South African Revenue Service

DRAFT INTERPRETATION NOTE

DATE:

ACT : VALUE-ADDED TAX ACT 89 OF 1991

SECTIONS : SECTION 1(1) – DEFINITION OF "CONSIDERATION" AND "INPUT TAX" SECTION 7(1)(*a*)

SUBJECT : THE VALUE-ADDED TAX TREATMENT OF DEBT COLLECTION

Preamble

In this Note unless the context indicates otherwise –

- **"credit provider"** means a financier (for example, banks or micro-lenders) that provides credit without any underlying supply of goods or services, or a supplier of goods or services that provides credit to fund the purchase of such supply;
- **"debtor"** means the customer of the credit provider;
- **"debt collection"** means the process of recovering debts owed by customers, whether the process is conducted by the credit provider itself or a third party appointed as a debt collector;
- **"debt collector"** means a debt collector as defined in the DCA;
- **"DCA"** means the Debt Collectors Act 114 of 1998;
- **"NCA"** means the National Credit Act 34 of 2005;
- **"prescribed amounts"** means the amounts prescribed in Annexure B to regulation 11 of the DCA in respect of expenses and fees that the debt collector may collect from the debtor (refer to **Annexure B**);
- **"section"** means a section of the VAT Act;
- **"VAT"** means value-added tax;
- **"VAT Act"** means the Value-Added Tax Act 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This Note provides clarity on the VAT treatment of debt collection activities, whether undertaken by credit providers, in-house or outsourced to external debt collectors. In particular, this Note examines the VAT treatment of the prescribed amounts recovered by the debt collector from the debtor under the DCA.

This Note does not address debt collection activities outsourced to attorneys.[1]

[1] Attorneys are currently not regulated by the DCA.

2. Background

Credit providers incur substantial debt collection costs when debtors default on payment. Typically, the debtors are contractually liable under the credit agreement governing their relationship with the credit providers for the payment of the debt collection costs. The NCA regulates the legal relationship between the credit provider and the debtor. This is discussed in more detail in **4.1.1(b)**.

The debt collection process may either be undertaken in-house by credit providers or outsourced to debt collectors for an agreed remuneration. The latter arrangement is formalised under a service level agreement (SLA) between the credit provider and the debt collector. The debt collector's remuneration will vary depending on the contractual terms agreed upon between the parties. Generally, the agreed remuneration includes a commission paid by the credit provider, calculated as a percentage of the amount collected from the debtor, as well as the recovery of the prescribed amounts under the DCA. The debt collector therefore acts on the mandate of the credit provider to collect the outstanding amounts owed by the debtor to the credit provider.

Debt collectors are regulated by, amongst others, the DCA. The recovery of the prescribed amounts is stipulated in the DCA. Examples of these prescribed amounts include fees for writing and sending letters, making telephone calls, and sending e-mails and short message services (SMSs). In practice, the prescribed amounts recovered from the debtor are usually retained by the debt collector, although the debt collector is normally obliged to first collect the actual debt from the debtor before proceeding to collect the prescribed amounts.

The issue at hand is whether the remuneration referred to under the SLA, including the commission and the prescribed amounts recovered by the debt collector from the debtor under the DCA, constitutes "consideration", as defined in section 1(1) of the VAT Act, for the supply of debt collection services. Should these amounts be regarded as consideration for such supply, the question that follows is whether the credit provider or the debtor, being a vendor, is entitled to deduct the VAT paid on these amounts as input tax.

3. The law

The relevant sections of the VAT Act are quoted in **Annexure A**.

4. Application of the law

4.1 Output tax

Generally, vendors are required to charge VAT at the standard rate on all supplies of goods or services in South Africa, subject to certain exemptions and exceptions.

