Tax & Exchange Control

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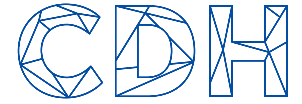

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SOUTH AFRICA

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Rising rates, rising resilience: Navigating the VAT rate increase

With another value-added tax (VAT) rate increase on the horizon, businesses are once again required to navigate both the legal complexities and the operational challenges that come with the change.

In his Budget Speech on 12 March 2025, the Minister of Finance (Minister) announced a phased increase in the standard rate of VAT from 15% to 15,5%, set to take effect on 1 May 2025, and thereafter from 15,5% to 16%, effective from 1 April 2026. The upcoming increases build on the 2018 amendment that raised VAT from 14% to 15%.

Legislative and regulatory framework

In terms of section 7(4) of the Value-Added Tax Act 89 of 1991 (VAT Act), the increased rate will apply from the effective date announced by the Minister in the Budget, and Parliament then has 12 months to amend the VAT rate. If Parliament does not pass the necessary legislation during this period, we may have the absurd situation where we have a VAT rate of 15,5% until 31 March 2026, which rises to 16% on 1 April 2026 and which reverts back to 15% again on 30 April 2026.

Following the Minister's announcement, opposition has been voiced against the proposed VAT rate increase. It is therefore uncertain whether Parliament will pass legislation to give effect to the rate increase. Notwithstanding this, the VAT rate will increase with effect from 1 May 2025 by virtue of section 7(4) of the VAT Act, and as such, given the short timeframe, businesses should adjust their systems and processes to ensure that VAT is correctly accounted for from 1 May 2025, and to avoid penalties and interest.

What VAT rate should be charged?

In terms of the general time of supply rule contained in section 9 of the VAT Act, a supply takes place at the earlier of when an invoice is issued or payment is received. Therefore, the VAT rate applicable at the date on which the supply takes place in terms of section 9 is the rate applicable to such supply. Uncertainty may arise where supplies commence before 1 May 2025 and continue thereafter or where agreements are concluded before 1 May 2025 and goods or services are only supplied thereafter. In such instances, the VAT Act contains specific transitional rules that guide how the VAT rate should be applied to such supplies.

Section 67: Contracts concluded prior to the VAT rate increase

Section 67 of the VAT Act applies to agreements concluded before the effective date of the increase. This section entitles the supplier to recover from the recipient, in addition to the amounts payable as stipulated in the agreement and notwithstanding anything to the contrary in any law, the additional amount of VAT that becomes payable as a result of the VAT rate increase on supplies made thereafter, unless the agreement specifically stipulates otherwise.

If the agreement precludes the supplier from recovering an increased VAT rate from the recipient, the supplier will nevertheless be required to pay the increased VAT rate as output tax.

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Section 67A: Transitional rules

Section 67A provides for certain transitional rules in relation to supplies that span the implementation date of the VAT rate increase, and it also contains anti-avoidance measures.

Supplies made before 1 May 2025

Where goods (excluding fixed property supplied by way of a sale) are provided before 1 May 2025, or where services are performed during a period commencing and ending before 1 May 2025, the current rate of 15% will apply to these supplies, irrespective of the fact that an invoice for such supply may only be issued after 1 May 2025, and payment is received after that date.

Goods are deemed to be provided when they are delivered to the recipient. It is not clear what is meant by "*delivery*", but it seems that the concept is wider than just physical delivery, and that it includes "*delivery*" in the legal sense. If the goods are supplied under a rental agreement, such goods are deemed to be provided when the recipient takes possession or occupation thereof.

There is, however, no guidance as to when services are deemed to be performed. It seems that services must be carried out or physically performed for the services to be considered to have been performed.

Supplies commencing before but ending on or after 1 May 2025

The rules with regard to the supply of goods or services commencing before and ending on or after 1 May 2025 are contained in section 67A(1)(ii) and cover the following supplies:

- goods that are provided under a rental agreement;
- services which are performed under an agreement or law that provides for periodic payments;
- goods supplied progressively or periodically under an agreement or law that provides for the consideration to be paid in instalments or periodically; and
- goods or services supplied directly in the construction, repair, improvement, erection, manufacture, assembly or alteration of goods under any agreement or law that provides for the consideration to be paid in instalments or periodically.

