

DRAFT INTERPRETATION NOTE 57 (Issue 2)

DATE:

ACT : VALUE-ADDED TAX ACT 89 OF 1991
SECTIONS : SECTIONS 8(7), 8(16), 11(1)(e) AND 18A
SUBJECT : DISPOSAL OF AN ENTERPRISE OR PART THEREOF AS A GOING CONCERN

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Preamble

In this Note unless the context indicates otherwise –

- a vendor being entitled to an input tax deduction will be subject to the vendor complying with the provisions of section 16(3) read with the definition of the term “input tax” and sections 16(2), 17 and 20;
- “**enterprise disposed of as a going concern**” includes any separate part of an enterprise capable of separate operation which is disposed of as a going concern;
- “**section**” means a section of the VAT Act;
- “**VAT Act**” means the Value-Added Tax Act 89 of 1991; and
- any word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This Note sets out the –

- VAT implications regarding the supply of an enterprise disposed of as a going concern;
- requirements for zero-rating the supply of an enterprise disposed of as a going concern; and
- VAT treatment of the supply of goods or services used partly for carrying on the enterprise disposed of as a going concern and partly for other purposes.

2. The law

The relevant sections of the VAT Act are quoted in the **Annexure**.

3. Application of the law

A vendor making taxable supplies of goods or services in the course or furtherance of its enterprise, is required under section 7(1)(a) to levy VAT at the standard rate on these supplies. However, this levying of VAT is subject to the zero-rating provisions of section 11.

The disposal of an enterprise as a going concern is deemed, under section 8(7), to be a supply of goods made in the course or furtherance of this enterprise. This supply of goods may be zero-rated under section 11(1)(e).

3.1 Requirements of section 11(1)(e)

In order for the supply of an enterprise to be subject to VAT at the zero rate, under section 11(1)(e), certain requirements must be met. Section 11(1)(e) contains the following six requirements:

- The seller and purchaser must be registered vendors.
- The supply must consist of an enterprise or part of an enterprise which is capable of separate operation.
- The parties must agree in writing that the supply is that of a going concern.

- The seller and purchaser must, at the conclusion of the agreement for the disposal of the enterprise, agree in writing that this enterprise will be an income-earning activity on the date of transfer of this enterprise.
- The seller must dispose of the assets which are necessary for carrying on the enterprise to the purchaser.
- The parties must agree in writing that the consideration for the supply includes VAT at the zero rate.

The aforementioned six requirements are discussed in further detail below.

3.1.1 The seller and purchaser must be registered vendors

A person that carries on an enterprise is liable to register for VAT under section 23(1) if the total value of taxable supplies made by that person, in the course or furtherance of that person's enterprise, exceeds R1 000 000 in any 12-month period or will exceed that amount under a contractual obligation in writing. A person will not be obliged to register as a vendor if the total value of that person's taxable supplies in a 12-month period will exceed the R1 000 000 limit merely as a result of, amongst others, the sale of that person's enterprise.

Non-resident suppliers of certain electronic services are required to register for VAT at the end of the month in which the total value of the taxable supplies exceeds R50 000.

A person may apply for voluntary registration, under section 23(3) even though the total value of taxable supplies is less than R1 000 000 if that person amongst others –

- carries on an enterprise and the value of taxable supplies made has exceeded the minimum threshold of R50 000 in the past 12-month period;
- supplies commercial accommodation, provided the minimum threshold of R120 000 is met;
- carries on an enterprise and the value of taxable supplies has not exceeded the R50 000 minimum threshold but can reasonably be expected to exceed that threshold within 12 months from the date of registration;¹ or
- intends to carry on an enterprise, from a future date, as a result of purchasing a going concern and the value of the taxable supplies made by the supplier of the going concern has exceeded R50 000 in the past 12-month period.

The Commissioner will determine the effective date of registration as a vendor upon receipt of an application provided the applicant has satisfied the requirements to be registered voluntarily.