4.1.1 Supply of debt collection services

The supply of debt collection services by a debt collector to a credit provider is subject to VAT at the standard rate under section 7(1)(*a*), unless an exemption or exception[2] applies to the supply. Whilst it may be clear contractually that the commission paid by the credit provider to the debt collector is in respect of the supply of debt collection services, a question arises as to whether the recovery of the prescribed amounts is

[2] For example, zero-rating under section 11(2).

also in respect of the supply of debt collection services to the credit provider. This is examined in **4.1.1(b)**.

The consideration for a supply is represented by the value plus the VAT charged.[3] The term "consideration" in its simplest form means anything that is received in return for the supply of goods or services. There must therefore be a causal link between the payment and the supply for the payment to constitute consideration. Consideration can be received from a third party on behalf of the recipient or beneficiary.[4]

In this regard, the consideration for the supply of debt collection services will be equal to the amount that is payable for such supply. Each of the common elements of the agreed remuneration catered for under the SLA between the credit provider and debt collector, is briefly analysed below.

(a) Commission

The commission is generally calculated as a percentage of the amount actually collected from the debtor by the debt collector. The commission paid by the credit provider to the debt collector has a sufficient nexus to the debt collection services performed by the debt collector under the SLA. The commission deducted from the amounts collected, before being paid over to the credit provider, is regarded as payment of the consideration by the credit provider for the debt collection service. As a result, the commission paid by the credit provider in regard to the supply of debt collection services is generally subject to VAT at the standard rate under section 7(1)(*a*).

(b) Recovery of the prescribed amounts under the Debt Collectors Act

In determining the full consideration for the debt collection services, a question arises as to whether the prescribed amounts recovered by a debt collector from a debtor under the DCA also constitutes "consideration" for the debt collection services supplied by the debt collector to the credit provider. In order to answer this question, it is necessary to examine the relevant legislation governing the recovery of debt collection costs from the debtor.

Relevant governing legislation

(i) National Credit Act

The NCA regulates the relationship between a credit provider and a debtor. Section 101 of the NCA deals with the cost of credit and includes collection costs. Section 101(1)(*g*) of the NCA makes provision for the credit provider to recover collection costs from the defaulting debtor. The collection costs may not exceed the amounts prescribed by tariff as set out in, amongst others, the DCA. It stands to reason that the recovery of the collection costs from the debtor by the credit provider must comply with the NCA with regard to the limitation discussed above and where the debt collection process is outsourced by the credit provider to a debt collector, the recovery must likewise comply with the NCA.

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3 Section 10(2).

4 See 5.1.2 of Interpretation Note 70 (Issue 2) "Supplies Made for No Consideration" for a more detailed explanation of the term "consideration".

The recovery of the debt and collection costs outsourced by a credit provider to a debt collector is undertaken by the debt collector on behalf of the credit provider. The debt collector therefore merely recovers the collection costs on behalf of the credit provider limited to the amount prescribed by tariff in the DCA.

(ii) Debt Collectors Act

As previously mentioned, debt collectors are regulated by the DCA. According to the preamble to the DCA, one of the purposes of the act is to legalise the *recovery of fees or remuneration* by registered debt collectors (own emphasis). According to section 19 of the DCA, a debt collector may collect only the following amounts from the debtor:

- The capital amount of the debt and interest on the amount.
- Necessary expenses and fees as prescribed.

Annexure B to regulation 11 of the DCA, prescribes the amounts that the debt collector is entitled to collect from the debtor.[5]

Consideration for debt collection services

Based on the above, the prescribed amounts are regarded as fees or remuneration of the debt collector in *lieu* of expenses incurred. These expenses are incurred by the debt collector in the very act of carrying out the debt collection mandate. It follows that the prescribed amounts recovered by the debt collector are in respect of its fees or remuneration for debt collection services supplied to the credit provider. There is a clear causal link between the prescribed amounts recovered from the debtor and the debt collection services supplied to the credit provider.

