

TAX IMPLICATIONS WHEN BUYING A VEHICLE

BY

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In 1992, the Danish Department of Agriculture did a study amongst Danish farmers to determine how they approach the decision to buy a new tractor. With regards to the specific time within the financial year when tractors are bought, it was found that most purchases were made during the last month of the tax year. The months during which the tractors were most often used did not play any part. In the South African context it would mean, in other words, that there would be many purchases in February when the tax year ends, while few purchases will take place in October/November when tractors are most often used. The same assumption can probably be made around vehicles, and for this reason the farmer should always be aware of the tax implications around the buying of a bakkie.

There are tax implications with the purchase and sale of a vehicle. In many cases, a farmer exchanges a used vehicle when he or she buys a new bakkie. Consequently, he or she will be subject to more than one tax form both on the purchasing and sales side.

PURCHASING

Because the presumption is that farmers use their bakkies in the operational process, the Receiver allows them to make certain deductions for tax purposes. The most important point of departure is that in the first instance the farmer must really farm. Secondly, only vehicles used in the farming operation will qualify for these deductions. Private vehicles do not qualify, and there is a further special arrangement about double-cab bakkies.

VAT

Should the farmer use his or her bakkie for farming purposes, he or she can claim the VAT back, provided he or she is registered for VAT purposes. It is then claimed back as a capital input. Double-cab bakkies qualify as passenger vehicles, and the VAT on them can thus not be claimed back. The new “King Cab” or “Club Cab” bakkies currently available from Ford and Colt do not qualify as passenger vehicles, so VAT can currently be claimed back on these vehicles. It’s an open question how long the Receiver will endure this novelty before he decides not to allow the VAT to be claimed back on these vehicles.

Wear and tear

A vehicle becomes worn out over a few years while it is used in the production process. So this reduction in value can be deducted from a farmer’s taxable income at a certain rate over the vehicle’s lifetime. In the case of vehicles such as bakkies and motorbikes, there is a variable rate of application, namely 50% of the net purchase price (so VAT is excluded) in the first year, 30% in the second year and 20% in the third year. In this way the vehicle’s entire purchase price can be deducted as an expense from the farming

operation's taxable income over a period of three years, despite the fact that the economic lifetime of the vehicle may be 10 years. Thus an accelerated writing-off takes place for tax purposes, and this holds an advantage during the purchase transaction.

Financing

If a vehicle is bought by hire purchase or other financing scheme, the farmer can deduct the annual interest accrued from his or her taxable income. This is only valid for the interest portion and not for the capital portion. The capital is in effect deducted as part of the wear and tear. The interest can be deducted annually until the outstanding amount has been settled, so there's no correspondence with the three-year wear-and-tear period. Should the financing agreement stretch over five years, the interest portion can thus be deducted from taxable income for each of the five years.

The danger for the farmer lies especially in the fact that he or she only enjoys the tax deduction on the capital portion for the first three years, while the premiums during the years thereafter are to be settled from after-taxed income. So it is wise to keep the repayment term of a purchased vehicle as close as possible to the tax-deduction term.

Lease

In the case of lease, the vehicle does effectively not belong to the farmer, but he or she rents it. In practice, the farmer might feel as if it's still his or her vehicle, but the tax implications do differ. The Receiver regards the lease's premium as a tax-deduction for both VAT and income tax. The VAT cannot be deducted from the total purchase price. Every premium's VAT is deducted separately. The same applies to income tax in that only the payments that have been made (without VAT) may be claimed as a tax deduction.

SALES

The purchase of a new vehicle holds a definite tax benefit for the farmer. Unfortunately the process is reversed when the farmer sells a vehicle, either privately or by exchanging it for a new bakkie.

VAT

The collection of VAT on a sales transaction depends on the seller's position. If the seller is VAT registered, he or she has to levy taxes on the sold or exchanged bakkie regardless of whether the buyer is VAT registered. There is quite some confusion about this matter amongst farmers, but the fact remains that the Receiver will demand VAT from the seller, regardless of whether he or she made the buyer pay VAT. The only exception is if the farmer is not VAT registered, but then he or she would not in the first place have been able to reclaim VAT at the time of buying the vehicle.

Recuperation of wear and tear

The Receiver allows wear and tear as deduction because it is assumed that the vehicle is worn down in the production process. If the vehicle is sold at a higher value than the permitted wear and tear, the wear and tear must be recovered because the tempo against which the wear and tear was permitted was too high. This is only valid for the recuperation of wear and tear. Should the vehicle be sold for more than its initial value, the surplus is a capital gain, and it is not approached as recuperation of wear and tear.

During the year the vehicle is sold, the wear and tear is again treated as a taxable income. When the farmer exchanges his or her old bakkie for a new one, the negative effect of the recuperation will be cancelled out by the 50% deduction of the new vehicle.

Capital-gains tax

Capital-gains tax became effective on 1 October 2001. When a vehicle is sold for more than its purchase price, a capital gain is created. In terms of natural persons, 25% of this profit must be added to the farmer's taxable income, while it's 50% in the case of legal persons (CCs, companies or trusts). An annual deduction of R10 000 is applicable on capital-gains tax.

If the asset is sold for less than its initial purchase price, a capital gain can be amassed that can later be deducted from a future capital gain.

IN CLOSING

The purchase of a vehicle purely for tax purposes is not recommended. Vehicle purchases should take place following a well thought-through replacement decision, regardless of the farmer's taxable position at that specific point in time. The 50% initial wear-and-tear deduction is usually very attractive when the farmer experiences a tax problem during February. The financing implications, recuperation of wear and tear and the impact on capital gains should have a farmer thinking twice before he or she makes a shortsighted purchase decision on the grounds of the tax deduction.

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