The seller must be a registered vendor

Only a vendor can make a taxable supply of goods or services and charge VAT at the standard rate under section 7(1)(a) or at the zero rate under section 11. Accordingly, in order for an enterprise to be supplied as a going concern at the zero rate under section 11(1)(e), the seller must be a registered vendor.

¹ Regulation 447 in *Government Gazette* 38836 of 29 May 2015.

The purchaser must be a registered vendor

Section 11(1)(e) requires that the **supply** must be to a registered vendor but does not stipulate the date on which the purchaser is required to be registered as a vendor.

In terms of the rules regulating the time of supply in section 9(1),² the purchaser is required to be registered as a vendor at the time the supply is deemed to take place, which is the earlier of the time an invoice is issued for the supply or payment of the consideration is received by the seller. Any deposit (not being a deposit for a returnable container) received in respect of the purchase price is not regarded as consideration received until such time that the deposit is applied as payment for the supply of goods or services. Therefore, the time of supply is not triggered when payment of a deposit is received provided the deposit is not applied as payment for the supply.

An “invoice” is defined in section 1(1) as a document notifying an obligation to make payment. Therefore, an agreement for the sale of an enterprise disposed of as a going concern will constitute an invoice where it does not contain any suspensive conditions.³ It follows that, once the agreement is signed by both the seller and the purchaser, the agreement will constitute an invoice and the time of supply will be triggered. In this case the purchaser is required to be registered as a vendor before concluding the agreement for the sale of an enterprise disposed of as a going concern in order to meet the requirements of section 11(1)(e).

Due to the risks associated with fraudulent refunds and illegitimate registrations, 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.

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 (that is, the Notice of Registration) within a period of 90 days⁴ calculated from the time of supply being the date on which an invoice is issued (for example, the date on which the agreement is concluded) or payment is received, whichever is earlier. Purchasers must ensure that they are registered as vendors with effect from the date on which the time of supply occurred.

The seller must include the value of the supply in field 2 of the VAT return in the tax period in which the time of supply occurs.

In the event that the purchaser fails to obtain the Notice of Registration within the prescribed 90-day period, the zero-rating provisions of section 11(1)(e) cannot apply. The seller will be required to account for output tax on the supply of the going concern by effecting an adjustment. Under section 64, the purchase price is deemed to include VAT and as such, the output tax is calculated by applying the tax fraction to the consideration for the supply. The seller must include such output tax in field 12 of the VAT return in the tax period in which the 90-day period expires.

² In the case of connected persons, the time of supply as set out in section 9(2) will apply.

³ A suspensive condition suspends the operation of all or some of the obligations flowing from the contract until the occurrence of a future uncertain event. Lexus Nexis, *Law of Contract in South Africa*, Christie, 5th Edition, 2006.

⁴ Refer to Interpretation Note 31 (Issue 4) dated 9 March 2016.

It is therefore advisable that the agreement provides for the application of the zero rate subject to the purchaser being a registered vendor with effect from the date an invoice is issued or payment is made, whichever is earlier.

3.1.2 Supply of an enterprise or part of an enterprise which is capable of separate operation

The definition of “enterprise” specifically excludes, under proviso (v) to the definition, activities to the extent it involves the making of exempt supplies. Therefore, the sale or disposal of a business which only makes exempt supplies does not constitute the supply of an “enterprise” as required under section 11(1)(e).

Example 1 – Supply of a business making exempt supplies

Facts:

A sells ABC Learning, a school which only supplies educational services, to B.

Is the supply of ABC Learning zero-rated under section 11(1)(e)?

Result:

ABC Learning only supplies educational services, which are exempt from VAT under section 12(h)(i). The supply of educational services cannot be zero-rated as it does not constitute the supply of an enterprise as envisaged under section 11(1)(e).