Having regard to the NCA and the DCA, the prescribed amounts recovered from the debtor form part of the collection costs of the credit provider. Prescribed amounts allowed by the credit provider to be retained by the debt collector, is regarded as payment made by the credit provider to the debt collector in respect of fees or remuneration for debt collection services. Consequently, the prescribed amounts that are retained by the debtor collector are in respect of debt collection services provided by the debt collector to the credit provider and VAT should therefore be levied under section 7(1)(*a*).

4.1.2 Recovery of debt collection costs by the credit provider

The recovery of debt collection costs by the credit provider (which costs are collected by the debt collector on behalf of the credit provider) does not constitute payment for anything done or to be done (that is, the supply of services) *by the credit provider to, or on behalf of, the defaulting debtor*. These costs are incurred in the course of collecting debt that is already due to the credit provider as opposed to the credit provider making a separate supply for a consideration to another person. The recovery of the costs concerned can therefore not be regarded as consideration received by the credit provider for any supply that it makes to the defaulting debtor.

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[5] Note that the DCA does not state whether the prescribed amounts are inclusive or exclusive of VAT. Since the prescribed amounts are expenses or fees that are legislated as opposed to prices advertised by a vendor, it is regarded as being exclusive of VAT.

The recovery of debt collection costs of the credit provider from the debtor is made possible by the terms of the credit agreement between the parties where it provides that in the event of default, the debtor is held liable for these costs.

Accordingly, no output tax should be levied or accounted for on the recovery of debt collection costs by the credit provider, on the basis that such recovery does not constitute consideration for any supply made by the credit provider.

4.2 Input tax

Generally, the VAT charged by a vendor to another vendor on any goods or services acquired for taxable purposes will qualify as input tax in the hands of the recipient. Furthermore, input tax may only be deducted to the extent that the goods or services are acquired in the course or furtherance of conducting an enterprise. No VAT can be deducted as input tax on expenses incurred wholly for making exempt supplies or other non-taxable purposes.

4.2.1 Debt collection costs incurred by the credit provider

Outsourced debt collection

In the case of outsourced debt collection, the debt collection services are acquired by the credit provider to collect the debt. The debt arises from the provision of credit by the credit provider that is either a financier or a supplier that funds the supply of goods and services. In the latter case, the provision of funding is a separate and distinct activity to the original supply of goods or services.

In both cases, however, the debt amount consists of the outstanding capital, interest and fees. Since the debt collection services relate in its entirety to the collection of the debt, it is regarded as not being acquired for purposes of consumption, use or supply in the course of making taxable supplies. As such, the credit providers cannot deduct the VAT on debt collection services as input tax.

In-house debt collection

The debt collection that is undertaken in-house by the credit provider to collect the debt (being the outstanding capital, interest and fees), also relates in its entirety to the collection of the debt that is not for purposes of consumption, use or supply in the course of making taxable supplies. Hence, the credit providers likewise cannot deduct the VAT on in-house debt collection costs as input tax.

4.2.2 Expenses relating to debt collection services supplied by the debt collector

The supply of debt collection services by the debt collector to the credit provider is a taxable supply. As such, any VAT incurred on goods or services acquired for the purposes of supplying debt collection services will qualify as input tax. The debt collector is therefore entitled to deduct VAT incurred on expenses in respect of the debt collection service as input tax.

4.2.3 Prescribed amounts and other debt collection costs paid by the debtor

Based on **4.1.1**, the prescribed amounts and other debt collection costs are in respect of debt collection services provided by the debt collector to the credit provider. Furthermore, having regard to **4.1.2**, the debtor is merely held liable for these costs by virtue of default. Hence, the debtor does not acquire the debt collection services and as such is not entitled to deduct any VAT relating to the prescribed amounts or any other debt collection costs paid over to the debt collector.

5. Conclusion

This Note provides clarity on the VAT consequences of debt collection services for various parties involved, namely, the debt collector, the credit provider and the debtor. In particular, it deals with the effect for the various parties regarding the recovery of certain costs and expenses as provided for in the NCA and DCA. (See comprehensive example in **Annexure C**.)

