RM 216

ARTS and CRAFTS
&
VAT

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Index

A Introduction

Value Added Tax - what is it?

VAT is a tax on spending. It is ultimately paid and borne only by final consumers of goods and services and is designed to tax their spending evenly and fairly. It is not a tax on the sellers of goods and services; they will simply collect the VAT on behalf of the Government.
VAT will neither favour nor discriminate against individual suppliers. The tax will be charged on virtually all goods and services whether supplied by government, business, or non-profit organisations. It is not a tax on profits and therefore profit-making intentions do not come into consideration.
If you are an artist or craftsperson, you may be liable to register for VAT and will have certain new liabilities and responsibilities.
This booklet is designed to explain the impact of VAT on you and to provide specific information to assist you in understanding VAT and in deciding whether or not to register.
More information on registration and accounting for VAT is available in our booklet '**VAT Do you need to register'**.

How VAT works
In effect, VAT works in two steps;

- A registered person, e.g. an artist whose turnover is more than $30,000 per annum, pays 12.5% on all the goods and services purchased for business use. But a credit can be claimed for this tax (called input tax) - **therefore no VAT is borne by the artist.**
- The artist includes 12.5% VAT in the price of all the goods and services sold and pays this amount (output tax) minus the input tax to the Revenue Management Division (RMD) of the Ministry of Finance & Economic Management (MFEM). - **Therefore the VAT is all charged to the buyers/recipients of the goods and services.**

So every dollar you pay in VAT at the input stage can be recovered if you are registered. For example, you may buy some paints, canvas, etc from a supplier for $400 And pay that price plus $50 VAT to the supplier.
You then produce a painting and sell it for $800 Plus $100 VAT. You collect this $100 From the buyer, deduct the $50 Already paid to the supplier and send the balance (i.e. $50) to the RMD.
However, you do not have to wait until the painting is sold before a credit can be claimed for the input tax on the paint, canvas and all your other purchases, i.e. the credit can be claimed in the return period during which the purchases are made.
In practice, because a credit can be claimed for input tax all VAT is passed on through the production and distribution chain, and only the final consumer of the goods and services actually bears the tax. Like all other private consumers you will, of course, bear the cost of VAT on all purchases made for private use.

B Registering for VAT

Who should Register?
If your activity is a private recreational pursuit or a hobby you cannot register - you are not regarded as carrying on a taxable activity.
The dividing line between a hobby and a taxable activity is not clearly defined.
The features of a taxable activity are:

- it must be continuous or regular;
- goods and services must be sold, or intended to be sold in the future, for a consideration(cash, credit, barter etc).
- the activity can be carried on in the form of a business, trade, manufacture, profession, vocation, association or a club.
- profit making intentions are not relevant

If you are unsure whether your activity is a taxable activity rather than a hobby the RMD will assess your situation for you. If your activity is not a hobby, and;

- your turnover is not more than $30,000 per annum, you have the option of registering or not registering;
- your turnover is more than $30,000 per annum you must register and become a 'registered person'.

Advantage of registering

You can claim a credit for the VAT that you pay on purchases, e.g. paint, clay, equipment, electricity, used in your business. If you do not register you will have to absorb these additional costs in your prices, so you may have to put your prices up. This will not matter if you are selling to other non-registered persons, i.e. the general public, because your prices will be similar to or less than those of artists who register and include VAT in their prices.

It will matter, however, if you are selling to registered persons because they can claim a credit for VAT paid on their inputs, i.e. your sale. If you are not registered your prices may be more expensive to them than the prices of someone who is registered. For example, if you are a commercial artist, your customers will probably be registered and wish to claim a credit for VAT on artwork you do for them. They can only do so if you are registered and charge VAT on your invoice.

Disadvantage of registering

The disadvantage of registering is that you will have to keep records of VAT and account for the tax to the RMD. This may not be too difficult because;

- Most people who wish to register will already keep basic records for income tax purposes. These records should in most cases be sufficient to complete a VAT return.
- Since VAT is at a single rate and applies to virtually all goods and services, the calculation is relatively simple.