Example 2 – Supply of an activity of making exempt supplies

Facts:

J, the majority shareholder in 123 Trading, sells all of the shares held in 123 Trading to K.

Is the sale of the shares zero-rated under section 11(1)(e)?

Result:

The change in ownership in an enterprise as a result of the sale of shares in a company is not the supply of an enterprise. The supply of shares is exempt from VAT under section 12(a) read together with section 2(1)(d). Therefore, the supply of the shares in 123 Trading cannot be zero-rated under section 11(1)(e).

“Part of an enterprise which is capable of separate operation” includes a “stand alone” division of a business or some of the outlets of a business which are operated at various locations. 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.

Example 3 – Supply of an enterprise capable of separate operation

Facts:

X owns an office park consisting of four free-standing and fully tenanted buildings in which a commercial leasing enterprise is conducted. X sells the commercial leasing enterprise including, one of the buildings (Block A), all the leases and equipment to Y.

Is the supply of the commercial property leasing enterprise an enterprise capable of separate operation?

Result:

The building and leases transferred to Y are capable of separate operation by Y as Y is placed in a position to carry on the commercial leasing enterprise separately from X.

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

This requirement gives effect to the intention of the contracting parties to dispose of the enterprise as a going concern and avoids further intervention where a dispute arises regarding the rate of tax to be applied. Therefore, if the parties have not agreed about this aspect in writing, the zero rate cannot apply even if the enterprise is in fact supplied as a going concern. Compliance with this requirement is further illustrated below.

In the case of *Milner Street Properties v Eckstein Properties Pty (Ltd)*,⁵ the written agreement did not comply with the requirements contained in section 11(1)(e) as it did not state that the enterprise is disposed of as a going concern. The parties failed to appreciate that certain facts had to be formally recorded in writing to apply the zero rate. The issue before the court was whether an agreement that was intended by the parties to be a zero-rated VAT disposal from one vendor to another of an enterprise as a going concern but which failed to satisfy the formal requirements imposed by section 11(1)(e) could be rectified, with retrospective effect, so as to satisfy those requirements.

The court *a quo* granted the seller the right to rectify the agreement in order to comply with the formalities contained in section 11(1)(e). The court stated that the non-compliance with the formalities prescribed by section 11(1)(e) concerns not the conclusion and hence the formal validity of the transaction but a *fiscal* consequence of the non-compliance, that is, the rate at which VAT is to be levied.⁶ The court stated that the formalities required under section 11(1)(e) are not constitutive but probative: the underlying purpose of the legislation will be enhanced, not undermined if the rectification is granted.⁷ The court *a quo* stated that the requirement at hand was inserted “largely for the benefit of the Commissioner to enable him to determine whether what was supplied was indeed an enterprise which was supplied as a going concern and to satisfy him that the parties, when they concluded the agreement, did indeed contemplate that the enterprise would be an income-earning activity at the date of its transfer”. This case illustrates the necessity to comply with the formal requirements contained in section 11(1)(e) in order to apply the zero rate as the court did not dispense with the requirement that the parties must agree, in writing, that the enterprise is disposed of as a going concern despite the fact that it was clear that the parties intended to dispose of the enterprise as a going concern.

⁵ 2001 (4) SA 1315 (SCA), 2002 (2) JTLR 41.

⁶ In 26.

⁷ In 27.

The term “going concern” is not defined in the VAT Act and it is therefore necessary to determine the ordinary meaning. The Oxford Dictionary⁸ defines “going concern” as –

“a business that is operating and making a profit”.

Therefore, in order to comply with this requirement the parties must merely agree in writing to dispose of an existing business. Although section 11(1)(e) does not define the term “going concern”, it does provide for further requirements that must be met in order for a supply of an enterprise to be the supply of a going concern.

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 of section 11(1)(e), and the seller is required to account for output tax by effecting an adjustment. The output tax must be calculated as set out in **3.1.1**, and the consideration must be reflected in field 11 of the VAT return relating to the period in which the date of transfer occurs.