The conclusions may be summarised as follows:

- The supply of debt collection services by the debt collector to the credit provider is taxable at the standard rate, therefore, the commission paid for such services is subject to VAT at 15%.

- In the event that the agreed remuneration for debt collection services includes the recovery of the prescribed amounts under the DCA, such amounts retained by the debt collector are regarded as also being for the taxable supply of debt collection services. Accordingly, the prescribed amounts received for these services is also subject to VAT at 15%.

- Debt collection costs incurred by the creditor and recovered by the debt collector on behalf of the credit provider is not regarded as consideration received by the credit provider for any supply that it makes to the defaulting debtor. Since the recovery of such costs by the credit provider is not for any supply made, VAT is not required to be levied by the credit provider.

- The costs of outsourced debt collection services (that is, the commission paid by the credit provider and the prescribed amounts under the DCA retained by the debt collector) relate in its entirety to the collection of the debt that is not for purposes of consumption, use or supply in the course of making taxable supplies. Therefore, the credit provider is not entitled to deduct the VAT on the outsourced debt collection service as input tax.

- The costs of in-house debt collection also relate in its entirety to the collection of the debt that is not acquired for purposes of consumption, use or supply in the course of making taxable supplies. Thus, no input tax may be deducted by the credit provider in respect of acquisitions relating to such costs.

- The debt collector on the other hand is entitled to deduct the VAT incurred on their own goods or services acquired as input tax, to the extent that they relate to the taxable supply of debt collection services.

- The debtor does not acquire debt collection services and as such is not entitled to deduct any VAT relating to the prescribed amounts or any other debt collection costs paid.

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Annexure A – The law

Section 1(1) – Definitions

"consideration", in relation to the supply of goods or services to any person, includes any payment made or to be made (including any deposit on any returnable container and tax), whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person, but does not include any payment made by any person as a donation to any association not for gain: Provided that a deposit (other than a deposit on a returnable container), whether refundable or not, given in respect of a supply of goods or services shall not be considered as payment made for the supply unless and until the supplier applies the deposit as consideration for the supply or such deposit is forfeited;

"input tax", in relation to a vendor, means—

(*a*) tax charged under section 7 and payable in terms of that section by—

(i) a supplier on the supply of goods or services made by that supplier to the vendor; or

(ii) the vendor on the importation of goods by him; or

(iii) the vendor under the provisions of section 7(3);

(*b*) an amount equal to the tax fraction (being the tax fraction applicable at the time the supply is deemed to have taken place) of the lesser of any consideration in money given by the vendor for or the open market value of the supply (not being a taxable supply) to him by way of a sale on or after the commencement date by a resident of the Republic (other than a person or diplomatic or consular mission of a foreign country established in the Republic that was granted relief, by way of a refund of tax as contemplated in section 68) of any second-hand goods situated in the Republic; and

(*c*) an amount equal to the tax fraction of the consideration in money deemed by section 10(16) to be for the supply (not being a taxable supply) by a debtor to the vendor of goods repossessed under an instalment credit agreement or a surrender of goods: Provided that the tax fraction applicable under this paragraph shall be the tax fraction applicable at the time of supply of the goods to the debtor under such agreement as contemplated in section 9(3)(c),

where the goods or services concerned are acquired by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies or, where the goods or services are acquired by the vendor partly for such purpose, to the extent (as determined in accordance with the provisions of section 17) that the goods or services concerned are acquired by the vendor for such purpose;

Section 2 – Financial services

(1) For purposes of this Act, the following activities shall be deemed to be financial services:

(*a*) …

. . . . . .

(*f*) the provision by any person of credit under an agreement by which money or money's worth is provided by that person to another person who agrees to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money's worth;

. . . . . .

Section 7 – Imposition of value-added tax

(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax—

(*a*) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him;

. . . . . .

calculated at the rate of 15 per cent on the value of the supply concerned or the importation, as the case may be.