Summary

If your turnover is under $30,000 per annum, the decision as whether you opt in or out depends largely on whether you sell to registered or non-registered persons.

If you sell mainly to non-registered persons, your prices will probably be cheaper than those of a registered person selling a similar product and you will therefore be able to remain competitive without the necessity of completing a VAT return. This will be so particularly if a large content of your selling price is the value of your own labour. **You will probably be best not to register.**

If you sell to registered persons, it comes down to a trade-off between the increase in costs you would have to face and possibility of becoming uncompetitive if you opt out, and the cost of producing a VAT return every month if you opt in.

If you do not register:

- You would pay VAT on all your purchases but won't be able to claim a credit for the VAT paid. The amount by which your expenses will increase can't be calculated precisely because there will probably be Turn Over Tax (TOT)included in the price of the goods you buy now. This will be abolished when VAT is introduced.

- You would have to put up your prices to recover the extra costs or absorb them in your existing pricing structure, for your profit margin to remain the same.

If you do register:

- You would be required to account to the RMD for VAT. You would probably need to increase you prices by up to 12.5% to cover the VAT. The exact amount by which your prices would increase would depend on the turnover tax included in the products you sell.
- You would pay VAT on all your purchases but can claim credit for the VAT paid.
- Your net cash position would be about the same as at present but you would be required to complete a VAT return every month. If you already keep records for income tax purposes, this would not be too much trouble.

C VAT vs income tax

If you are registered:

- VAT is not a tax on your income. You are collecting tax on someone else's spending.
- You do not claim expenses as such, but you can claim a credit for VAT paid on your purchases, e.g. business cards, petrol, materials.
- Depreciation is not relevant for VAT purposes. You will pay VAT on capital purchases but again you may claim a credit for the VAT paid. You may claim depreciation for income tax purposes on the VAT exclusive price of the asset.
- VAT must be accounted for in the period during which the sale is made. You have collected tax on behalf of the Government. The income spreading provisions for income tax do not apply to VAT.
- You do not have to match expenditure to income - you can claim a credit for VAT on your purchases as soon as you pay for them even if, for instance, you sell only one painting a year (providing your activity is not a hobby).
- Your VAT return is completely separate from your income tax return and VAT on all expenses is claimed as a credit in your VAT return. The VAT transactions are complete in each return period - there is no end-of-year adjustments nor matching to income tax returns. However if you or your accountant find that you have inadvertently omitted to claim some input tax, an adjustment can be made in a later VAT return.
- Royalties are subject to withholding tax. This is part of the income tax system and is similar to PAYE except that the writer is not an employee. This will not change with the introduction of VAT. However, if the writer is registered for VAT, VAT will be charged on the royalty. However, the registered person paying the royalty will get a credit for the VAT paid.

If you are not registered:

- VAT will be a tax on your spending. You will in fact be a final consumer of goods and services and cannot

claim a credit for VAT paid on purchases.
- You may then claim the VAT inclusive price of your expenses when calculating your income for income tax purposes.
- You may claim depreciation on the total price including VAT paid for a capital asset.

D Equipment and records

The introduction of VAT will not mean that you will have to change your current method of recording sales. Sales to the general public will not require a special sales docket.
However, a Tax Invoice must be provided on request for the sale of most goods and services to another registered person. In such a case the following rules apply:

- No Tax Invoice is required for sales of less than $50. A record of payment is required e.g. a receipt.
- If the amount of the sale is more than $50, the Tax Invoice must show:
    - the words **Tax Invoice** in a prominent place;
    - an individual serialised invoice number;
    - the name, RMD number and address of the supplier;
    - the name of the recipient;
    - the date;
    - a quantity or volume of the goods and services;
    - a description of the goods and services supplied;
    - either the VAT inclusive price and a statement that it includes a charge for the tax; or the total amount of the tax, the price excluding tax and the price including tax.