Example 4 – Agreement for the sale of an enterprise as a going concern

Facts:

A and B enter into a written agreement for the sale of a commercial property leasing enterprise, including buildings, office equipment and existing leases. In terms of the agreement A and B agree that the sale is that of a going concern. However, it later transpires that only a vacant building was transferred and not an income-earning activity.

Is the supply of the commercial property leasing enterprise zero-rated under section 11(1)(e)?

Result:

All the requirements of section 11(1)(e) have not been complied with and as a result the supply must be subject to VAT at the standard rate, irrespective of what the agreement states. In addition, the seller will also be liable for interest and penalties on the late payment of the VAT relating to the supply of the enterprise.

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

Owing to the fact that transfer of the enterprise only takes place in the future, there is no certainty at the time of signing the agreement that the enterprise will in fact be “income-earning” when transfer takes place. This requirement indicates that at the time of concluding the agreement⁹ the parties must both have the intention that the enterprise will be income-earning when transferred. At the date of transfer a further test must be applied to determine whether an income-earning activity has in fact been transferred. This requirement must be specifically stated in the agreement in order to clearly give effect to the intention of the parties that the enterprise will be an income-earning activity at the date of transfer. In the event that the enterprise is not

⁸ https://en.oxforddictionaries.com/definition/going_concern [Accessed 22 March 2017].

⁹ In the case of a written agreement, the date of the last signature is the date of conclusion of the agreement.

an income-earning activity, as agreed at the date of transfer, the zero rate will not apply.

In addition, where it was never possible that the enterprise would be an income-earning activity at the date of transfer, the supply cannot be zero-rated irrespective of what the agreement provides. For instance, irrespective of whether parties agree in writing that a commercial leasing business, which includes the transfer of existing leases that expire before the date of transfer and the seller has not subsequently made any attempt to enter into new lease agreements, will be income-earning at the date of transfer, it does not alter the fact that what was transferred was not an income-earning activity. In this instance there was never a possibility that the sale of the commercial leasing business will constitute a going concern (that is, there was no possibility of performance in terms of the contract).

The agreement must provide for the sale of an independent income-earning activity together with the necessary infrastructure, and the purchaser must be placed in possession of a business which can be operated in that same form, without any further action on the part of the purchaser. The parties must therefore agree that the enterprise will remain active and operating until its transfer to new ownership.

Example 5 – Income-earning activity

Facts:

Company A is a registered vendor and conducts a manufacturing activity in a specially designed manufacturing plant. Company A conducts its manufacturing activity on premises (fixed property) fitted with specialised equipment which it leases from Property Company B. Company A enters into an agreement with Company C to sell the manufacturing activity, which includes all the assets necessary for carrying on the enterprise. In terms of the agreement, Company A will terminate the lease for the building with Property Company B. The building is an integral part of the manufacturing activity conducted by Company A, in terms of the agreement, and requires Company C to enter into a simultaneous lease agreement with Property Company B. Company C enters into a separate lease agreement with Property Company B for the lease of the building that was previously leased by Company A.

Will the sale of the manufacturing activity constitute the sale of an income-earning activity?

Result:

The agreement for the sale of the manufacturing activity read together with the lease agreement entered into between Property Company B and Company C will ensure that the sale constitutes a going concern as Property Company B is required to lease the premises to Company C in order for the manufacturing business to constitute an income-earning activity on date of transfer and to place Company C in a position to continue operating this manufacturing business. In the instance that the premises was not an integral part of the manufacturing activity of Company A (that is, the business could still continue trading if relocated to a different venue), the sale agreement comprising of only the sale of the manufacturing activity together with the assets necessary for carrying on the business, would satisfy the requirements of an income-earning activity.¹⁰

The following scenarios provide guidelines as to what will or will not constitute an income-earning activity.

