Memorandum

VAT rate change: Practical implications and proposed treatment

To: Affected departments/faculties and staff within Stellenbosch University

3 March 2018

Background

During the Budget Speech delivered on 22 February 2018, the Minister of Finance announced that the VAT rate will increase by 1% to 15% with effect from 1 April 2018.

The following meetings/discussion took place to date:

- 1 March 2018: A preliminary meeting between representatives of Finance and PwC as our tax consultants to discuss the impact and proposed treatment of the announcement.
- 2 March 2018: High level overview of the possible preliminary financial impact on SU tabled at the Finance Committee.
- 6 March 2018: High level overview of the possible preliminary financial impact on SU tabled at the Rectorate meeting.
- 8 March 2018: Workshop between relevant stakeholders (representatives from Finance as well as IT) to unpack the implications across the University as well as consider the changes required to the financial system to cater for the announcement.
- 11 March 2018: A follow-up meeting between representatives of Finance and PwC to discuss SU's proposed treatment, including system changes, of the announcement.
- 13 – 29 March: IT develops the proposed changes to the financial system, Finance users testing the proposed changes in the test environment, divisional meetings within various Finance divisions (Debtors, Creditors, Financial Services) to unpack the practical implications as well as systems changes and how queries will be dealt with.

The impact of the VAT rate change was also registered as a financial risk on the risk register.

The system changes will affect the following structures within the financial system:

- US/UB/HK/SR: SU VAT registration (4920118959)
- ED/UP/UI: Inactive structures, no impact
- ST (Stias): Separate entity, using SU financial system, but with separate VAT registration
- ET (STB Trust): VAT exemption, no impact
- UK (MGD, Aids Action and STB Work Centre): MGD is registered for VAT, but in process of deregistering.

- UG (SUSPI and Innovus): Separate VAT registrations for the 2 entities using the SU financial system.
- WAT: Separate entity, using SU financial system, but with separate VAT registration

Certain external financial systems which integrates with SU's financial system will also have to be updated, incl. POS system at the Maties Shops, Gym card system being used at SUSPI, Elixer (medical packaged) being used at CHS, system for administering motor vehicle loans used by Transport Services etc.

The financial system will be changed (on 1 April 2018) that the default VAT rate is 15% (as opposed to the 14%). Situations where the 15% default rate can be overridden as part of the transition arrangements, will be explained below under the applicable sections.

Overview of the financial impact on SU

Output VAT

The University pays over output VAT (100%) on income received for goods and services rendered. As from 1 April 2018 our "price" for delivering those goods and services will increase with 1% as we will now charge our clients VAT of 15%.

Impact on various income categories

Subsidy and Student fees
No output VAT is paid on subsidy and student fees (1^{st} & 2^{nd} stream income), thus no impact on the treatment of those funding streams. The risk has been flagged that universities cannot claim any input VAT on activities relating to delivery of the academic offering (i.e. costs funded from the 1^{st} two income streams). The costs for delivering these activities will thus increase, but the income from subsidy and student fees will not necessary increase to compensate for these costs.

Bursary income
Bursaries paid into SU accounts to administer and pay out to students, is exempt from VAT and thus not affected by the announcement. No output VAT is paid over to SARS, so the funding received will still be utilised fully towards students.

Income received for the attendance of a short courses and conferences
This category of income is exempt from VAT as it relates to the academic offering and will not be affected. It must again be noted that the expenses relating to the delivery of these activities will increase, and that the price of the courses/conferences should be considered in the light of these increases.

Membership fees
Certain membership fees which are directly related to the academic offering, is exempt from VAT and thus not impacted by the announcement.
All membership fees for other activities are normally charged at the beginning of the year when student sign up for the club/society. All funds charged and received up to 31 March 2018 should

be deposited into the various cost centres to attract output VAT at 14%. Any income received into the cost centre subsequent to the effective date (1 April 2018) will attract 15% VAT.