You will need a supply of Tax Invoices if you sell to registered persons.

Note that you must also keep Tax Invoices to support your claims for input tax credits on goods and services over $50 that you buy yourself. However, the Tax Invoices do not need to be sent to the RMD with each return. For purchases under $50, some sort of receipt or proof of purchase is still required.

E Input tax credits

Use of home as studio/office
If you must or if you decide to register, you may claim a credit for VAT on all the goods and services which you purchase for your business. In most cases, such purchases will be clearly identifiable and the VAT input tax credit will be easy to identify. However, sometimes it may not be so clear-cut. For example you may use your home as a studio or office.
VAT may be claimed automatically on purchases if the goods or services purchased are being used solely for business use. This means that the VAT on a desk, furniture, or stationery purchased specifically for a studio or office or for business use may be claimed as a credit. Similarly, a credit can be claimed for VAT on floor coverings, paint, wallpaper, etc in the room used as a studio or office.
Where items are bought and used for business use and partly for private purposes, an input tax credit can be claimed, but only to the extent of the business use.

Example 1: if you have a telephone in your office which is used 75% for business and 25% for private calls, the following adjustment should be made:

	$
Telephone rental for 2 months	40
plus 12.5% VAT	5
	45

An apportioned expense for $3.75 may be claimed. (ie 75% of $5.00)

If there are toll charges on the telephone account, the VAT component of only business calls may be claimed as a credit.

Example 2: if in the example above, the telephone was used 75% for private calls and 25% for business calls, an apportioned claim of $1.25 will be allowed.(ie 25% of $5.00)

Use of private vehicle
The rules here are exactly the same as for the home studio/office. There are basically two situations regarding vehicles:

- The vehicle is used exclusively for business - a full input tax credit can be claimed on purchase of the vehicle and running expenses;
- The vehicle is used partly for business and partly for private use - an input tax credit can be claimed, but only to the extent of the business use. If you wish to claim VAT on a motor vehicle not used solely for business, a logbook must be kept for three months in any three year period, to determine the business portion to be claimed.

F Types of sales

Craft Shops
The specific points relating to retailing can be found in the booklet 'Retailers and VAT' in this series. Of particular relevance to craft shops, however, are the provisions regarding sales by agents and sales to tourists.

Agents
If a shop or a co-operative you have formed sells craft work on your behalf, ownership of the goods remains with you until they are sold and there are two separate transactions:

- You are responsible for VAT on sales of your goods. If your total sales (including those sold by the shop or co-operative as your agent), exceeds $30 000 per annum you **must** register for VAT.
- The shop or co-operative is responsible for VAT only on total commissions or fees it receives for selling the goods and only the commissions need be taken into account for the purposes of the $30,000 threshold.

If, on the other hand, the goods are purchased by the shop, you charge VAT to the shop on your sale if you are registered. You then account for the VAT to the RMD and the shop claims a credit for the same amount. The shop in its turn will account for VAT when the goods are resold to a customer. In both cases total sales of goods are relevant for the purposes of the $30,000 threshold.

Sales to tourists
There are no special VAT concessions for tourists buying goods in the Cook Islands. However, a shop posting goods overseas for a tourist or for a Cook Island resident wishing to send gifts overseas may enter the goods for export with the Customs Department. The goods will be classed as exports and

VAT will be charged at a zero rate rather than the standard 12.5%. VAT paid by you on the purchase of materials used in making these goods would be subject to a full VAT input tax credit in the normal way.

Service or labour only contracts

VAT is a tax on spending. When this involves the purchase of goods there is little difficulty in identifying the goods and applying the tax to the sale price. All services are also subject to VAT but because there is no physical commodity the transactions and their value are not so clearly defined as in the case of the sale of goods.

You may be selling your labour only as a service direct to the public (e.g. a street performer) or to an agency (e.g. a singer on contract to a recording studio).

