

18 August 2020

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BY EMAIL: [policycomments@sars.gov.za](mailto:policycomments@sars.gov.za)

**RE: SAIT COMMENT IN DRAFT INTEPRETATION NOTE: INCOME TAXATION OF DEPOSITS (RECEIPTS)**

Dear Sir/Madam

We thank you for the invite to comment on this draft interpretation note dealing with the income tax impact of receipts coming in the form of deposits. Taxation of receipts dedicated toward deposits is a recurring issue for most businesses. The interpretation note is helpful and supported. The points raised are suggestions that could take the interpretation note a step further.

A. Basic considerations

The timing of deposits for purposes of receipt essentially boils down to two main factors. Firstly, there is a question of how the funds are applied by the seller / service-provider. Secondly, there is the intention for the use of the deposit.

As a general matter, it appears that funds should be segregated from general usage by the service-provider. If deposits funds are commingled and utilised like any other form of cash receipt, presumably the receipt must be included as gross income regardless of the intention behind the deposit. Secondly, what is the minimum level of segregation required? A mere separate accounting entry presumably does not suffice. Generally, a separate bank account (even with the same bank) should be sufficient. The holder of the deposit should not be required to keep the funds in a separate legal entity (such as an independent trust).

In terms of the second factor, the main issue appears to be the distinction between a deposit and an advanced payment. Hence, a rental deposit to protect against damaged property (tangible property such as a car rental or immovable property rentals) should largely fall outside a legal receipt. These types of deposits are often referred to as "security" deposits. On the other hand, deposits to secure (often prestige) goods on order, hotels, air / other travel and entertainment (e.g. weddings) should almost exclusively be taxable upon receipt. Even if refundable, these latter sets of deposits (often referred to as "reserve" deposits) will largely be applied against the future purchase.

Some unique items to consider:

- *Legal fees.* Many lawyers place certain retainer fees in a separate trust until applied against services are billed. Some of these fees may be for the lawyer; while other amounts may be for government court costs or an independent advocate. Many lawyers view the receipt as an item in their hands only once taken from the trust. Is the existence of this separate trust for initial receipt sufficient to delay a tax receipt?

Does it make any difference if the funds are eventually applied to the lawyer's hourly billing or for use toward third parties (e.g. government costs and the independent advocate)?

- *School fees.* Most schools require a deposit to secure space. Non-refundable deposits should clearly be viewed as taxable receipts. However, what about refundable deposits at final year. Presumably, these amounts should be deferred (if properly segregated) because school use of the deposit is only intended as a penalty for early student withdrawal.
- *Gift cards / vouchers:* Gift card / vouchers are often more akin to advanced payments on goods (especially if non-refundable). Presumably, these amounts should be taxable when initial payment is made.

#### B. Interaction with other provisions

Although SARS interpretation notes mostly deal with a single tax act section at a time, some integration with other provisions would be useful in this area. Most importantly, deposits are best understood when the gross receipt question is combined with the application of section 24C. A good example is an upfront payment for construction, which would be fully includible as a gross receipt with a section 24C allowance. Perhaps, the legal retainer fees should be viewed in the same light.

A second related point that is worthy of attention is the definition of "consideration" for VAT. It seems that deposits are often deferred for VAT; whereas, no deferral would exist for income tax purposes.

#### C. Accounting and Invoice Terminology

One issue relevant for audit is how tax and the accounting terminology combine. Perhaps the draft interpretation note could provide some clarification on the distinction made between "Payments received in advance", "Deposits" and "Deferred income". These items are commonly used terms on the balance sheet of a business. It's not explicit as to where this terminology fits into the examples.

On a similar vein, the labelling of invoices can also be a cause for confusion. More specifically, is the amount considered a deposit if paid on a quote or pro-forma invoice? Does the terminology on these requests for payment make any difference?

#### D. Consumer Protection Act

The draft interpretation note specifically carves out the Consumer Protection Act from analysis. This carve-out greatly undermines the value of the draft interpretation note given the wide scope of the Consumer Protection Act. Most deferred deposits (typically for security) are in the consumer sphere as opposed to business-to-business transactions, and the Consumer Protection Act dominates the consumer sphere. Hence, without application of the Consumer Protection Act, the draft interpretation note has little practical meaning.

The Consumer Protection Act applies to most purchases of goods and services by natural persons (section 5(1) of the Consumer Protection Act). It also applies to most purchases of goods and services by smaller entities – i.e. those entities with an asset value or annual turnover not exceeding R2 million (section 5(2) of the Consumer Protection Act).

The key point made by the Consumer Protection Act is that the seller / service provider must treat deposits and prepayments as property of the consumer. More specifically, section 65(2) of the Consumer Protection Act states:

- (2) When a supplier has possession of any prepayment, deposit, membership fee, or other money, or any other property belonging to or ordinarily under the control of a consumer, the supplier—
- (a) must not treat that property as being the property of the supplier;
  - (b) in the handling, safeguarding and utilisation of that property, must exercise the degree of care, diligence and skill that can reasonably be expected of a person responsible for managing any property belonging to another person; and
  - (c) is liable to the owner of the property for any loss resulting from a failure to comply with paragraph (a) or (b).

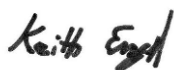
Similarly, section 63(3) of the Consumer Protection Act states that “Any consideration paid by a consumer to a supplier in exchange for a prepaid certificate, card, credit, voucher or similar device contemplated in subsection (1) is the property of the bearer of that certificate, card, credit, voucher or similar device to the extent that the supplier has not redeemed it in exchange for goods or services, or future access to services.”

In view of the above, can consumer deposits, vouchers, etc. really be treated as a immediate gross receipt when the Consumer Protection Act shifts ownership back to the consumer? One could argue perhaps that the supplier should still be subject to immediate tax if the funds are commingled with the rest of the supplier’s receipts. On the other, if the supplier segregates these funds (especially if held in trust), a strong judicial argument can be made that the law expressly excludes these funds from being an actual receipt until applied toward a purchase.

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You are welcome to contact me (082 455 5597 or [kengel@thesait.org.za](mailto:kengel@thesait.org.za)) should you have any comments or questions.

Yours faithfully,



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