Other income, i.e. rental, sale of goods

Rental income is linked to a rental agreement, and all rent charged from April, will be subject to the 15%. The rental agreements does not have to change, since contracts will have been negotiated at a VAT exclusive rate. A communique can be send to clients to inform them of the rate change.

Income from all sales transactions conducted after 1 April 2018 will be subject to 15% VAT.

Most customers will be in VAT neutral position, since they will be able to claim the full 15% as VAT input. Signage will have to be placed in relevant areas, i.e. Maties Shop indicating the price changes due to the VAT increase.

Research income

Imported goods and services (including income received from overseas for research projects) are zero rated, and will not be affected.

Research income is linked to the agreement with the funder, and from 1 April 2018 it will be subject to the 15%, i.e. if we issue an invoice for services rendered post 1 April, 15% VAT will be applied on the invoice. Provision has been made for instances where services was rendered prior to 1 April, but the invoice only raised thereafter. Refer to section below.

The agreements does not have to change, since contracts will have been negotiated at a VAT exclusive rate. A communique can be send to clients to inform them of the rate change.

If contracts where however concluded and signed at a VAT inclusive price, the project will have to absorb the increase, since we need to pay over 15% output VAT.

Most clients (corporate clients registered for VAT) will be in a VAT neutral position however, since they will be able to claim back the 15% VAT (as they currently do). Possible affected clients are entities not registered for VAT, or other universities also subject to the VAT Class Ruling (VCR). We will charge 15% on goods and services delivered after 1 April 2018, as we need to pay 15% output VAT.

It should be noted that the cost of delivering the research will increase, as we can in most cases only claim back 50% of the input VAT. This should be considered when negotiating any new contracts.

Practical treatment and system changes

Invoices

All invoices generated from 1 April 2018, will be subject to 15% VAT.

The system has been adjusted to invoice for services rendered prior to 1 April 2018. This entails that Finance cannot manage this transition internally as we have a decentralised system and invoices are generated by various departments.

For such instances, the departments need to forward a request to the Debtors division. This request will require sufficient paper trail for audit purposes and should include a copy of the contract as well as a written confirmation from the cost centre owner that the services were rendered prior to 1 April 2018. If all documentation provided are found to be in order, the Debtors division will then override the VAT percentage to 14% (using FDB151P).

All invoices for the delivery of goods relating to a transaction prior to 1 April, must be invoiced by 21 April 2018 (delivery can occur thereafter).

Credit notes and bad debt

Our system was adjusted that when a credit note/write-off of bad debt is requested, that this will automatically be done at the VAT rate of the original transaction.

Unallocated payments received on bank statements

All unallocated payments received until 31 March 2018, i.e. where invoices were not generated as yet, will be evaluated and treated according to the applicable VAT rate of 14% at time of delivery of the goods and/or services.

Input VAT

Universities are subject to the VAT Class Ruling (VCR) for claiming input VAT. Under the VCR there are various categories determining how much VAT can be claimed back from SARS. The nature of the underlying activities determines the VAT treatment, and are summarised as follows:

0% (i.e. no VAT can be claimed back):

- Academic activities: All activities relating to the delivery of the academic project is classified at 0%. Thus no VAT inputs can be claimed on any expenses incurred in this category. In SU's case, that is basically all cost centres funded with income from the 1st & 2nd income streams (i.e. main budget cost centres).

- Capital costs: No VAT is claimed back on any capital costs (including building costs).

- Basic research: No VAT can be claimed back on the costs of goods and services required to deliver basic research. In the SU context, this has largely been classified as NRF funded research projects.

12.5% (i.e. 12.5% of the 15% can be claimed back):

Certain overhead cost centres (institutional costs within the main budget) has been classified in this category (list determined and signed-off by PwC when VCR came into effect).

50% (i.e. 50% of the 15% can be claimed back):

This category relates to applied research with student involvement. For practical purposes, most cost centres managing research funding (other than NRF funding) has been classified within this category.