Section 12 – Exempt supplies

The supply of any of the following goods or services shall be exempt from the tax imposed under section 7(1)(*a*):

(*a*) The supply of any financial services, but excluding the supply of financial services which, but for this paragraph, would be charged with tax at the rate of zero per cent under section 11;

. . . . . .

Section 16 – Calculation of tax payable

(1) . . . . . .

(2) . . . . . .

(3) Subject to the provisions of subsection (2) of this section and the provisions of sections 15 and 17, the amount of tax payable in respect of a tax period shall be calculated by deducting from the sum of the amounts of output tax of the vendor which are attributable to that period, as determined under subsection (4), and the amounts (if any) received by the vendor during that period by way of refunds of tax charged under section 7(1)(*b*) and (*c*) and 7(3)(*a*), the following amounts, namely—

(*a*) in the case of a vendor who is in terms of section required to account for tax payable on an invoice basis, the amount of input tax—

. . . . . .

Section 17 – Permissible deductions in respect of input tax

(1) Where goods or services are acquired or imported by a vendor partly for consumption, use or supply (hereinafter referred to as the intended use) in the course of making taxable supplies and partly for another intended use, the extent to which any tax which has become payable in respect of the supply to the vendor or the importation by the vendor, as the case may be, of such goods or services or in respect of such goods under section 7(3) or any amount determined in accordance with paragraph (*b*) or (*c*) of the definition of "input tax" in section 1, is input tax, shall be an amount which bears to the full amount of such tax or amount, as the case may be, the same ratio (as determined by the Commissioner in accordance with a ruling as contemplated in Chapter 7 of the Tax Administration Act or section 41B) as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services: Provided that—

. . . . . .

(i) where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95 per cent of the total intended use of such goods or services, the goods or services concerned may for the purposes of this Act be regarded as having been acquired wholly for the purpose of making taxable supplies;

(ii) where goods or services are deemed by section 9(3)(*b*) to be successively supplied, the extent to which the tax relating to any payment referred to in that section is input tax may be estimated where the calculation cannot be made accurately until the completion of the supply of the goods or services, and in such case such estimate shall be adjusted on completion of the supply, any amount of input tax which has been overestimated being accounted for as output tax in the tax period during which the completion occurs and any amount of input tax which has been underestimated being accounted for as input tax in that period; and

(iii) where a method for determining the ratio referred to in this subsection has been approved by the Commissioner, that method may only be changed with effect from a future tax period, or from such other date as the Commissioner may consider equitable and such other date must fall—

(*aa*) in the case of a vendor who is a taxpayer as defined in section 1 of the Income Tax Act, within the year of assessment as defined in that Act, or

(*bb*) in the case of a vendor who is not a taxpayer as defined in section 1 of the Income Tax Act, within the period of twelve months ending on the last day of February, or if such vendor draws up annual financial statements in respect of a year ending other than on the last day of February, within that year,

during which the application for the aforementioned method was made by the vendor.

Annexure B – The prescribed amounts in regulation 11 of the Debt Collectors Act

"ANNEXURE B
Expenses and fees
[Regulation 11]

Note: The total amount to be recovered from the debtor in respect of items 1 to 7 of the Annexure shall not exceed the capital amount of the debt or R1023, 00, whichever is the lesser.

