

Interpretation Note 48 - Debtors Allowance

Interpretation Note 48 (“IN48”) provides guidance on the application and determination of the debtors allowance granted under section 24(2) as it applies to credit instalment agreements. IN48 replaces Practice Notes 12 and 13.

IN48 does not apply to debtors’ allowances and the allowance for contingent development expenditure in respect of township developers.

The IN further provides that the debtors allowance is not applicable to:

- Sales on extended credit in the absence of a condition suspending the passing of ownership
- Sales subject to a resolutive condition; and
- Leases with the option to acquire the goods at the end of the lease

The allowance does apply to lay-buy agreements of not less than 12 months.

IN48 reiterates the fact that the whole amount received or accrued in respect of the disposal of trading stock under an instalment credit agreement, excluding finance charges (dealt with under s24J) is included in gross income at the time of entering into the agreement (s24(1)).

The guidance on the debtors allowance is in far greater detail than that previously contained in practice note 12.

Deposits are regarded as payment of a portion of the sale price when determining the portion payable after 12 months.

The debtors allowance can create or increase an assessed loss.



Debtors allowances claimed must be added back in the succeeding year of assessment

The allowance may be limited when a transaction is entered into that is not related to normal business activities or a scheme is entered into to make use of the gross profit element.

In practice the commissioner’s discretion is exercised upon assessment or audit – there is no need for upfront application. Allowances claimed must be supported by necessary information or documentation.

Quantum of debtors’ allowance

The debtors allowance is calculated by applying the gross profit percentage (“GP%”) to qualifying outstanding debtors. Whereas practice note 12 had little guidance on determining these elements, the IN provides detailed guidance on each.

Allowance = Qualifying Outstanding Debtors X GP%

Qualifying Outstanding Debtors

- Excluding VAT and finance charges
- Reduced by s11(i) bad debts and s11(j) doubtful debts

$$\text{GP\%: } \frac{(\text{sales} - \text{cost of sales})}{\text{sales}} \times 100$$

OR

$$\frac{\text{Gross profit}}{\text{sales}} \times 100$$

- Finance charges and VAT are excluded from sales and cost of sales
- Gross profit includes other forms of income, such as (but not limited to) delivery charges, fees for maintenance contracts and insurance premiums.

Calculation of GP%

The allowance is ideally to be applied on a *debtor by debtor basis*, which is manageable in cases where there are few instalment sale debtors, or the taxpayer's computer systems can determine the exact GP% applicable to each debtor. The IN gives an example of such a method, as well as guidance on applying *globular methods* where determining the GP% on a debtor by debtor basis is not possible.

These methods must be consistently applied, and any switch between methods must be done for a very sound reason.

- Aged-debtors basis using applicable average gross profit percentage

Outstanding debtors at the end of the year of assessment are aged and allocated across the years of assessments to which they arose. The average gross profit percentage for a year of assessment is then applied to the debtors that arose in that year of assessment.

- Moving weighted-average

Due to build up of debtors and varying GP% due to changes in prices, products, competition etc this method seeks to account for these factors by determining a moving-weighted-average percentage based on each years sales and cost of sales and taking into account the average period of the relevant agreements. The average GP% is then applied to total outstanding debtors.

- Current years GP%

It will be acceptable to use the current years GP% provided the level of variation does not exceed 2% of the previous year's percentage.

The complete IN is available on the SARS website (www.sars.gov.za – under "Legal & Policy") or from any of the PwC contacts listed here.

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