100% (all the VAT charged can be claimed back):

This category relates to applied research no student involvement and consultation contracts. All commercial contracts also falls into this category.

Impact on various expense categories

Salary and bursary expenses are exempt from VAT, so this only impacts the costs of other goods and services acquired. The cost of other goods and services purchased will increase with 1% from 1 April 2018, as our suppliers will now charge 15% VAT, and we will, in most cases, only be able to claim back a portion (if any) of the VAT. This creates a major problem in the short term regarding the contracts which has already been signed, since we will have to absorb the additional costs from own funding. The same applies for main budget allocations which have been determined prior to the announcement, and additional costs in the rendering of the academic offering will have to be absorb from own funding.

Practical treatment and system changes

The default point of departure will be that we will rely on invoice received from supplier. We will however scrutinize the descriptions on the invoice to ensure that VAT is treated correctly at 14%/15%. It could in some cases mean that we will have to request an updated invoice from suppliers. Departments will need to assist Finance to identify such invoices.

Orders placed prior to 1 April 2018, and goods invoiced and delivered by 21 April 2018, will still be treated at 14%. Commitments on the system would have been created at 14%, so departments should note that orders raised for goods/services only to be delivered after 21 April, will differ from the final invoice, which will be at 15%. This will be treated as normal orders outside the parameters, but it should be considered taking into account the available funds on a cost centre.

In cases where a supplier invoice SU for services rendered over a longer period spanning across the effective date, the suppliers should be requested to issue separate invoices for the period prior and post 1 April 2018.

- <u>Creditor payments:</u>
  The creditor clerks (Finance) loads the invoices incl. VAT. The system will automatically deduct VAT at 15% as of 1 April. The clerks will review the invoices to possibly identify invoices which should still be treated at 14%, but due to the large volumes processed daily, this cannot be viewed as the only control, and we will rely on departments to flag invoices which needs to be changed by suppliers, or should still be treated at 14%.

  A report will be drawn to identify all invoices loaded where the goods receipt was done prior to 1 April 2018, and those will be manually corrected to reflect 14% VAT (we are investigating an option to do an electronic upload of the correction to minimise risk of capturing errors).

- Sundry payments:
  The faculty accountants (Finance) loads the VAT amount on the system when the invoice is reviewed for payment. They will select an option of 14% VAT if the invoice relates to goods/services rendered prior to 1 April 2018. The system was changed to load an additional indicator if 14% is applied.

  The accountants will review the invoices to possibly identify invoices which should still be treated at 14%, but due to the large volumes processed daily, this cannot be viewed as the only control, and we will rely on departments to flag invoices which needs to be changed by suppliers, or should still be treated at 14%.

Deposits and final payments will be treated depending on the time of supply, i.e. it might be that a deposit was due before 1 April, then that payment will be treated at 14%, and the final payment (payable after 1 April) will be at 15%.

Monthly payments for services rendered in terms of a contract (i.e. rental) will increase to 15% from 1 April 2018, and contracts does not have to be amended. The same will apply for goods/services being acquired under a tender, since prices are normally negotiated excluding VAT.

Other implications

- The replacement values of assets needs to be updated on the EBR system. That will be done programmatically by the Funds and Asset Management division.

- All costs which are recovered and allocated through journals (i.e. telephone costs), should make provision for the new VAT rate to ensure the allocations are processed correctly.

VAT Returns

We are still not certain what the requirements for the VAT returns will be and what additional information needs to be provided. All the system changes explained above, have been done to allow us to draw reports splitting the 14% and 15% transactions. The reports are being finalised, but the data are captured in the system as of 1 April 2018, so extracting reports should be possible.

Enquiries

Queries relating to invoicing for income (debtors) and credit notes: Kindly contact the Debtors division (deb@sun.ac.za).

Queries relating to invoices for payments (sundry payments and creditor payments): Kindly contact your faculty accountant at Financial Services.

All other VAT related queries can be directed to Reinet Uys (reinet@sun.ac.za) as the accountant responsible for VAT.