

GUIDELINES FOR THE APPLICATION OF STANDARD ALTERNATIVE METHOD OF APPORTIONING INPUT TAX

1.0 Introduction

These guidelines have been developed by the Domestic Taxes Department with the aim of facilitating best management in the administration of Standard Alternative Method (SAM) of Apportioning input tax for VAT purposes.

2.0 Objectives of the guidelines

- a) To provide for a uniform and consistent application of the provisions of the VAT Act and the VAT regulations on input tax apportionment.
- b) To guide staff of Domestic taxes on the correct procedural requirements to be followed in handling SAM applications.

3.0 Scope of the guidelines/Legislative basis

These guidelines have been developed for internal use and are based on the provisions of Section 28 of the VAT Act and paragraph 15 of the VAT Regulations, 1996 which provide that where a taxpayer is disadvantaged by the normal method of apportionment of input tax, the Commissioner General can approve an alternative method referred to as the Standard Alternative Method (SAM).

4.0 Definition of Input tax

Input tax means tax (VAT) paid or payable by a taxable person on local purchases made from registered persons and on imports of goods made by the taxable person in the course of a business activity. In order for VAT on purchases to qualify as input tax for VAT purposes, the following conditions must apply;

- Purchases must be wholly or partly for use in the course of making taxable supplies,
- VAT must have been charged at the standard rate.
- The person claiming must have a proper tax invoice or import documents.

A deduction of input tax can only be made once in a tax period/calendar month to the extent that the purchase/supply will be or was utilized for taxable supplies.

A person who makes only taxable supplies/sales (standard & zero rated) is entitled to deduct all the input tax incurred for the purposes of making those supplies. A person who makes only exempt supplies is **not** entitled to any such deduction.

However a person who makes both taxable and exempt supplies is not entitled to the full input tax credit for that period and therefore has to apportion the input tax in respect of both taxable and exempt supplies.

4.1 How does apportionment arise?

Apportionment arises when a taxable person is not entitled to deduct the full amount of VAT on his or her purchases/inputs.

When a taxable person deals in both taxable and exempt supplies such that some purchases made in a period are partly for making taxable supplies and partly for making exempt supplies, only that part of input tax that can be attributed to taxable supplies will be credited.

The process of attributing input tax to taxable and exempt supplies is referred to as apportionment. The result of apportionment must be a fair and reasonable input tax credit to the taxable person.

The VAT law provides for two methods of input tax apportionment;

- i. The Normal method of apportionment and
- ii. The Standard Alternative Method.

4.2 The Normal Method of apportioning Input tax

The normal method of apportioning input tax provides that where the taxable person is dealing in both taxable and exempt supplies, all the input tax (other than the disallowable input tax) is apportioned. For each tax period, the value of taxable sales (VAT exclusive) is expressed as a percentage of the total supplies (including exempt supplies). This percentage is then applied to total input tax and the result is the claimable input tax for the tax period.

Illustration

Company X which deals only in sugar and beans made the following transactions in the month of June 2006. Assume these were the only purchases for this company in the period.

Purchases

Item	Nature of supply	Value in '000	VAT in '000
Sugar	Standard	100,000	18,000
Rent	Standard	2,000	360
Beans	Exempt	400,000	Nil
Electricity	Standard	100	18
Security	Standard	1,000	180
Insurance	Exempt	1,000	Nil
TOTAL			(A) 18,558

Sales

Item	Nature of supply	Value in '000	VAT in '000
Sugar	Standard rated	(B) 150,000	27,000
Beans	Exempt	500,000	Nil
Total		(C) 650,000	27,000

Apportionment formula is **A x B/C** where,

A= total amount of input tax in the tax period

B=total value of taxable supplies (sales) for the tax period without VAT

C= total value of all supplies (excluding VAT) made during the tax period including exempt supplies.

