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V A N U A T U
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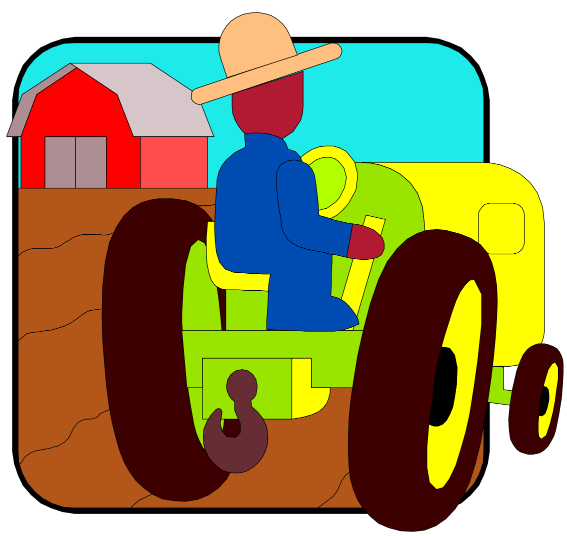
Farmers and VAT



A Introduction

This booklet was first printed in May 1998 and reviewed in September 2005. Any changes that take place after September 2005 will not be reflected in this booklet.

Value Added Tax - What is it?

VAT is a tax on spending. It is ultimately paid and borne only by the final consumers of goods and services and is designed to tax their spending evenly and fairly. It is not a tax on the producers and sellers of goods and services; they will simply collect the VAT on behalf of the Government.

VAT will be collected at a single rate (12.5%) on virtually every transaction of goods and services throughout the production and distribution chain. But in the case of most producers, distributors and sellers, VAT paid out on business costs and purchases can be claimed back.

VAT will not therefore mean an increase in tax liability for businesses. It is only the end consumer, who buys the finished goods or services and does not resell them or process them further, who finally pays the tax, and cannot claim it back.

VAT was introduced as a means of reforming the tax systems as part of the Comprehensive Reform Programme (CRP).

Some primary producers will be liable to register as VAT 'collectors' and as such will have certain new liabilities and responsibilities.

The booklet is designed to address concerns, provide specific information to assist farmers in understanding and working with VAT, and to explain the overall impact of VAT on farming.

More information on registration and accounting for VAT can be found in our booklet 'Do you need to Register' and the 'VAT Guide'.

How VAT works

In effect, VAT works in two steps:

- A registered person e.g. a farmer, who pays 12.5% tax on all goods and services purchased for use on his farm. But this tax, is subsequently credited back to the farmer - **therefore no VAT is borne by the farmer.**
- The farmer adds 12.5% tax onto the price of all the goods and services he sells, and pays this amount, (minus the VAT paid on expenses) to the Department of Customs and Inland Revenue, VAT Office - **therefore the VAT is all charged to the buyers/recipients of the goods and services.**

Example: a farmer buys 100 chickens from a country farmer for VT 500 each.

	VT
100 chickens @ VT 500 each	50,000
plus 12.5% VAT	6,250
Payment to farmer	**56,250**

After fattening the chickens the farmer sells them for VT 1,000 each

VT	
100 chickens @ VT 1000 each	100,000
plus 12.5% VAT	12,500
Payment to farmer	**112,500**

The farmer collects this VT 12,500 VAT, deducts the VT 6,250 he paid to the farmer, and sends the balance
(VT 6,250) to the VAT Office.

In practice the farmer would have had a number of other expenses relating to fattening the chickens, such as fencing, feed, capital equipment, etc, and would therefore also be deducting all the VAT paid on these from the amount he collected on his sales.

In the case of cattle, all the charges made to the farmer by the abattoir which are deducted from the gross value of the cattle, e.g. processing charges, transport costs, etc are also expenses, and the VAT on these would also therefore be claimed as a deduction.
In other words, every vatu the farmer pays in VAT at the expense/input stage is recovered.

In practice the farmer does not have to wait until the cattle are sold before he can claim back the VAT paid on expenses. He can claim in the period during which the purchases are made.

Taking the next step, the abattoir would deduct the VAT it paid to the farmer from its VAT on income, e.g. on sales of meat to a butcher, and then pay only the balance to the VAT Office. So it can be seen that all the VAT transactions throughout this production and distribution chain are self-balancing, and only the final consumer, who buys the meat in a butcher's shop, actually pays the tax. Like all other consumers the farmer will, of course, bear the cost of VAT on all purchases made for private use.