Farming activities

The mere sale of farm land does not constitute the supply of a farming enterprise and is rather the supply of a capital asset used in a farming enterprise. In order to supply a farming enterprise as a going concern, the seller and purchaser must agree in writing that the income-earning activities of the farm are disposed of together with, amongst others, the crops, livestock, assets and equipment necessary for carrying on these farming activities.

Leasing activities

Leasing activities generally consist of, amongst others, –

- an underlying asset that is the subject of a taxable leasing activity (a building, premises, hotel etc.); and
- a lease agreement.

A vendor conducting a leasing activity in respect of fixed property and intending to supply an enterprise comprising the leasing activity must therefore make provision in the contract stating that existing lease agreements and any other assets necessary for carrying on the enterprise are disposed of together with the fixed property in order to constitute an income-earning activity. Section 11(1)(e) will not apply if the agreement does not provide for a property together with the lease agreements to be transferred and only the property is sold. The supply of a business comprising only an exempt activity such as residential leasing, or the supply of an underlying asset applied for residential leasing will neither be that of an enterprise supplied as a going concern nor a taxable supply.

Fixed property sold to the tenant

An agreement to sell fixed property to a sole tenant does not constitute the disposal of a going concern, as the income-earning activity (being the leasing activity) is not sold to the purchaser. The purchaser obtains a capital asset without the capacity to continue the leasing activity.

¹⁰ The VAT rate on disposal of the enterprise as a going concern from Company A to Company C (zero-rated) will differ from the supply of the right of use of the property from Company B to Company C (standard-rated), in terms of the lease agreement.

Sale and lease back

There is no agreement to sell an income-earning activity if the agreement provides that the seller being the occupier or user of an asset will lease the asset back from the purchaser. In this instance, at the time of entering into the sale agreement there is no income-earning activity and the parties merely agree to sell a capital asset as the leasing activity (that is, the income-earning activity) will only commence following the sale of the asset.

Business yet to commence or dormant business

An asset which is merely capable of being operated as a business does not constitute an income-earning activity as there must be an actual or current operation. For this reason, the agreement to dispose of a business yet to commence or a dormant business is not a going concern.

As the parties must agree that the enterprise will on the date of transfer of the enterprise be an income-earning activity, the zero rate can apply where the seller is in terms of the contract obliged to start the business and ensure it is income-earning before transfer the enterprise. Furthermore, 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.

Example 6 – Business yet to commence or dormant business

Facts:

Company A is a registered vendor and has decided, in addition to its current activities, to commence with a property construction activity. Company A acquires fixed property with the intention to develop residential units and sell the individual units to prospective buyers. However, before construction of the residential units commences, Company A experiences financial difficulties and sells the property construction activity together with the property and building plans to Property Company B.

Does the supply of Company A's enterprise activity constitute an income-earning activity?

Result:

Company A's enterprise activity which is being sold to Property Company B was not an income-earning activity before it was sold and neither will it be an income-earning activity on the date ownership of the property is transferred to Property Company B.

Sale of share block shares

A vendor, that has applied its share block shares for purposes of making taxable supplies and subsequently supplies these shares to another registered vendor, may zero-rate the supply if the parties agree that the enterprise carried on in relation to the share block is disposed of as an income-earning activity by way of the supply of the shares.

3.1.5 Disposal of the assets which are necessary for carrying on the enterprise

The assets which are necessary for carrying on the enterprise must be disposed of by the seller to the purchaser and the assets which are not necessary for carrying on the enterprise need not be disposed of with the enterprise. The seller may, for example, decide to retain certain assets or the purchaser can decide not to purchase certain old stock or book debts without affecting the application of the zero-rating.

