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Submission File

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South African Revenue Service  
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0001

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Dear Sir/Madam

**PUBLIC COMMENTS ON THE DRAFT INTERPRETATION NOTE (ISSUE 2): DISPOSAL OF AN ENTERPRISE OR PART THEREOF AS A GOING CONCERN**

1. Thank you for affording the South African Institute of Chartered Accountants (SAICA) VAT Subcommittee (a subcommittee of the National Tax Committee) the opportunity to provide our feedback and inputs on the above mentioned matter.
2. Set out below are our comments. You are welcome to contact us should you wish to clarify any matter raised below.

**GENERAL COMMENTS**

**Inconsistent numbering**

3. The inconsistency in detailed numbering of the subparagraphs of the Draft Interpretation Note 57 (issue 2) (draft IN) makes it difficult to reference to specific issues in the draft IN and to navigate in the document.
4. For example no subparagraph number is allocated to leasing or farming activities whereas in issue 1 both parts had subparagraph references.

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| 5. <u>Submission</u> : It is submitted that consideration be given to numbering the paragraphs similar to the numbering convention used in VAT Interpretation Note 57 (Issue 1). |
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### **Lack of clarity**

6. The draft IN does not currently deal with the following situations, namely, where a:
- a. person acquires a going concern without the intention of continuing operating the going concern after the acquisition; and
  - b. portion of a business is sold, in circumstances where that business is used exclusively for exempt or non-enterprise purposes. The draft IN currently only deals with the sale of businesses making mixed supplies.

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| 7. | <u>Submission</u> : It is submitted that these matters be addressed to clarify what the correct VAT consequences will be in the stated circumstances.  |
| 8. | It is also submitted that the draft IN should clarify the provisions of section 11(1)(p) of the VAT Act with regard to the transfer of an enterprise as a going concern in relation to that section. |
| 9. | The draft IN should preferably also provide guidance as to what would be considered to be the transfer of an enterprise as a going concern for the purposes of section 8(25) of the VAT Act.         |

### **Retrospectivity**

10. It often happens that an agreement for the sale of a going concern is signed with a retrospective effective date.
11. The draft IN clarifies that there is no supply for VAT purposes until the time of supply is triggered, i.e. by the issue of an invoice or making any payment.

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| 12. | <u>Submission</u> : We therefore submit that SARS should expressly clarify that despite the retrospective effective date, the seller should continue to account for VAT on the business transactions 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. |
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## SPECIFIC COMMENTS

### Paragraph 3.1.1 - The seller and purchaser must be registered vendors

#### Page 4 – The purchaser must be a registered vendor

##### Comment 1

13. The second paragraph on page 4 under the heading “The purchaser must be a registered vendor” states:

*“In terms of the rules regulating the time of supply in section 9(1), the purchaser is required to be registered as a vendor at the time the supply is deemed to take place...”*

14. This creates possible ambiguity as there is more than one date that can apply.

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| 15. <u>Submission:</u> We recommend the following change to the first sentence of the said paragraph in order to avoid the current ambiguity: <i>“The purchaser is required to be registered as a vendor at the time the supply is deemed to take place which is, in terms of section 9(1), the earlier of ...”</i> |
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##### Comment 2

16. Although the draft IN indicates that the Commissioner will not register a purchaser that is not in possession of a signed agreement evidencing the sale of an enterprise disposed of as a going concern, it does not clearly indicate that the purchaser has 90 days within which to register "from" the effective date of the supply.
17. It merely states that in order for the supply of a going concern to qualify for the zero-rating, the supplier is required to obtain proof of the purchaser's VAT registration within a period of 90 days.
18. The requirement is still that the purchaser is required to be registered as a vendor **at** the time the supply is deemed to take place and not **from** the time the supply is deemed to take place just as long as it is within 90 days.

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| 19. <u>Submission:</u> We recommend that the draft IN clearly indicates that the purchaser has 90 days within which to register from the effective date of the supply. |
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##### Comment 3

20. Furthermore, in terms of the new 90-day rule, a non-VAT registered purchaser will have 90 days to provide the Notice of Registration to the seller, failing which the supply becomes a standard rated VAT supply.



21. However, in practice delays on the part of SARS to register vendors are often experienced. In such circumstances the draft IN does not make provision for the extension of the 90-day period which is problematic in practice.

22. Submission: We recommend that where the registration is delayed by circumstances beyond the control of the purchaser, provision should be made either to extend the 90-day rule or alternative proof should be accepted by SARS.