B Registering for VAT

Assessing 'taxable' sales

In determining whether or not they must register for VAT, farmers will need to assess the nature and annual value of their sales. Almost all farmers are engaged in making 'taxable' sales, i.e. sales made in the course of a commercial activity (excluding hobbies or occupation as an employee) that is carried on regularly or continuously.
If the value of these sales exceeds VT 4 million a year the farmer will be obliged to register with the VAT Office. In assessing the value and nature of their sales, farmers should check whether any of their sales are zero-rated or exempt. If a farmer has exempt sales these cannot be included in the VT 4 million for the purposes of assessing liability to register. However if any of a farmer's sales are

zero-rated these should still be included in the VT 4 million.

Zero-rating

Although VAT will apply to virtually all sales at a rate of 12.5% there are some transactions which will be zero-rated. This means VAT will be charged at a rate of 0%, i.e. no VAT is charged on a sale, but VAT paid on related expenses can still be claimed back. Zero-rating that may affect farmers is the exports of goods or services.

- **Exports**

Where a farmer exports directly or is a member of an exporting co-operative which operates as **an agent** for its members, (i.e. the farmer retains ownership of the product until it is exported), then the above points on zero-rating will apply to his/her exports.

However, although he/she produces goods destined for export, the farmer is not generally the exporter, i.e. the person whose supply is zero-rated. The exporter is the person who enters the goods for export, i.e. lodges the customs document, and this is usually a processing company, a producer board, or someone else who has bought the goods from the farmer. The farmer will therefore still be liable to charge VAT on sales.

Exemptions

Some types of sales will be exempt from VAT. This means that no VAT will be payable, but unlike the case with zero-rating, the VAT paid on expenses relating to exempt sales cannot be claimed back.

Below are the categories of exempt goods and services:

- Donated goods and services sold by a non-profit body;
- Financial services; these include the exchange of money or currency, issue of cheques, postal notes, interest payments, provision of credit, life insurance contracts and superannuation schemes, underwriting and brokerage and arranging any of these, for example, arranging mortgages,
- Residential housing rental,
- Educational Institutions,

The exempt categories most likely to affect farmers are financial services such as credit provisions.

It is important to note that a business which deals solely in exempt activities does not have any special advantage. That business will in effect be treated as a final consumer, bearing the full cost of VAT on all expenses.

Who must register?

All farmers with ‘taxable’ sales of more than VT 4 million a year must register with the VAT Office.

Registration for farmers with sales below VT 4 million per annum is optional. Farmers in this situation (except employees or those whose work is in the nature of a hobby) should consider the advantages of registering:

- VAT paid on purchases for the farm can only be claimed back if the farmer is a ‘registered person’. This will be important if the farm is capital intensive or operates on a low margin.
- If a farmer is selling principally to other businesses, those businesses, if registered, are likely to favour dealing with a ‘registered person’ This is because the prices of a non-registered person are likely to be higher, because

no input tax credit can be claimed on those prices by the buyer.

- If a farmer is setting up a new venture or has a farm in a development phase, e.g. a pawpaw grower which would involve substantial capital expenditure, it would be advisable to register in order to claim deductions for VAT paid on expenses/inputs. Small businesses which do not register will in fact be treated as final consumers.

Partnerships and joint ventures

For registration purposes, companies or unincorporated bodies such as partnerships, joint ventures, trustees of trusts and unincorporated clubs must register in their own name and not in the names of their members or shareholders. In the case of trustees of a trust, registration is in the name of the trust. The trust therefore becomes a 'registered person'. Provided that the body itself is registered, the individual members or shareholders need not register although members of an unincorporated body (such as partners or club committee members) are personally liable for any obligations of the unincorporated body.

Grouping of companies

Where companies are controlled by the same person or people they may apply to the Director to be grouped for VAT purposes. Such a group would nominate one member to represent the group and assume responsibility for accounting for VAT on the activities of all the group members. Although the individual members will still need to register, keep records and issue tax invoices, they will not need to make returns and account for VAT.

C Calculating VAT payable on income

Farmers will be liable to account for VAT on all their sales of goods such as livestock, produce, crops, seed, timber, etc (unless they are exported directly).

Example: If the price of 100 chickens is VT 100,000, the VAT will be VT 12,500, making the final tax-inclusive price VT 112,500. The VAT content of the tax-inclusive price will therefore be $1/9^{th}$. The easiest way of determining the tax content of any tax inclusive price is to divide the total by 9.

In practice, farmers will have to adjust their prices, i.e. add on 12.5% in order to ensure that they still receive the net value for their products.

In general, the price will be established by the same means as at present, e.g. the going rate. VAT will have to be added either by the farmer when an invoice is issued.

D Types of sales

Sales to another farmer

VAT will be added by the seller to the price established between them.