The term “dispose” in the context of “dispose of” means, amongst others, giving or selling to someone else.¹¹ Therefore, the phrase “disposed of”, within the context of section 11(1)(e), can be interpreted to include an outright sale as well as a lease or rental of the assets necessary for the carrying on of the enterprise. While the sale of the enterprise as a going concern can be a zero-rated supply, the lease or rental to the purchaser of the assets necessary for the carrying on of the enterprise will be a standard-rated supply. The purpose of entering into lease or rental agreements in respect of assets must be to give effect to, and not merely to purport, the supply of a business which is a going concern and an income-earning activity.

3.1.6 Parties agree in writing that the consideration includes VAT at the zero rate

In the event that the enterprise is not disposed of as a going concern or any of the requirements of section 11(1)(e) as discussed are not complied with, the supply cannot be zero-rated. As a result, a dispute may arise as to whether the consideration agreed includes VAT at the standard rate. In the event that the parties agree that the consideration for the supply is inclusive of VAT at the rate of zero per cent, the output tax should be determined by applying the tax fraction to the consideration received.

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

It is common cause that in carrying on an enterprise, a vendor may acquire goods or services used for purposes of making taxable and other (non-taxable) supplies.

Generally, the supply of goods or services used or held by a vendor for purposes of making non-taxable supplies, would not be subject to VAT as these goods or services are normally not supplied in the course or furtherance of the vendor's enterprise. In order to determine the VAT treatment of goods or services held or applied partly for purposes of carrying on an enterprise disposed of as a going concern and partly for other purposes, it is necessary to determine whether proviso (ii) to section 11(1)(e) or section 8(16) is applicable as discussed below.

3.2.1 Goods or services used mainly for purposes of an enterprise disposed of as a going concern

This proviso was introduced in order to prevent apportioning the selling price where goods or services were applied partly for purposes of the enterprise disposed of as a going concern and partly for other purposes. This proviso requires the vendor to determine whether these goods or services, which were used partly for carrying on the enterprise disposed of as a going concern and partly for other non-taxable purposes, were applied mainly (that is a quantitative measurement of more than 50%) for the purpose of the enterprise disposed of as a going concern. Goods or services that were applied mainly for purposes of the enterprise disposed of as a

¹¹ <https://en.oxforddictionaries.com/definition/dispose> [Accessed 22 March 2017].

going concern, shall be deemed to form part of the enterprise disposed of as a going concern and are subject to VAT at the zero rate under section 11(1)(e).

Generally, under paragraph (v) to the proviso of the definition of “enterprise” when a vendor acquires goods or services which are used partly for making exempt supplies, these goods or services are deemed not to form part of the carrying on of the enterprise to the extent of any exempt activities. Ordinarily this would require the vendor to apply section 8(16) and charge VAT at the standard rate on the assets when they are sold. However, proviso (ii) deems these goods or services to form part of the enterprise disposed of as a going concern. The full supply is subject to VAT at the zero rate, despite the fact that the goods or services may have been partly applied for making exempt supplies. However, the purchaser will be required to make an adjustment as contemplated in section 18A if the enterprise, goods or services concerned will be used by the purchaser less than 95% for making taxable supplies.¹²

Example 7 – Goods or services used mainly for purposes of a going concern

Facts:

Farmer B, a registered vendor, uses farm land for purposes of farming crops and cattle (taxable supplies), providing accommodation to labourers (exempt supplies) and housing for the farmer’s family in the farm house (non-taxable supply). Farmer B sells the farming enterprise to Farmer G as a going concern and the parties agree that the supply will be zero-rated (that is, the parties agree that the farming part of the enterprise will be transferred as an income-earning activity at the zero rate.)

The farm land is used as follows:

- 60% for planting crops;
- 10% for grazing land;
- 20% for the farmhouse;
- 10% for the labourer’s accommodation.

Can the supply of the entire farm land, including the portion used for purposes of making non-taxable supplies constitute a going concern which is zero-rated under section 11(1)(e)?