From the above therefore,

$$\mathbf{A \times B/C} = 18,558 \times 150,000 / 650,000 = 4,283$$

Using the above figures, tax payable for the month of June 2006 would be
output tax less allowable input tax(27,000 less 4,283)=22,717

4.3 The Standard Alternative Method

For a taxable person to qualify to use the Standard Alternative Method of apportioning input tax, the following conditions must apply;

- Taxable person must be dealing in taxable and exempt supplies.
- Taxable person must apply to the Commissioner General.
- Taxpayer must obtain written approval of the CG.

4.4 How does Standard Alternative Method work?

Under this method a taxable person can,

- (i) claim all the VAT that relates to the standard rated/zero rated supplies
- (ii) claim none of the VAT that relates to exempt supplies to the extent that this is attributable to exempt supplies,
- (iii) apportion the VAT that cannot be directly attributable to both taxable and exempt supplies

This method requires that **three** separate purchase records are kept as follows;

1. A record of purchases of taxable goods and services specifically related to taxable supplies.(All input tax here is creditable)
2. A record of purchases of taxable goods and services directly related to exempt supplies. Here the taxpayer is not entitled to any input tax credit.
3. A record for purchases of taxable goods and services where the purchases cannot be related to either taxable or exempt sales. E.g. overheads and general business expenses. (Credit for input tax is apportioned using the ordinary method).

Illustration

Company X which deals only in sugar and beans made the following transactions in a tax period. Assume these were the only purchases for this company in the period.

Purchases

Item	Nature of supply	Value in '000	VAT in '000
Sugar	Taxable	100,000	(V) 18,000
Rent	Taxable	2,000	(A) 360
Beans	Exempt	400,000	(X) Nil
Electricity	Taxable	100	(A) 18
Security	Taxable	1,000	(A) 180
Insurance	Exempt	1,000	(X) Nil
TOTAL			18,558

Sales

Item	Nature of supply	Value	VAT
Sugar	Taxable	(B) 150,000	27,000
Beans	Exempt	500,000	Nil
Total		(C)650,000	27,000

4.5 Determination of creditable input tax using SAM

Step 1: Identify input tax that is directly attributable to taxable sales e.g VAT on sugar. The full VAT here is allowable.

Step 2: Identify input tax in respect of exempt supplies. No claim is allowed for this. E.g. VAT paid on gunny bags for packing beans, VAT on security services to a store of beans only.

Step 3: Identify input tax that cannot be directly attributed to either taxable or exempt supplies e.g. VAT on rent, electricity, telephone services, water, audit fees and security(generally overheads). Here the person must deduct a proportion of input tax which correctly reflects the extent to which the dual-use purchase is used for the purpose of that person's taxable supplies.

From the table above, the following can be derived for purposes of computing creditable input tax;

VAT directly attributable to taxable supplies=V

VAT in respect of exempt supplies= X

VAT not directly attributable to taxable or exempt supplies=A

Computing creditable input tax using SAM;

V + (Ax B/C) where'

V= 18,000

A= 360+18+180= 558

B= 150

C= 650

$18,000 + (558 * \frac{150}{650}) = 18,000 + 129 = 18,129$

Therefore Company X's input tax allowable for the period is 18,129

Output tax payable for period =27,000(see table above)

VAT payable/refundable for period =Output tax less Allowable Input tax (27,000-18,129) =8,871

From the above illustration, the ordinary method of apportionment will be disadvantageous to the taxpayer while the SAM provides a fair and reasonable amount of input tax for the tax period.

Please note that where the ratio B/C is less than 5%, the taxpayer shall not claim any input tax for the period and if B/C is greater than 95% the taxpayer may claim all the input tax. These ratios are applicable under the normal and standard alternative methods of apportioning input tax.

5.0 End of Year Adjustments

A taxpayer who has apportioned input tax using any of the methods mentioned above shall in the first tax period following a calendar year make adjustments using the annual value of taxable and exempt supplies. This adjustment is intended to allow for variations in the different tax periods resulting from use of different percentages.