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Where these goods are provided or services are performed during a period that commences before 1 May 2025 and ends thereafter, the vendor must apportion the value of the supply (i.e. the VAT exclusive price charged) on a fair and reasonable basis between the supplies made before and after 1 May 2025. VAT is then payable at the rate of 15% on the value attributed to supplies made before 1 May 2025, and is payable at the new rate of 15,5% on the value attributed to supplies on or after that date. There are no guidelines as to the basis of apportionment which must be used. The onus is on the vendor to substantiate that the apportionment applied is fair and reasonable.

Supplies made after 1 May 2025

Generally, where supplies are made on or after 1 May 2025, such supplies will be subject to VAT at the new rate of 15,5%.

Section 67A(2) of the VAT Act contains certain anti-avoidance rules that apply to prevent vendors from taking advantage of the lower rate by artificially triggering the time of supply rules in section 9.

The anti-avoidance rules apply where goods (excluding the sale of residential property) or services are supplied where the time for such supply was triggered in terms of section 9 between 12 March 2025 (when the VAT rate increase was announced) and 30 April 2025, but the goods are provided 21 days after 1 May 2025 (i.e. after 22 May 2025) or the services are performed on or after 1 May 2025.

Such supplies are deemed to take place on 1 May 2025 and VAT at the increased rate of 15,5% will apply. The VAT must then be accounted for in the May 2025 tax period, irrespective of when the goods are provided or the services are performed. Therefore, if the goods are provided within the 21-day period, i.e. before 22 May 2015, VAT will still be payable at the current rate of 15%, but all services supplied on or after 1 May 2025 will attract VAT at 15,5%.

The anti-avoidance provisions of section 67A(2) do not, however, apply where it is the normal business practice of the vendor to receive payments or to issue invoices before goods are provided or services are performed. For example, a professional body that customarily issues invoices to its members for annual subscriptions.

Sale of residential property

Section 67A(4) of the VAT Act provides for a concession in relation to the sale of residential property by a VAT vendor. This section applies to sales of the following types of residential properties:

- the sale of fixed property consisting of any dwelling together with the land on which it is erected;
- any real right conferring a right of occupation of a dwelling;
- any sectional title unit where such unit comprises a dwelling;
- any share in a share block company that confers a right to or interest in the use of a dwelling;
- the sale of fixed property consisting of land for the sole or principal purpose of the erection by or for the purchaser of a dwelling as confirmed by the purchaser in writing; or
- the construction by a vendor carrying on a construction enterprise of any new dwelling.

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If the price of the sale or construction of such residential property was determined and stated in a sale agreement which was signed by the parties before 1 May 2025, and the registration of transfer and payment will only take place on or after 1 May 2025, then VAT is payable at the current rate of 15%.

Commercial property

There are no transitional rules in relation to commercial property. The normal time of supply rule therefore determines the rate of VAT that will be applicable.

Consequently, if the date of registration of transfer in the name of the purchaser is effected and payment is made to the seller on or after 1 May 2025, VAT at the increased rate of 15,5% will be payable by the seller, irrespective of when the sale agreement was concluded.

However, where a written sale agreement was concluded before 1 May 2025 and the purchaser makes any payment of the purchase consideration to the seller (other than a deposit to the transferring attorney) between 12 March 2025 (being the date of announcement of the VAT rate increase) and 30 April 2025, and the property is registered in the name of the purchaser on or before 22 May 2025, the current VAT rate of 15% will still apply.

Lay-by agreements

Where a lay-by agreement is concluded prior to 1 May 2025, VAT at the rate of 15% will be payable on the supply in terms of such an agreement, provided a deposit is paid before 1 May 2025. If such an agreement is cancelled before the supply is made, the supplier must account for VAT on any amount retained at the tax fraction applying the rate of 15%.

Supplies made under any lay-by agreements concluded after 1 May 2025 are subject to VAT at 15,5%, and any amounts retained under such cancelled agreements will attract VAT at the tax fraction applying the increased rate of 15,5%.

Practical considerations

Completion of the VAT 201 return

The VAT rate change will affect the preparation and completion of the VAT 201 return. Vendors that are not registered to submit monthly VAT returns and whose VAT return period spans both the period before and after the VAT rate increase must file a single VAT 201 return.