23. For example proof that in the view of the SARS current VAT registration procedures, which often cause significant delays in the issue of a VAT registration number, the requirement in the draft IN and in IN 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.).

Page 4 - Third paragraph under paragraph 3.1.1

24. The third paragraph on page 4, deals, *inter alia*, with suspensive conditions. The wording of the paragraph can be interpreted as meaning that the agreement will become an invoice once the suspensive conditions have been met.

25. It is submitted that such an interpretation would be incorrect because the VAT Act only makes provision for a document to be an invoice on issue thereof; it cannot become an invoice afterwards.

26. Submission: In order to remove this uncertainty, we recommend that this paragraph be amended to make it clear that the agreement will only constitute an invoice if there are no suspensive conditions attached to the agreement **and** the agreement represents an existing obligation to make payment. If not, an invoice issued once the agreement has become unconditional must be issued to trigger the VAT event (if payment of the consideration had not been received at the time).

**Paragraph 3.1.2 - Page 5 – First paragraph after examples**

Comment 1

27. The reference to “stand alone” division may create confusion.

28. For example, an IT service division within an organisation may be capable of separate operation, but can never be a supply of a going concern if it is outsourced, as it would not have been an income earning activity on the date of transfer.

29. Furthermore, the standard practice is for the use of inverted commas to be avoided in interpretation notes, unless the term is separately defined, as this may create confusion.



30. Submission: We recommend that you reconsider the reference to “stand alone division” given that it can be incorrectly interpreted and if used in inverted commas, then to clarify by definition what is meant by the term.

Comment 2

31. The last sentence of the paragraph reads:

*“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.”*

32. This clause should reference the undivided ownership share as being incapable of separate operation and not the enterprise which is in fact capable of separate operation.

33. Submission: It is submitted that the sentence be amended to read: *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] undivided ownership share is not capable of separate operation.”*

34. We do however also have reservations as to the correctness of this statement in general as stated below.

Comment 3

35. It is submitted that it is incorrect to make a ‘blanket statement’ that the sale of an undivided ownership share in an enterprise is not capable of separate operation.

36. In some instances the transactions are structured to provide that the owner of the undivided interest makes the undivided interest available to the body of persons that operates the enterprise, for a taxable consideration equal to the undivided owner’s profit share. The undivided interest owner therefore generates taxable income from the making available of its undivided interest.

37. In these circumstances the disposal of the undivided interest to another owner which will carry on with the same structure indeed qualifies as an enterprise as a going concern, which will qualify for VAT at the rate of zero per cent under section 11(1)(e).

38. Submission: It is therefore submitted that the sentence “*The sale of an undivided ownership share in an enterprise does not constitute the sale of part of an enterprise...*” should be amended to read: “*The sale of an undivided ownership share*



in an enterprise **may, in certain circumstances**, not constitute the sale of part of an enterprise **if...**”

Comment 4

39. As aforementioned, the last sentence states 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.*
40. Although this statement is technically correct, it disregards the practical application as set out below.
41. Where one member of an unincorporated joint venture (UJV) disposes of its undivided share in the UJV to either one of the other members of the UJV or a new member of the UJV, the enterprise carried on by the UJV generally continues to be carried on as a going concern as before. This is due to the fact that the sale of an undivided share in a UJV is akin to the sale of a share in a corporate entity, with the result that it does not impact on the activities of the enterprise.
42. However, unlike the sale of share in a corporate entity, the sale of an undivided share in a UJV has the effect that a new UJV, comprising of the new members come into being. Thus, should the UJV continue to carry on its activities as before, it implies that the old UJV effectively disposed of its enterprise to the new UJV.
43. It is for this reason that section 51(2) of the VAT Act specifically provides for this situation, namely to provide that should the enterprise of the UJV continue to be carried on by the new UJV as a going concern, the old and the new UJV will, unless the Commissioner otherwise directs, be deemed to be one and the same person.
44. Submission: For the sake of completeness of the draft IN, we recommend that this aspect be included in the draft IN.
45. In addition to the above scenario, it is often found that where there is a change in the co-owners of a UJV, an agreement of sale is entered into between the old UJV and the new UJV, which is properly structured as the sale of a business as a going concern, and which is compliant with section 11(1)(e) of the VAT Act.
46. Submission: We therefore recommend for the sake of completeness and clarity that this scenario also be specifically included in the draft IN.
47. It also often happens that a co-owner sells its undivided interest to the remaining member of the UJV. In these circumstances the body of persons ceases to exist and the business automatically reverts back to the remaining member, as an enterprise as a going concern.