Result:

Owing to the fact that the farm is used mainly (60% for planting crops plus 10% for grazing land = 70%) for farming enterprise activities, the farm land is deemed to form part of the supply of the farming enterprise, and therefore the total value of the farm is subject to VAT at the zero rate under proviso (ii) to section 11(1)(e).

As a result, Farmer B is entitled to deduct, under section 16(3)(h), the portion of input tax previously denied on acquisition of the farm, that is, the portion of the farm used for making non-taxable supplies.

In the event that Farmer G applies the farm the same way as Farmer B, an adjustment will be required under section 18A (this adjustment is discussed in further detail below).

¹² The application of section 18A is discussed in further detail in **3.3**.

3.2.2 Goods or services not used mainly for purposes of an enterprise disposed of as a going concern

Proviso (ii) to section 11(1)(e) will not apply if goods or services are not applied mainly for the enterprise disposed of as a going concern. The subsequent supply of those goods or services will fall within section 8(16) and will be subject to VAT at the standard rate despite the fact that the good or services have been used partly for making non-taxable supplies as discussed below.

Section 8(16) deems the supply by a vendor of any goods¹³ or services acquired previously and held or applied partly for purposes of making taxable supplies and partly for making non-taxable supplies, to be a fully taxable supply made in the course or furtherance of its enterprise despite the fact that these goods or services were only partly used for its enterprise activities. As a result, the vendor must account for output tax under section 7(1)(a) on the full value of these goods or services supplied. It follows that the vendor making this supply may deduct the input tax that was previously denied in respect of the “non-taxable” portion of the supply in accordance with section 16(3)(h).

Example 8 – Goods or services not used mainly for purposes of an enterprise disposed of as a going concern

Facts:

K, a registered vendor uses 40% of farm land for purposes of growing grapes for wine making (taxable supply) and 60% for making non-taxable supplies. K sells the wine making enterprise to J as a going concern and the parties agree that the supply will be subject to VAT at the zero rate.

Can the supply of the entire farm, including the portion used for purposes of making non-taxable supplies constitute a going concern which is zero-rated under section 11(1)(e)?

Result:

Proviso (ii) to section 11(1)(e) does not apply because the farm land, which is an integral part of the supply, is not used mainly for purposes of conducting the wine-making activities. As a result, the supply of the wine-making enterprise does not constitute a going concern and the supply cannot be zero-rated under section 11(1)(e). The supply is subject to VAT at the standard rate and VAT must therefore be levied on the full value of the supply.

The supply of the land, which is applied for making taxable and non-taxable supplies, is deemed to be a taxable supply under section 8(16). As a result, K is entitled to a deduction envisaged in section 16(3)(h) on the portion of input tax previously denied (that is, the portion that is used for making non-taxable supplies).

J is entitled to deduct input tax on the acquisition of the land to the extent that the land is used in the course of carrying on the wine-making business.

¹³ No such deemed supply will arise, where the goods supplied consist of fixed property acquired by the vendor before the commencement date, the vendor is a natural person, the property was used by the vendor mainly as private residence and no deduction of any input tax has been made in relation to the property.

3.3 Going concern acquired wholly or partly for purposes other than making taxable supplies

The term “input tax” is defined in section 1(1) to mean, amongst others, the VAT paid by a vendor on a taxable supply of goods or services acquired for the consumption, use or supply in the course of making taxable supplies. In the case where goods or services are acquired by a vendor partly for making taxable supplies and partly for making non-taxable supplies, input tax may only be deducted to the extent that the goods or services are to be used, consumed or supplied by the vendor in the course of making taxable supplies.

By granting the zero rate in section 11(1)(e), the law envisages that, had VAT been charged at the standard rate, the transaction between the vendors would result in neutrality. In the event that the sale of an enterprise as a going concern was standard-rated, the seller would be obligated to account for output tax in relation to the purchase price received. The purchaser would in turn be entitled to deduct the VAT incurred as input tax to the extent that the enterprise or any goods or services which formed part of this enterprise will be used by the vendor in the course of making taxable supplies.