Example: a nurseryman sells a farmer 500 young fruit trees:

	VT
500 trees @ VT 525	262,500
plus 12.5% VAT	32,813
Total price	**295,313**

Trading in kind

A farmer may pay a fencing contractor for work done with meat and produce, or he may supply grazing for the local vet's horses in return for free veterinary care for his own horse. In both cases the supply, i.e. the meat and the grazing is assessed in value as the open market value of the goods given as payment, i.e. the contract work and the veterinary care. These are included as income in the farmer's VAT calculation.

Goods taken for private use

Produce or other goods taken from the farm for private use by the farmer, his family, or any associated person, are regarded as sales and must be included as outputs in the farmer's regular VAT calculation. In other words, the supplying of such goods will be regarded as a taxable transaction because the goods are farm outputs supplied or sold in the course of the farmer's taxable activity. This would apply, for example, to produce taken for the family's consumption. For the farmer's VAT calculation the value of such a supply will be the lesser of the cost of the goods or their open market value, i.e. the amount the goods would generally fetch on the open market.

Gate sales / roadside stalls

Cash sales of farm goods sold at a roadside stall will also attract VAT. The prices shown on the produce should be inclusive of VAT and the farmer will have to account for that VAT to the VAT Office as 1/9th of his takings.

Trading between two farms

Where farms are owned by 'associated persons' (e.g. members of the same family, partners, a farmer and employee, etc,) and goods are sold from one to the other as part of their taxable activities (ie both are to be VAT registered), at below market cost, the sale will incur VAT and the value of the goods sold will be the price charged.

E Land and buildings

Residential buildings

If a new house or cottage is built on a farm after 1 August 1998, VAT will be charged on all building costs and materials. VAT is claimable on the portion of the costs and materials that relate to farm use.

New farm buildings

If a farmer builds a business-related building, e.g a packhouse, all the building costs and materials will be subject to VAT but a full credit for that VAT can be claimed.

Farm office/workshop in a farmhouse

Most farmers use a room in the farmhouse as an office, or for some other farm-related activity. VAT may be claimed on goods and services purchased for such rooms where the goods or services are being used for the business. For example, the VAT on a desk, furniture or stationery for an office may be claimed as a credit.

Where items are bought principally for farm use but are used partly for private purposes, a partial VAT credit can be claimed, this is apportioned to the business use or percentage.

Example: If there is a telephone in the farm office which is used 1/2 for business and 1/2 for private calls, the following adjustment should be made to the rental portion of the bill:

	VT
Telephone rental for 2mth	5,000
plus 12.5% VAT	625
Total	**5,625**

A partial VAT claim can be made on VT 2813, which is 1/2 of the total account VT 5,625.

If there are toll call charges on the telephone account, only the VAT portion of any calls may be claimed

F Types of payments

Time of supply

It may sometimes be difficult for farmers to assess when - i.e. in which return period - they are liable to account for VAT on a particular transaction, as the 'time of supply' or the actual time a transaction takes place is frequently unclear. The VAT Legislation defines the 'time of supply' as the earlier of the time an invoice is issued or the time payment is received by the supplier. The legal time of supply will depend on the type of transaction being made.

The following examples explain in which return period specific transactions are required to be included in.

Advance payments

A banana grower sells his banana crop in advance, i.e. before it is ready to be delivered to the buyer. It will depend on which accounting basis you have choosen as to when VAT is accounted for.

- **Invoice basis**

VAT would be payable on the whole of the advance payment at the time of invoice or payment, whichever is earlier. (Most often, payment would probably be accompanied by the invoice.) Any subsequent payment would be regarded as a separate transaction, also attracting VAT.

- **Payments basis**

VAT would be accounted for on the advance payment, when the payment is made. VAT will be accounted for on the subsequent payments when they are paid.

Discounts

- **Prompt payment discounts**

Where a farmer buys goods on credit and a discount is given for prompt payment the VAT will be charged on the gross amount of the invoice.

Example

	VT
1,000 metres fencing wire	100,000
plus 12.5% VAT	12,500
Total	**112,500**

A discount of 2% may be taken if paid within 7 days. If a farmer takes up this discount he will pay 98% of the full price:

	VT
98% of VT 100,000	98,000
plus 12.5% VAT	12,250
Total	**110,250**

In such a case the supplier will not have to issue a credit note, but, although the invoice will show the full undiscounted amount of VAT, i.e. VT 12,500, the farmer should only claim a credit for the discounted amount, i.e. VT 12,250.

- **Trade or bulk purchase discounts**

These are ~~a~~ special prices for certain purchases of goods or services. The special price will always be the amount paid by the purchaser and the VAT will be payable on that price.

G Specific purchases

Retention payments

Example: A farmer signs a contract with a builder to construct farm buildings. The contract has a provision for retention of part of the payment pending full performance of the contract. VAT on the retained sum can be deducted in the period in which payment of the sum is due or paid.