Item	Description	Amount
1.(a)	Necessary ordinary letter, registered letter, facsimile or e-mail:	R21,00 (and in the case of a registered letter, the costs of the registration fee to be added).
1.(b)	Registered letter (section 57 of the Magistrates' Courts Act, 1944 (Act No. 32 of 1944)):	The amount as prescribed from time to time in item 8 of Annexure 2, Table A, Part II of the Rules Regulating the Conduct of the Proceedings of the Magistrates' Courts of South Africa.
1.(c)	Necessary electronic communication, other than facsimile or e-mail, (per electronic communication):	R3,00 (maximum of ten electronic communications per month).
2.	Necessary phone call, which is not a consultation (per call):	R21,00.
3.	Other necessary expenses not specifically provided for, a total amount of:	R21,00.
4.(a)	Acknowledgement of debt and undertaking to pay debt in terms of section 57 or section 58 of the Magistrates' Courts Act, 1944 (Act No. 32 of 1944) (including the necessary consultation with debtor):	The amount as prescribed from time to time in items 9 and 10 of Annexure 2, Table A, Part II of the Rules Regulating the Conduct of the Proceedings of the Magistrates' Courts of South Africa.
4.(b)	Original documents signed by the debtor under item 4(a) at the debtor's residence or place of work:	R210,00.
4.(c)	Necessary registered credit bureau search:	R14,00 (maximum of four searches per month).
5.	At the request of the debtor, the drawing up and furnishing of a settlement account, other than the six monthly settlement account:	R41,00.
6.	Correspondence received and attended to:	R11,00.
7.	Necessary consultation with debtor:	R52,00.
8.	Attending taxation:	R82,00.
9.	On receipt of an instalment (one or more) in redemption of the debt inclusive of instalments made directly to the client:	A fee of 10% of the instalment received, subject to a maximum amount of R509,00. No additional fee shall be charged for any attendance in connection with the receipt or payment of any instalment.".

Annexure C – Comprehensive example: VAT consequences of debt collection services for the debt collector, the credit provider and the debtor

Facts:

ABC Bank provides a loan of R 10 000 to D. In the event that D defaults on payment, D would be held liable under the credit agreement for the bank's debt collection costs. A few months after taking out the loan D defaults on payment. ABC Bank engages XYZ Debt Collection Services to collect the outstanding debt of R 7 000 on its behalf. Under the service level agreement, the remuneration agreed to includes a commission (calculated as 20% of the amount collected, exclusive of VAT) and the recovery of the prescribed amounts under the DCA.

XYZ Debt Collection Services was able to successfully collect the outstanding debt of R7 000. In addition, it was able to also recover the prescribed amounts under the DCA from D, totalling R700. ABC Bank pays XYZ Debt Collection Services a commission of R1 400 (20% of R7 000) for the debt collection services. XYZ Debt Collection also retains R700 of the amount collected being the prescribed amounts recovered from Mr D and the balance collected is paid over to ABC Bank.

Result:

XYZ Debt Collection Services

Output tax

The supply of debt collection services by XYZ Debt Collection Services to ABC Bank is a taxable supply at the standard rate. Therefore, the commission paid for such services is subject to VAT at 15%. Similarly, the prescribed amounts recovered from D are also for the taxable supply of debt collection services and are likewise subject to VAT at 15%.

XYZ Debt Collection Services must therefore declare output tax on the debt collection services as follows:

- R1 400 (commission paid by ABC Bank) × 15% = R210
- R700 (prescribed amounts recovered from Mr D) × 15% = R105

The total output tax that must be declared by XYZ Debt Collection Services on the debt collection services is R315.

Input tax

VAT incurred on goods or services acquired by XYZ Debt Collection Services for the purpose of making a taxable supply of debt collection services will qualify as input tax. XYZ Debt Collection Services can therefore deduct any VAT incurred on expenses in respect of the debt collection service as input tax.

ABC Bank

Output tax

The recovery of the debt collection costs by ABC Bank (which costs are collected by the XYZ Debt Collection on behalf of ABC Bank) is not received for any supply that it makes to D (the defaulting debtor). Since the recovery of such costs by ABC Bank is not for any supply made, VAT is not required to be levied by ABC Bank.

Input tax

The debt collection services relate in its entirety to the collection of the debt, and is regarded as not being acquired for purposes of consumption, use or supply in the course of making taxable supplies. As such, ABC Bank cannot deduct the VAT on the debt collection services as input tax.

D

Would D be entitled to deduct any VAT relating to the prescribed amounts paid, if registered for VAT?

D does not acquire debt collection services, and is accordingly not entitled to deduct any VAT relating to the prescribed amounts paid as input tax.