

Introduction

The purpose of this paper is to discuss the tax treatment of income received in advance for services to be rendered or goods to be delivered in a subsequent year of assessment. This discussion is crucial because income used to be included in gross income at the earlier of receipt or accrual before **Section 8(3) of the Income Tax Act [Chapter 23:06]**¹ was inserted by the **Finance Act No. 1 of 2018**².

Advance payments are often received under contracts which are entered into in one year of assessment for goods to be delivered or services to be rendered in a later year. Examples are audit fees received in 2020 year for assessment by an audit firm for audit work to be performed in 2021, a construction company can also receive revenue for work to be done in later years and a manufacturer of fertilizer can receive payment of fertilizer to be delivered in the next rain season.



Tax Treatment on Earlier of Receipt or Accrual Basis

When an amount received is included in gross income upon receipt, this simply means that an amount is included in taxable income in the year of assessment that the taxpayer receives the amount on their own behalf for their own benefit **Geldenhuis v CIR 7947 (3) SA 256 (C)**³ even though the services are to be rendered in subsequent years.

1. Section 8(3) of the Income Tax Act

2. Finance Act No. 1 of 2018

3. Geldenhuis v CIR 7947 (3) SA 256 ©

4. CIR v Delfos 1933

On the other hand, an amount is included in gross income upon accrual meaning that once a taxpayer performs the services, or delivers the goods, the amount becomes due and payable (**CIR v Delfos 1933**)⁴ to them. Hence it can be concluded that income has accrued to the taxpayer.

Before 1 January 2018, revenue was included in gross income at the earlier of the above two discussed concepts, all things being equal. However, the Finance Act number 1 of 2018 w.e.f 1 January 2018 brought about some confusion and a lot of errors may occur as prepaid revenue will only be included in gross income using S8(1) in isolation.

Section 8(3) inserted by the Finance Act number 1 of 2018. Any amount received as prepayment for goods or services that will be used up in the future shall not constitute gross income when preparing a return for the year of assessment in which the amount was received. This is the first time that the recognition of revenue received in advance agrees with step 5 of the revenue recognition model in **IFRS15 Revenue from Contracts with Customers**⁵ which stipulates that revenue is recognized when an entity satisfies its performance obligations. In the case of income, the performance obligations will be the services to be rendered or the goods to be delivered in subsequent years of assessment.

In conclusion, to avoid the confusion brought about by the **Finance Act No.1 of 2018**, companies should read **Section 8(1)** together with **Section 8(3)** in determining their taxable income when prepaid revenue is involved.

4. *CIR v Delfos 1933*

5. *IFRS 15 Revenue from Contracts with Customers*