48. The UJV then needs to cancel its registration
49. Since a UJV is not a legal person that can enter into a sale agreement, the UJV and the remaining member cannot conclude an agreement in terms of which the requirements of section 11(1)(e) can be complied with.
50. Submission: We therefore recommend that SARS clarifies that the transfer of the business from the UJV to the remaining member in these circumstances qualifies for the zero-rating in terms of section 11(1)(e) read with section 72 of the VAT Act.

Comment 5

*Page 5 - Example 3 - Supply of an enterprise capable of separate operation*

51. Under the 'Facts', it is stated: "*X sells the commercial leasing enterprise ...*"
52. The example deals with the partial sale of an enterprise that by itself is capable of separate operation. In the example the vendor rents out various commercial buildings and sells one of the buildings. The vendor accordingly does not dispose of its leasing enterprise, but only a portion thereof.

53. Submission: We recommend that you change the wording to: "*X sells a portion of the commercial leasing enterprise ...*"

**Paragraph 3.1.3 - Parties must agree in writing that the supply is a going concern**

Comment 1

*Page 6 – Paragraphs 2 & 3 under paragraph 3.1.3*

54. The Draft IN correctly in our view identifies that a written agreement is an outright requirement of section 11(1)(e).
55. However paragraph 2 & 3 conflates the concept of rectification, which is a special rule in law, with that of the outright requirement by stating it to be an example thereof, which it is not. At most only the concluding remark is applicable, namely that the court did not dispense with the written agreement just enabled rectification.
56. It is rather an example that a written agreement that can be rectified to comply with the outright written agreement requirement after the fact where the parties intention was incorrectly reflected in the written terms.

57. Submission: It is submitted that the requirement of a written agreement should be dealt with separately from rectification so that the two legal concepts are not confused, though related. Furthermore we agree that SARS should then include the



clarification that rectification does not mean that the requirements for a written agreement are dispensed with, but supports that it must be complied with.

### Comment 2

Page 7 - Paragraphs 3 & 4 under paragraph 3.1.3.

58. In paragraph 3, the draft IN references the Oxford Dictionary definition of 'going concern' as being "*a business that is operating and making a profit*".
59. It should be noted that the definition of "*enterprise*" in section 1(1) of the VAT Act specifically includes activities, whether or not carried on for a profit.
60. Paragraph 4 then provides that "*Therefore, in order to comply with this [above] requirement ...*".
61. This creates the impression that only businesses operated on a profitable basis qualify to be supplied at the rate of zero percent.

62. Submission: It is therefore submitted that the draft IN should clarify that it is not only businesses that operate on a profitable basis which will qualify for the zero-rating, irrespective of the dictionary meaning which is persuasive not conclusive as the literal interpretation must still be given a contextual meaning within the section and part as a whole, where profitability is clearly not required.

### Comment 3

Page 7 - Paragraphs 3 under paragraph 3.1.3.

63. The third paragraph on page 7 provides that:
64. "*The zero rate will not apply to a contract that specifically states that an enterprise is disposed of as a going concern and it is subsequently determined that the enterprise did not meet the requirements ...*" (our emphasis).

65. Submission: Since the requirements of section 11(1)(e) of the VAT Act are not limited to requirements of the "*enterprise*" being disposed of, we recommend that this is clarified by virtue of the reference to "*enterprise*" being replaced with a reference to "*disposal*" did not meet the requirements.

66. It is furthermore submitted that the requirement that the output tax must be reflected in field 11 of the VAT return is incorrect as it is not a change in use adjustment as envisaged by section 18. We submit that the adjustment should instead be reflected in field 12.



### **Paragraph 3.1.4 - Page 10 - “Business yet to commence or dormant business”**

#### **Comment 1**

##### *Second paragraph – page 10*

67. The last sentence in the paragraph states that *“the zero-rate will not apply if the purchaser takes possession of the enterprise before the date of transfer and the enterprise is only income-earning after the date of transfer”*.
68. The only test contained in section 11(1)(e) of the VAT Act is that the parties must agree in writing at the time of conclusion of the agreement that the enterprise must be an income-earning activity on the date of transfer.
69. The date of transfer is not necessarily the date of the supply (and is often not, in practice).
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| 70. <u>Submission:</u> We recommend that the draft IN clarifies the difference between the date of transfer and the date that the agreement is concluded.                 |
| 71. The draft IN should further clarify how the date of taking possession of the enterprise impacts on the date of transfer and the date that the agreement is concluded. |