Illustration

Assume that the figures used above represent the only transactions of the business in the year (read year I). The end of year adjustments would be done as follows;

Total calendar year I credit	18,000
	360
	18
	<u>180</u>
	18,558

but the return credit for the period is 18,129

balance c/f to year II 429

The return credit is the total allowable input tax after apportionment
Therefore in the first tax period of year II, Company X would open with an input tax credit of **Shs. 429**.

Assume the activities of year II were as follows;

Purchases

Item	Nature of supply	Value in '000	VAT in '000
Sugar	Taxable	150,000	(V) 27,000
Rent	Taxable	4,000	(A) 720
Beans	Exempt	500,000	(X) Nil
Electricity	Taxable	200	(A) 36
Security	Taxable	2,000	(A) 360
Insurance	Exempt	2,000	(X) Nil
TOTAL			28,116

Sales

Item	Nature of supply	Value	VAT
Sugar	Taxable	(B) 200,000	36,000
Beans	Exempt	500,000	Nil
Total		(C)700,000	36,000

Input tax creditable in year II would be:-

Attributable input tax for the period (VAT on sugar)	27,000
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Apportionable input tax:

Bal b/d from year I	429	
Add: Rent	720	
Electricity	36	
Security	<u>360</u>	
	$1,545 \times \frac{200,000}{700,000} =$	441

Total Input tax for the period	27,441
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But output tax for the tax period in year II is...	36,000
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Less input tax for the period (return credit)	27,441
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Therefore VAT payable for period	<u>8,559</u>
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End of year II adjustment

Calendar year credit (attributable)	27,000	
Add apportionable input tax	1,545	28,545
Less return credit for the year		<u>27,441</u>
Credit c/f to year III		<u>1,104</u>

Where the return credit is more than the calendar year credit, the excess shall be treated as tax charged (output) by the taxable person in the first tax period of the following calendar year while input tax credit will be treated as tax claimable by the tax payer.

5.1 Handling the Application

The officer handling the application **must** assess the extent of the disadvantage by carrying out the following checks;

- Establish the turnover from taxable sales and exempt sales using the information available in office (e.g. A recent VAT audit report). In absence of any reliable information, an issue audit shall be carried out to establish the extent of the disadvantage.
- Ascertain that the ratio between taxable and exempt sales is at least less than 50%. If more than this it is unlikely that the taxpayer is disadvantaged by the normal method of apportionment.

- Ensure that input tax is readily attributable to both taxable and exempt supplies.
- Ensure that the taxpayer is ready to keep three separate sets of records and an inspection must be carried out to verify this.
- Check the taxpayer's compliance record to ascertain filing and payment record.

Based on the above checks, the officer may accordingly recommend or reject the application. The recommendation/rejection from head of station shall be forwarded to the office of Commissioner Domestic Taxes from where the decision shall be made.

Once granted, the taxpayer must use the method for a period of at least 2 years subject to review.

Officers shall regularly ensure that the method is still valid, appropriate and reliable and that it does not yield a biased result both to URA and the taxpayer. There will be need to check that the taxpayer is not deriving undue benefits by crediting more input tax than he is entitled.

Taxpayers shall not be allowed to apply the Standard Alternative Method retrospectively. **The effective date of applying SAM shall relate to a subsequent tax period after the date of application. This is to avoid unnecessary administrative procedures of refunding VAT already paid resulting from the use of the Normal Method and even requiring the taxpayer to amend all affected VAT returns.**

Taxpayers who use the Standard Alternative method without prior approval shall have their records audited as if they were applying the normal method of apportionment and any taxes established shall be assessed under normal assessment procedures.

- An approved method for one taxpayer is not transferable to any other taxpayer.

6.0 Helpline

Should you have any questions regarding the application of these guidelines or further guidance, please contact AOM staff on telephones 041-317178/75/65/74, or e-mail aom@ura.go.ug