from or payable to SARS is calculated as the net amount of output VAT collected and input VAT paid. As the amount due from or to SARS is already a net amount, there is no separate recognition of a receivable or payable.</p>
<p>VAT accrual account (debit or credit)</p>	<p>The VAT accrual account does not represent amounts to be received or paid, but rather amounts that are associated with transactions that are yet to be settled. There is no money to be received or paid to SARS for these amounts as yet.</p> <p>As there is no transaction to “settle” with a specific counterparty at this point, the requirements for set off are inappropriate. As a result, separate presentation of the VAT accrual “debit” and “credit” may be more appropriate.</p>

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ANNEXURE – CLASSIFICATION OF TRANSACTIONS

CLASSIFICATION – SALES OF GOODS AND/OR SERVICES

The following scenario is used to illustrate the issue...

An entity sells goods to another party. The transaction value is R100, and includes R10 VAT. R50 is received 30 days after invoice date.

Initial recognition

Invoice (accrual) basis

Dr Receivable (goods)	R100 [Financial asset]	
Cr Revenue		R90
Cr VAT control (payable to SARS)		R10 [Statutory payable*]

*VAT receivable from and payable to SARS presented on a net basis

Payments (cash) basis

Dr Receivable (goods)	R100 [Financial asset]	
Cr Revenue		R90
Cr VAT accrual (only liable to SARS once received)		R10 [Obligation to collect VAT**]

**VAT control debit and credit presented separately

Receipt of cash

Entry 1 – Record receipt of cash and reduction of receivable

Dr Bank	R50	
Cr Receivable		R50

Entry 2 – Recognise liability due to SARS [Only applicable to VAT vendors on the payments basis]

Dr VAT accrual	R5**	
Cr VAT control		R5 [*Statutory payable]

*VAT receivable from and payable to SARS presented on a net basis

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CLASSIFICATION – PURCHASE OF GOODS AND SERVICES

The following scenario is used to illustrate the issue...

An entity buys goods from another party. The transaction value is R100, and includes R10 VAT. R50 is paid 30 days after invoice date.

Initial recognition

Invoice (accrual) basis

Dr Expenses (goods)	R90	
Dr VAT control (receivable from SARS)		R10 [Statutory receivable*]
Cr Payable		R100 [Financial liability]

*VAT receivable from and payable to SARS presented on a net basis

Payments (cash) basis

Dr Expenses	R90	
Dr VAT accrual (only a right once received)		R10 [Right to receive VAT**]
Cr Payable		R100 [Financial liability]

**VAT control debit and credit presented separately

Payment of cash

Entry 1 – Record payment of cash and reduction of payable

Dr Payable	R50	
Cr Bank		R50

Entry 2 – Recognise receivable due from SARS [Only applicable to VAT vendors on the payments basis]

Dr VAT control	R5 [Statutory receivable*]	
Cr VAT accrual		R5

*VAT receivable from and payable to SARS presented on a net basis