

5 May 2017

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RE: Draft Interpretation Note 57 (issue 2): Disposal of an enterprise or part thereof as a going concern

We write to comment on the draft interpretation note on the disposal of an enterprise or part thereof as a going concern in terms of the Value-Added Tax Act, 89 of 1991 (VAT Act).

A. Paragraph 3.1.1: The seller and the purchaser must be registered vendors
(The purchaser must be a registered vendor)

a. Suspensive conditions

The note correctly indicates that an agreement for sale qualifies as an invoice as long as that agreement is not subject to any suspensive conditions (i.e. is fully effective). However, the note fails to deal with agreements containing a suspensive condition.

An agreement subject to suspensive conditions should not qualify as an invoice. The question becomes what happens once the suspensive condition is satisfied. Does the agreement then become an invoice or is a separate invoice required? We recommend that the note should also deal with an agreement subject to suspensive conditions as many agreements contain suspensive conditions.

b. Newco purchases

One issue alluded to in the note is newly registered purchasers. Many company purchases involve the creation of a newly formed company or the use of a shelf company (owned by a purchasing group of companies or a pre-existing small / medium business owner). Purchasers often prefer to acquire assets of a going concern of a selling company rather than the selling company shares because asset purchases do not come with the assumption of inherent prior business liabilities. Hence, the issue of going concern purchases is of high importance for business. In these cases, the newly formed company purchaser will only have a VAT recognised enterprise based on the going concern to be acquired via the acquisition agreement.

The note states that the purchaser must be a registered vendor before concluding the agreement of sale. The note then goes on to state that SARS will not register a purchaser that is not in possession of a signed agreement. This sounds contradictory and requires further clarification. Presumably a retrospective effective date of registration is envisaged so that, even though the purchaser only applies for registration after the agreement is concluded, the effective date of the registration is before the agreement was concluded. It would be helpful if the note explains how this should be done in practice or how newly formed companies can acquire ongoing concerns pursuant to the zero-rating of section 11(1)(e). A specific example that includes process steps would be of great assistance.

c. 90-day notice period

The 90-day period for the seller to obtain proof of the purchaser's VAT registration mentioned in the note is not stipulated in the VAT Act. We question SARS's authority for adding this requirement. Moreover, in view of SARS's current onerous registration procedures and requirements, the 90-day period is not reasonable. It may, for example take months for a new company to open a bank account, to obtain a utility account and proof of income.

We recommend that the requirement in this note and in Interpretation Note 31 to obtain the purchaser's notice of registration within 90 days should be amended to stipulate that the seller must obtain proof that the purchaser has applied for registration with SARS within the 90-day period.

B. Paragraph 3.1.2: Supply of an enterprise or part of an enterprise which is capable of separate operation

Between Example 2 and 3, an unrelated comment is made of concern. It is stated that:

“The sale of an undivided ownership share in an enterprise does not constitute the sale of part of an enterprise capable of separate operation, as the enterprise is not capable of separate operation.”

We believe that this sentence is wholly incorrect. Many separate businesses exist with multiple direct owners. These unincorporated joint ventures (UJVs) come in different forms but are most easily understood as a partnership. These ventures operate fully as an independent going concern on a day-to-day basis even though multiple owners exist. These enterprises may be sold as a whole or some of the owners may independently sell their undivided share of assets.

For example, assume an UJV has three members. If one member of an UJV sells its undivided share in the UJV to the other members of the UJV, the enterprise carried on by the UJV continues as a going concern. However, the sale results in the old UJV being terminated and a new UJV being formed (by operation of law / a typical result for partnerships). Therefore, the old UJV effectively disposes of its enterprise as a going concern to the new UJV. Section 51(2) of the VAT Act provides that the old UJV and the new UJV will be deemed to be one and the same person. We recommend that this aspect should be discussed in the draft or that the sentence above (in the note) dealing with undivided ownership shares be deleted entirely.

C. Paragraph 3.1.3: Parties must agree in writing that the supply is a going concern

a. Retrospective rectification

The requirement to comply with the provisions of section 11(1)(e), with reference to findings by the Supreme Court of Appeal in the case of Milner Street Properties v Eckstein Properties Pty Ltd is discussed. Brief reference is made in the note whereby the Supreme Court of Appeal allowed the seller to rectify the sale agreement after the fact. We recommend that the note should deal in more detail with this finding of the court (i.e. the core holding of the decision). As stated by the court, the parties may agree to rectify the agreement subsequent to its conclusion so as to incorporate the relevant requirements of the section (as long as the parties agreed and intended at the time of conclusion of the agreement to dispose of the business as a going concern). The draft interpretation should clarify the proper circumstances for this *ex post facto* rectification.

b. Definition of “going concern”

The draft interpretation note reference to the Oxford Dictionary definition of “going concern” of “a business that is operating and making a profit” does not take into account the context in which the phrase “going concern” is used. The definition of “enterprise” in section 1(1) of the VAT Act specifically includes activities, whether or not carried on for a profit. A welfare organisation could, for example, sell its business to another welfare organisation as a going concern. The note should also clarify that the transfer of income earning enterprises operating at a net loss would also qualify for the zero rate in terms of section 11(1)(e).