It is expected that the South African Revenue Service (SARS) will not amend the VAT return to cater for the current VAT rate and new VAT rate, and that SARS will implement a work-around solution similar to its approach with the 2018 VAT rate increase. As such, transactions on which output tax is payable at the revised VAT rate of 15,5% will be reflected in fields 1 and 4 of the VAT 201 return, while the output tax payable at 15% must be included under *"other"* in field 12.

Input tax to which the rate of 15,5% applies should be recorded in fields 14 and 15, while the input tax deductions at 15% should be included under *"other"* in field 18 of the return. For goods that are imported during this transition period, the VAT on the importation of all capital goods will be recorded in field 14A, while the VAT on other imported goods will appear in field 15A.

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Actionable steps

To ease the impact of the VAT rate increase and to ensure compliance, the following actions should be considered by vendors:

- **Agreements:** Review agreements to ensure that prices may be increased to reflect the new VAT rate.
- **Systems:** Ensure that accounting, invoicing, point-of-sale and billing systems are configured to distinguish between transactions and supplies before and after the VAT rate increase.
- **Keep an eye on timing:** Since VAT is typically applied based on the earlier of the issuing of an invoice or the receipt of payment, it is important to keep meticulous records of the time when transactions are concluded for VAT. This is especially important for supplies that span the transition period.
- **Stay informed of any legislative developments:** Given the current debate surrounding the VAT rate increase and the requirement that parliament approves the rate increase within the next 12 months, vendors should stay informed of further developments.
- **Training:** Staff responsible for VAT reporting must be informed of the time of supply and transitional rules to eliminate errors and non-compliance penalties.

Concluding remarks

Navigating the VAT rate increase requires vendors to gain an understanding of the legislative framework and the specific rules in sections 9, 67 and 67A of the VAT Act. There will, no doubt, be various transactions for which the transitional rules are unclear or where they may cause substantial practical difficulties to comply with. Careful consideration and a prudent practical approach for these transactions will be required to avoid any penalties and interest.

While compliance may require substantial system adjustments and strategic planning, proactive measures can assist to mitigate risks and ensure a smooth transition. Vendors are therefore strongly encouraged to ensure that their systems are prepared for the impact of the VAT rate increase so as to maintain tax compliance at all times and to avoid potential penalties and interest.

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Better late, or better never? Government wants to tighten rules on taxpayers incurring losses

Expenditure and losses incurred by individual taxpayers are generally deductible against their income under section 11(a) of the Income Tax Act 58 of 1962 (ITA), read with section 23(g), provided certain requirements are met. In other words, tax policy allows such expenses when they are, amongst other things, considered to produce income and are incurred pursuant to a trade. A taxpayer could also theoretically find themselves in a loss-making position in respect of a trade for more than one year.

Generally, these losses realised by individuals can be offset against other income in later years and irrespective of the source of that revenue. Said differently, an individual could make a loss in respect of one trade and offset that loss against income from another trade. However, there are certain limitations, exceptions and exclusions to that general rule.

Section 20A of the ITA is one of those rules. It comes into play when assessed losses from a trade were allowed in earlier years of assessment and determines whether or not a trade loss should be set off against other income, thereby reducing taxable income. In other words, it "*ring-fences*" certain losses from specific trades in that those losses can then only be offset against income from that same trade. Importantly, a "*ring-fenced*" loss is not "*lost*" or "*disallowed*", but merely carried forward to the next year of assessment and is available for set-off against any income derived from that specific trade in that year.

When does the ring-fencing of losses under section 20A apply?

Firstly and importantly, section 20A only applies to natural persons (i.e. individuals) and not companies, trusts or other juristic persons, which is somewhat ironic because it is quite a complex and intricate section. The South African Revenue Service's (SARS) Guide on the Ring-Fencing of Assessed Losses Arising from Certain Trades Conducted by Individuals (SARS Guide), lists four factors that need to be determined when considering if the section is triggered, namely:

1. The "*maximum marginal rate of tax requirement*".
2. The "*three-out-of-five*" years requirement or alternatively, the "*suspect trade requirement*".
3. The "*facts and circumstances*" test (the escape clause).
4. The "*six-out-of-ten-years*" requirement (the "catch all" provision).

Step 1 was the subject of Government's displeasure in the recent tax policy pronouncements in the 2025 Budget. Before considering that, it is worth looking at other requirements first.