Hire purchase

When VAT is accounted will depend on your VAT accounting basis.

- **Invoice basis**

Example: A farmer purchases goods under a hire purchase agreement, VAT paid on the total cash price can be deducted in the period during which the agreement is entered into.

- **Payments basis**

Example: In the above example, the farmer can only claim back VAT on each hire purchase payment as it is made.

Purchases from a non-registered person

Because non-registered persons cannot charge VAT on their sales, any business expenses paid to a non-registered person cannot be included in the VAT calculation for the purposes of claiming deductions, unless the goods are second hand.

Payments to employees

Because employees cannot register for VAT, salaries or wages paid to an employee will not attract VAT. Therefore

no VAT can be claimed back on salary and wage payments.

Goods for own use

VAT will be included in the purchase price of goods and services acquired for the private use of the farmer, or his family, such as food, clothing, farmhouse furniture, household electricity, etc. However, this VAT will not be recoverable as such purchases are for private use.

Distinguishing between private and farm use

Every farmer purchases a number of items which can be put to both private and farm use, e.g. fuel, horses, some stock and produce, etc.

In determining whether or not any VAT credit can be claimed on the purchase of these items and other expenses relating to them, the farmer must assess what portion each item is used for business.

H Invoices

Tax Invoices

- No tax invoice is required for sales of less than VT 5,000.
- If the amount of the sale is over VT 5,000 the tax invoice must show

  - the words **Tax invoice** in a prominent place;
  - an individual serialised invoice number;
  - the name and CT number and address of the supplier;
  - the name of the recipient:
  - the date;
  - the quantity or volume of the goods or services;
  - a description of the goods and services supplied; and
  - either the VAT inclusive price and a statement that it includes a charge for the tax; or the total amount of the tax, the price excluding tax and the price including tax.

Buyer Created Tax Invoices

A registered person who supplies goods or services to another registered person is required to issue a tax invoice, and with normal commercial practice it is the supplier of goods or services who determines the value of the supply so generally it is the supplier who issues the tax invoice.

However there are certain types of supplies where the recipient of the goods or services determines their value at the time the supply is made e.g. produce sold to a produce marketing board. In such cases it is more practical for the recipient of the supply to issue a tax invoice. The term for this type of invoice is “buyer created tax invoice”.

A recipient of a supply of goods or services is entitled to issue a buyer created tax invoice subject to these conditions:

- Written approval from the VAT Office is required prior to the issue of any buyer created tax invoices.
- The invoice must show the normal tax invoices particulars (including the name and registration number of the supplier of the goods).
- In each case that a buyer created tax invoice is to be provided, both

the supplier and the recipient must agree that the supplier will not issue a tax invoice in respect of that supply.

- The supplier must be provided with a copy of the buyer created tax invoice in respect of each supply.
- Each invoice must contain the words “Buyer Created Tax Invoice” in a prominent place.

There is a policy statement available from the VAT Office to explain more about Buyer Created Tax Invoices.

I Farm office record-keeping

Records of all VAT transactions must be kept. VAT credits on business purchases can be claimed only if supported by tax invoices. You must still hold evidence of payment for supplies less than VT 5,000. Similarly all sales documents must have supporting tax invoices showing VAT received on that sale. These documents do not have to be supplied with a VAT return, but the VAT Office is entitled to call and inspect the records of any registered person.

Invoices should therefore be filed regularly and cheque butts and bank statements should be kept. Improved accounting should in any case pay off in the form of more efficient farm management. All records must be kept for a period of 6 years.

If payment of VAT is made late, i.e. is not made by the 27th of the following month, 10% of the amount unpaid will be added as a penalty.

Conversely, where refunds are owing to the farmer they must be paid by the VAT Office within 15 working days of the lodgement of the return, otherwise interest will be payable to the taxpayer at the current rate of 15 percent. (There are very few exceptions to this).

The VAT Office will supply registered persons with all the information needed to register and to calculate and complete VAT returns. It will also offer an advisory visit to farmers or any businesses seeking assistance.

J Cost of VAT to the Farmer

Cash flow impact

The impact of VAT on a farmer’s cash flow will depend on the following factors:

- size of sales relative to purchases;
- whether sales and purchases are made on a seasonal basis, and if so when;
- the normal commercial credit period;
- prevailing overdraft and short-term interest rates; and

Based on overseas experience, it is generally expected that once VAT is established and running, most farmers will not experience any cash flow disadvantages.

Overall cost to the farmer

The impact of VAT on the finances of most farms should be minimal. There will be some cost in the form of improved on-farm record keeping.

K Further assistance/ information

If you require further assistance in administering VAT as part of your business, The VAT Office of the Department of Customs and Inland Revenue will be pleased to help you.