D. Paragraph 3.1.4: The seller and purchaser must, at the conclusion of the agreement for the disposal of the enterprise agree that the enterprise will be an income-earning activity on the date of transfer of the enterprise

The timing of the income-earning nature of the enterprise appears confused. We agree that the parties must agree on the date of conclusion of the agreement that the transferred enterprise will be an income-earning activity on the date of transfer of the enterprise. However, we refute any suggestion that the enterprise must actually be income-earning at the time of transfer.

The VAT status of a transaction and VAT rate applicable, including situations where there is an increase in the VAT rate, is determined at the time of supply of the transaction. What happens after the time of supply, cannot impact on the VAT status of the supply or the applicable rate where such supply was concluded at an earlier date, especially where such subsequent events are out of the control of the seller.

E. Paragraph 3.1.5: Disposal of assets which are necessary for carrying on the enterprise

The note properly states that the seller may decide to retain certain assets (or the purchaser can decide not to purchase certain assets) without undermining the notion that an enterprise (or independent part thereof) can be transferred pursuant to section 11(1)(e). For example, old stock or book debts should not undermine the application of section 11(1)(e) given the ancillary nature of these assets. Other assets may not be of interest to the purchaser if the purchaser already has those assets in the purchaser's possession. These assets can include shop fittings, specialised software etc. It would be helpful if the exclusion of ancillary or unwanted assets be discussed in some detail.

F. Paragraph 3.2: The supply of goods or services used partly for purposes of carrying on the business disposed of as a going concern and partly for other purposes

Reference is made to section 8(16). This section essentially deems the sale of income-producing assets to qualify as the sale of a taxable supply where these assets are mainly for taxable supplies. We believe this simplifying principle is largely correct but for ancillary assets falling outside the core business. For instance, financial assets (which are ancillary to the business) should be viewed independently.

Many sales of businesses as going concerns include assets and liabilities which are not taxable such as money, debtors, creditors and other similar working capital. We recommend that the draft interpretation note clarify that section 8(16) does not function in respect of such working capital and certain other ancillary assets.

G. Paragraph 3.3: Going concern acquired wholly or partly for purposes other than making taxable supplies

We recommend that this paragraph should make it clear that section 18A adjustments do not apply to non-taxable goods or services such as debtors and creditors.

The draft interpretation note should specifically deal with certain scenarios that are often found in practice, for example:

- In a farming environment, the use of farming land for exempt/non-enterprise purposes is often less than 5%. In practice uncertainty often exists with regards to the treatment of VAT on farmhouses and labourer accommodation
- Where a mining enterprise is sold, the employee housing is often disposed of together with the mining enterprise. The employee houses or hostels may not be situated on the same land on which the mining activities are carried on.

The note should specify how the employee housing should be treated in these circumstances, and how the 5% non-taxable usage should be determined (preferably by way of example).

H. Paragraph 3.5: Tax invoices

The transfer of an enterprise triggers transitional issues for the new purchaser that arise after the transfer. Debit and credit notes are a particular recurring problem. Section 21 seemingly only permits the vendor who originally issued the tax invoice to issue a debit or credit note so as to make appropriate adjustments to the initial supply. Guidance is needed on what the purchasing vendor should do to utilise debit or credit notices when the initial supply was performed by the seller.

I. Paragraph 3.6: Documentary proof

This draft interpretation note lists the documentation which the supplier needs to obtain and retain in order to support its entitlement to the zero rate. One of these documents is the tax invoice. Since tax invoices are often not issued in respect of the sale of a business as a going concern, it is recommended that the agreement be listed as the key document so as to fall within the spirit of section 11(1)(e). The note should also clarify what terms must be listed in the agreement (such as details mirroring a formal tax invoice).

It is not a requirement of section 11(1)(e) as stated in the note that the contract of sale must confirm in writing that the assets necessary for carrying on the enterprise or part of the enterprise must be disposed of to the purchaser. This is not required to be in writing or to form part of the agreement.

J. Further comments

In conclusion, we believe that the draft interpretation note should deal with additional recurring considerations not previously mentioned:

- The note should deal with the situation where a purchaser acquires a going concern without the intention of continuing to operate the going concern after its acquisition. The sale itself should

presumably qualify as a section 11(1)(e) zero-rated supply with a deemed supply when the purchaser ceases operations.

- It often happens that a sale of business agreement is signed in a current period with a retrospective effective date. The note should clarify that there is no supply for VAT purposes until the time of supply is triggered (by the issue of an invoice or making any payment). Therefore, despite the retrospective effective date, the seller should continue to account for VAT until the time of supply of the business, where-after the purchaser is liable to account for VAT on the business transactions under the purchaser's registration number.
- Lastly, the note should clarify the provisions of section 11(1)(p) with regard to the transfer of an enterprise as going concern in relation to a branch / division. The company reorganisation rules of section 8(25) are also of paramount concern given their widespread usage.

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We welcome the opportunity to comment on the draft interpretation note and look forward to future engagements.

Yours sincerely

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