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In this context, step 2 enquires into whether the taxpayer has made a loss from a specific trade in three out of the last five years or, alternatively, if the trade is a "*suspect trade*". The suspect trade list contains eight different trades including:

- sport practised by taxpayers;
- dealing in collectibles (e.g. art or coins or wine);
- renting of residential accommodation where 80% of the accommodation is used by relatives of the taxpayer who occupy the residence for at least half the year;
- rental of movables such as aircraft, boats or vehicles where 80% of the use is by relatives of the taxpayer who use the asset for at least half the year;
- animal showing;
- part-time farming;
- creative arts performances; and
- crypto-asset trading.

Step 3 of the test allows a taxpayer to not be caught by the provisions where, for example, they can show that there is at least a reasonable prospect of earning a profit within a reasonable period. This test is not always easy to apply as it's a "*facts and circumstances*" based test and even if a taxpayer believes it may make a profit, SARS does not always necessarily agree. The SARS Guide provides a list of factors to consider and apply when considering this leg of the test and this is indicative of the fact that its not simple. In this context, this step is often the subject of much debate between taxpayers and SARS.

Step 4 then provides that one cannot escape the claws of section 20A (i.e. the losses must be ring-fenced) if there has been a loss in at least six out of the last ten years. The assessed loss will be permanently ring-fenced in the year of assessment in which the rule applies. Said differently, one does not consider the "*facts and circumstances*" based test (step 3) if there have been losses in the past six out of ten years.

Government's proposal to remove the marginal income tax rate carve out

Notably, as already mentioned, the section does not come into play at all if the natural person in question is not taxed at the highest marginal income tax bracket. Moreover, if a person's taxable income is below the threshold for the highest marginal income tax bracket (currently R1,817,000 per annum), the assessed loss may not be ring-fenced under section 20A. This is irrespective of the number of years in which losses have been incurred and the nature of the trade being carried on.

However, the Minister of Finance recently announced in the Budget Review Documents 2025 that the current application of section 20A of the ITA enables taxpayers below the maximum marginal rate threshold to allegedly exploit the tax system by continuously offsetting losses from certain trades against other sources of income.

According to Government, this creates a loophole that leads to substantial revenue losses for the fiscus, as taxpayers receive full refunds of their employees' tax when those losses are allowed. It has therefore been proposed that the threshold at which ring-fencing rules apply be reviewed and amended.

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Observations

It is interesting to note Government's proposal and it is expected that there will be a robust public consultation process on this proposed change. This is especially against the background of Government also proposing not to adjust the personal marginal income tax brackets. In other words, given Government lessened its stance on the 2% value-added tax (VAT) increase (now a proposed staggered 1% increase over two years), it needed to find the money elsewhere (instead of cutting costs) and has chosen instead to target individuals through an indirect personal income tax increase by not adjusting the personal income tax brackets (for a second year running) and targeting amendments to section 20A.

It is further noticeable that the proposed amendments to section 20A stand at odds with the initial rationale behind the introduction of section 20A in its current form back in 2004. In the explanatory memorandum on the Revenue Laws Amendment Bill, 2003 (which introduced the current section 20A in its current form), Government was at pains to state that:

> "*...private consumption can be masqueraded as a trade (i.e. a hobby) so that individuals can set-off these expenditures and losses against other income (usually salary or professional income). This attempt to deduct hobby-like expenses undermines the ability to pay principle of the income tax system because wealthier individuals have more means to disguise hobby expenses as a trade. Hence, a more stringent "facts and circumstances" test will be introduced as a means to uncover these artificially labelled trades.*"
> [Our emphasis]

The explanatory memorandum states further that limiting the ring-fencing rule to high earners was important because "*this aspect of the threshold ensures that section 20A ring-fencing is targeted solely at higher income individuals who have the means for disguising hobbies as trades*".

It is accepted that 2004 is now over 20 years ago and "*facts and circumstances*" change. However, it is expected that there will be public pushback on this in the absence of evidence that supports Government's intentions. The reality is that many of these trades conducted by individuals are making losses because the South African economy is not growing. Hitting those taxpayers with an indirect "*additional tax*" may accelerate the economy's demise further.

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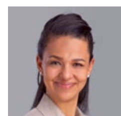

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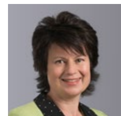

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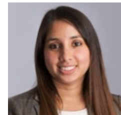

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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