#### **Comment 2**

72. Furthermore, a statement is made in the draft IN to the effect that if the parties agree in writing at the time of conclusion of the agreement that the enterprise will be an income-earning activity on the date of transfer and in the event that the enterprise is not an income-earning activity at the date of transfer, the zero rate will not apply.
73. It is submitted that this statement is incorrect.
74. 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 which is the conclusion of the agreement (i.e. invoice issued).
75. 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
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| 76. <u>Submission:</u> It is submitted that SARS should correct this paragraph to correctly reflect the law that the enterprise must only be an income earning activity at the time of the supply, not thereafter such as on transfer. We do not doubt that SARS will apply close scrutiny to the initial income earning activity determination in circumstances where this does happen, but that should remain a facts and circumstances enquiry. |
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### Comment 3

77. In practice, a scenario often occurs where a back-to-back on sale agreement is entered into for the disposal of a business as a going concern, for example, where party A sells the business as a going concern to party B, and party B immediately and simultaneously sells the business to party C.
78. Although party B acquires the business only for a moment in time, it remains that it is an operating income-earning business capable of separate operation, and therefore both sale transactions comprise the sale of income earning activities.
79. A specific example of this is where a share block shareholder operates its share block share as a hotel enterprise. A purchaser wants to purchase the hotel operation together with the fixed property. In order to give effect to the transaction the share block scheme must be cancelled. Upon cancellation of the share block shareholder's right of use, the share block shareholder disposes of the hotel operation to the share block company, and the share block company simultaneously disposes of the full title of the property together with the hotel operation to the purchaser.
80. What is being disposed of by both the share block shareholder and the share block company is the hotel operation that never ceases to generate income. The sale by the share block company therefore qualifies for the zero rating provided the other requirements of section 11(1)(e) are complied with, even though it owned the hotel operation only for a moment in time.
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| 81. <u>Submission:</u> It is submitted that paragraph 3.1.4 address instances where a going concern is disposed of in terms of a back-to-back on sale agreement and confirm the eligibility of the on sale for the zero rating. |
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### **Paragraph 3.1.5 - page 11 - Disposal of the assets which are necessary for carrying on the enterprise**

82. The second sentence of this paragraph makes reference to the fact that the seller may decide to retain certain assets or the purchaser can decide not to purchase certain assets, for example old stock or book debts, without affecting the application of the zero-rating.
83. Section 11(1)(e) of the VAT Act does not unequivocally state whether the necessary assets are assets which are necessary for the purchaser to continue carrying on the enterprise or whether the assets are necessary for the enterprise in question.
84. In this regard we can only assume it to be the former, which seems to be supported by the examples provided in the draft IN. The reason being that the very purpose of the zero-rating provision is to ensure that it only applies if the purchaser actually continues with the enterprise in question, whether in its original or in a different form.



85. It equally follows that certain assets such as fixed property are inherently necessary for the purchase, to continue carrying on a particular enterprise, which is the subject matter of a property rental enterprise.
86. We consider this aspect to be of importance since often the purchaser of an enterprise may be a competitor of the seller, who already has many of the assets necessary to carry on the enterprise, and will not need to acquire all of the purchaser's assets. These can include among other things shop fittings and specialised software.

87. Submission: It is submitted that it will be useful to taxpayers if SARS could clarify this principle in the draft IN, and to then support this with examples.

**Paragraph 3.2 - page 11 - 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**

88. The second paragraph makes reference to section 8(16) of the VAT Act, which essentially provides that where goods or services were utilized partly for taxable and partly for non-taxable purposes, and such goods are subsequently disposed of, such goods or services shall be deemed to be supplied wholly in the course or furtherance of the vendor's enterprise.

89. Submission: For the sake of clarity, and since the sale of many of businesses as going concerns includes assets and liabilities which are not taxable (such as money debtors, creditors etc.) we submit that this paragraph must make it clear that section 8(16) of the VAT Act does not function so as to subject non-taxable goods or services to VAT.

**Paragraph 3.2.1 - Page 12 - Example 7- Goods or services used mainly for purposes of an enterprise disposed of as a going concern**

90. 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.

91. Submission: We recommend that SARS specifically deals with this issue in the draft IN, especially with regards to the deduction in terms of section 16(3)(h) of the VAT Act to which a seller will be entitled to in respect of the erection of farm houses and labourer accommodation.

Yours sincerely



**Christo Theron**

**CHAIRMAN: VAT COMMITTEE**

*The South African Institute of Chartered  
Accountants*

**Pieter Faber**

**SENIOR EXECUTIVE: TAX**