THE SALE OF AN ENTERPRISE AS A GOING CONCERN - SARS' INTERPRETATION

SARS has recently issued a number of publications regarding the Value-Added Tax Act 89 of 1991, including a draft interpretation note relating to the zero-rating of a sale of an enterprise or part thereof as a going concern in terms of section 11(1)(e). The existing VAT Practice Note No 14 of 20 January 1995 will be replaced with effect from 1 April 2009 and comments are to be submitted by 31 July 2009.

REQUIREMENTS FOR ZERO - RATING

The content of the draft interpretation note, to an extent, amplifies the provisions of the existing Practice Note and updates same. For instance, the prevailing thresholds which are applied for purposes of registration as a VAT vendor are incorporated in the draft interpretation note.

The focus of the draft interpretation note remains the fundamental requirements which must be satisfied to qualify for zero-rating. It is necessary that -

1. the seller and purchaser are registered vendors
2. the supply consists of an enterprise or part thereof which is capable of
3. separation operation
4. the parties agree in writing that the supply is a going concern
5. the enterprise is an income-earning activity
6. the assets necessary for carrying on an enterprise are disposed of to the purchaser
7. the parties agree in writing that the consideration for the supply includes
8. VAT at the zero-rate.

In concluding any agreement for the disposal of an enterprise or part thereof as a going concern, the taxpayer must therefore carefully implement the requirements of section 11(1)(e). A failure to meet the formalities of section 11(1)(e) will automatically preclude the application of any zero-rating of a transaction. In this regard, SARS has issued a previous Interpretation Note No. 31 describing the required documentary proof to be submitted.

FURTHER CLARIFICATION

There have, however, been a number of instances where the application of the formalities prescribed in section 11(1)(e) have been considered by the Courts. For example, in the case of Milner Street Properties (Pty) Ltd v Eckstein Properties (Pty) Ltd, the Court had to consider if the rectification of an agreement to formally incorporate the requirements of section 11(1)(e) was possible and concluded that the amendment to the legislation did not preclude such rectification.

It is therefore of interest, that SARS has provided further clarification in the draft interpretation note regarding -

1. the backdating of any registration of the purchaser as a vendor
2. the meaning of 'disposal'
3. the requirements regarding the written record of the agreement between the parties and in particular, the ability to conclude an addendum incorporating
4. the provisions of section 11(1)(e) to the extent that the main agreement failed to do so
5. the implications of the inclusion of any suspensive conditions to any sale agreement.

REGISTRATION AS A VENDOR

From a practical perspective, it is necessary that both the seller and the purchaser be registered VAT vendors as at the date of the supply. In the draft interpretation note, it is clarified that the intention of the purchaser to register as a vendor must be evidenced in the sale agreement for any backdating of any registration to be considered by the Commissioner. The implication of this is that in drafting any sale agreement, it must be explicit regarding the intention for any purchaser to become a registered vendor.

DISPOSALS

In respect of the requirement that the assets necessary for carrying on an enterprise are disposed of to the purchaser, it is indicated in the draft interpretation note that previously the meaning of the phrase "disposal of" was limiting in that it referred to an outright sale of assets. It is now suggested that the preferable interpretation will be to include an outright sale as well as lease or rental of assets necessary for the carrying on of the enterprise. It is emphasised that the lease or rental must give effect to the supply of a business as a going concern and not simply purport to do so. This wider interpretation may be of assistance in cases where as an interim measure assets are to be leased to facilitate the transfer of a going concern.

EXECUTION IN WRITING

Importantly, it is indicated in the draft interpretation note that it is possible for an addendum to the sale agreement to be concluded if in the sale agreement the parties did not record the formalities of section 11(1)(e) and thereby avoiding the application to Court for rectification such as in the Milner case. The addendum will only be accepted if it complies with the requirements of section 11(1)(e) and 11(3) and if it was entered into before the date on which the tax period ends during which the time of supply for the going concern occurs. It will therefore be important that in making use of this exemption that the appropriate agreement is entered into timeously.

CONFIRMATION OF VAT LIABILITY

From a practical perspective, taxpayers are advised that provision should be made in the sale agreement for VAT to be levied at the rate of 14% in the event that the supply does not qualify to be zero-rated. This will ensure that there is no uncertainty between the parties.

SUSPENSIVE CONDITIONS

In the instance where a suspensive conditions are included in a sale agreement, it is only once the fulfilment of the suspensive conditions and transfer of ownership to the purchaser occurs that the purchasing vendor will be liable to account for input and output tax from the date of fulfilment of the conditions.

The newly released draft interpretation note therefore provides further clarification regarding the application of the requirements of section 11(1)(e). To an extent, SARS' interpretation assists in providing additional certainty and flexibility to the taxpayer, particularly with reference to the nature of the disposal and the ability to conclude an addendum