The situation here is the same for VAT as if you were producing physical goods. If you are registered, you will be required to account to the RMD for VAT on your street collections or your contract price. If your contract is for $1000, the VAT will be $125 making the final tax inclusive price $1125. The VAT content of the price will therefore be $1/9^{th}$. The easiest way of determining the tax content of any price is to divide the total price by 9. The principle is exactly the same as with the sale of goods except that the sole component of your outputs is labour.

If you work through an agent, the agent will charge you VAT on his or her commission if the agent is registered. You may claim a credit for this VAT if you are also registered.

Professional musical or theatrical performances

VAT will apply and $1/9^{th}$ of total ticket sales including VAT will be payable to the RMD. A credit for VAT on purchases will of course be allowed in the period during which they are made. A local company which produces a performance and spends some considerable time in rehearsal and production will probably be regarded as carrying out a taxable activity and would be subject to VAT if ticket sales exceed $30 000 per annum.

Larger scale theatrical performances will probably also be funded by sources other than ticket sales, for example;

- **Government Grants**
  Government departments will be registered for VAT and pay theatrical companies in order that they may conduct performances for the public. In effect they are 'buying services' from theatrical companies. VAT will therefore be included in the grant; the company will account to RMD for $1/9^{th}$ of the grant as output tax, the Govt dept will claim a credit for the same amount as input tax. A Tax invoice will be issued by the company to the Department as evidence of the transaction.

- **Sponsorship**
  Sponsorship money is similar to the Government grants for VAT purposes. The sponsor is buying a specific service i.e. advertising. VAT will be included in the sponsorship, the theatrical company will account to the RMD for $1/9^{th}$ of the sponsorship, the sponsor will claim a credit for the same amount; a Tax Invoice will be issued by the theatrical company to the sponsor as evidence of the transaction.

- **Tickets sold by agent**
  If a booking fee is charged by an agent that fee will be subject to

VAT, e.g. if the basic price of a ticket is $4.00 now plus a booking fee of 50cents, the price after VAT will be $5.06. ($4.50 plus 12.5%)

- **Sale of copyrights, performing rights, etc**
  Where an author, playwright or publisher sells the whole or part of the rights to a novel, play, etc, the price of the supply of those rights is often in the form of royalties. Whether or not the royalty is subject to VAT in the hands of the person who supplies the rights will be determined by:
  - the date the royalty agreement was entered into
  - the country of residence of the supplier
  - whether the supplier is a registered person

G Transitional Arrangements

Credit for Turnover tax (TOT)

A full credit will be given to registered persons for the turnover tax content, charged at a rate of 1% or 10%, on trading stock and stationery held at 1 July 1997. A credit will not be given for turnover tax on;

- goods which are part of a business' capital assets; or
- hired goods or goods available for hire; or
- second hand goods.

The claim may be made in any one return up to 30 September 1997. The Revenue Manager must be satisfied that turnover tax has been paid on goods for which a claim is made.

Pricing

Repricing during the transition period will need to take into account the removal of turnover tax. Overall, prices are expected to go up slightly because of VAT.

Sales spanning introduction

Special provisions exist for situations where the invoicing, payment for, and delivery of goods and services spans the VAT introduction date.

In cases where:

- Invoicing and/or payment occurs before 1 July 1997 but delivery of the goods and services takes place after that date, e.g. a ticket with a monetary value is sold before 1 July 1997 for a concert which will take place after 1 July 1997, the transaction will be taxable because VAT is charged at the time the goods are delivered or the service performed.
- Invoicing and/or payment occurs on or after 1 July 1997 but delivery of the goods and services takes place before that date, e.g. a piece of pottery sold to a craft shop and delivery is before 1 July 1997, no VAT will be payable because the goods were delivered before VAT came into force.

Further assistance/Information

If you require further assistance in administering VAT as part of your business, Revenue Management Division (MFEM) will be pleased to help you.

This booklet was prepared in Oct 1997, and figures and procedures mentioned

were correct at that date. Some may
have since been revised.