

Charging VAT on sales of second-hand goods with input tax undeducted 3/14/24

The Value Added Tax (VAT) Act prescribes a special scheme for charging VAT on supplies of second-hand goods. These include a variety of tangible items, such as cars, machinery, office equipment, furniture and other goods that are fit for future use in the same form with no modification or after repairs and that are not works of art, collectors' items or antiques.¹ A taxable person selling second-hand goods will normally charge VAT on the full price. However, certain supplies of second-hand goods can be exempt from VAT or taxable under a special scheme on the difference between the acquisition cost and the selling price (a margin scheme for second-hand goods as per section 138 of the VAT Act). This article explores what conditions have to be met before section 138 can be applied and when an exemption is available.

The secondary market may feature goods that did not have input tax deducted on their initial purchase because the buyer acquired them for an exempt business or did not even buy them for business (e.g. a luxury executive car or a yacht). Section 52(3) and (3.1) of the VAT Act exempts supplies of goods with no input tax deduction allowed on their initial purchase. This rule is designed to eliminate double taxation because VAT expenses are part of the cost of goods that did not have input tax deduction allowed on their purchase and there are no grounds for charging VAT on this amount again.

Examples include medical institutions, financial service providers, entities performing functions delegated by the state, and holding companies that are not conducting any active business. In these cases, persons will have bought goods that had VAT charged on their initial purchase, but since they were used for supplies that do not allow input tax deduction, the input tax paid will not have been deducted. So the VAT charged on the purchase will be part of the cost of these goods.

It's an open question whether and how this rule can be applied where input tax on the goods was deducted partially (e.g. on a car being used for private as well as business purposes, or if the taxable person runs a mixed business with taxable and exempt supplies and the goods are necessary for both types). Sales of goods with input tax deducted partially are unlikely to qualify for an exemption.

The VAT Act prescribes a margin scheme for supplies of second-hand goods. This is applied by a registered taxable person that has bought and wants to sell on any second-hand goods that have the cost of VAT included in their price. In this case VAT is chargeable on the difference between the acquisition cost and the selling price. If it's negative, no VAT is charged.²

Section 138 of the VAT Act defines the second-hand goods dealer and goods that qualify for the margin scheme, as well as restricting the dealer's right to deduct input tax. It's crucial that goods must be bought from a non-taxable person (mainly individuals), from a taxable person that makes only exempt supplies or deals in other second-hand goods and is already applying the margin scheme, or if the goods represent a non-current asset bought from an unregistered taxable person or an unregistered taxable person established in another member state.

It's important to note that VAT charged under the margin scheme will not appear on an invoice or a cash-register receipt. And the second-hand goods dealer has to keep a special record of the seller's identity, purchase prices and other information, and draw up a supporting document – a statement of purchase.

It's also worth mentioning that the SRS is carefully monitoring and will restrict application of the margin scheme if the trader is found to be in breach of any industry rules (e.g. second-hand car dealers must have their point of sale registered with the Road Traffic Safety Office). We believe this approach defeats the

purpose of the margin scheme – to eliminate double taxation.

¹ Paragraph 183 of the Cabinet of Ministers' Rule No. 17 of 3 January 2013, 'Procedures for applying the VAT Act's provisions and certain requirements for paying and administering VAT'

² Section 138(16) of the VAT Act