If the aforementioned transaction is subject to VAT at the zero rate, the purchaser is effectively being granted the right to deduct input tax in full as the assumption is that the enterprise or goods or services which formed part of this enterprise is acquired wholly for consumption, use or supply in the course of making taxable supplies. However, in the event the aforementioned enterprise or goods or services which formed part of this enterprise is only partly used or consumed in the course or furtherance of making taxable supplies, the vendor is effectively obtaining an undue input tax deduction. Section 18A therefore creates a consistent VAT treatment in the case where a supply of an enterprise as a going concern is subject to VAT at the standard- or zero-rate by requiring the purchaser, subsequent to acquisition, to account for output tax on a portion of the purchase price. This output tax adjustment is equivalent to the amount of VAT which a vendor would not be entitled to deduct as input tax had the aforementioned supply been subject to VAT at the standard rate.

In light of the above, a vendor that acquires an enterprise or goods or services which formed part of this enterprise as a going concern,¹⁴ and the intended taxable use of the enterprise or the goods or services is less than 95% of the total intended use, shall be deemed to make a taxable supply in the course of its enterprise under section 18A(1). As a result, the vendor must account for output tax, under section 18A(2), on the value of the supply which is calculated by deducting the portion of the consideration to be applied for taxable purposes from the total consideration paid for the going concern subject to the two provisos. The portion to be applied for taxable purposes can be determined by applying the ratio of intended use for taxable purposes to the total consideration. In the event that an enterprise, disposed of as a going concern is acquired from a connected person for either no consideration or, a consideration which is less than the open market value of the supply, the acquiring vendor must account for output tax, under proviso (ii) to section 18A(2) on the open market value of the supply.

Under the proviso to section 18A(1), where the intended use of this enterprise or the goods or services which formed part of the enterprise in the course of making taxable supplies exceeds 95% of the total intended use, the enterprise or goods or services

¹⁴ An enterprise which was subject to VAT at the zero rate under section 11(1)(e).

which formed part of this enterprise may be regarded as having been acquired wholly for making taxable supplies. In these instances the vendor acquiring the enterprise or goods or services which formed part of this enterprise, is not required to make the adjustment contemplated in section 18A(1).

Example 9 – Going concern acquired wholly or partly for purposes other than making taxable supplies

Facts:

Property Company XYZ is a registered vendor that sells a commercial leasing enterprise to School ABC, a private college established under the Further Education and Training Colleges Act 16 of 2006. School ABC is registered as a vendor to the extent of its property rental activities. The written contract between the parties complies with the requirements of section 11(1)(e) and the supply of the commercial leasing enterprise is zero-rated under section 11(1)(e). At the date of transfer, 70% of the building is occupied by tenants. The consideration payable for the building is R5 million. The time of supply occurs on 25 March 2015. Property Company XYZ declares this amount as a zero-rated sale in field 2 of its March 2015 VAT return.

School ABC, however, acquires the property with the intention of using the 30% vacant space in the building for purposes of supplying exempt educational services. School ABC accounts for VAT on a monthly basis under category C.

What are the VAT implications for School ABC when it acquires the building?

Result:

School ABC does not acquire the building with the intention of applying it more than 95% for making taxable supplies, and is deemed, under section 18A(1) to make a taxable supply and required to effect an output tax adjustment in its March 2015 VAT return. In view of this, School ABC is required to account for output tax of R210 000 (which is calculated below) in field 11 of its March 2015 VAT return:

	R
Purchase price	5 000 000
Section 18A value [R5 000 000 × 30%*]	1 500 000
VAT @ 14% [R1 500 000 × 14 / 100]	210 000

The adjustment places School ABC in the same position as it would have been, had it acquired the building under a standard-rated supply.

* Percentage used for other than taxable purposes 30%

3.5 Tax invoices

Generally, the sale of a business results in changes in the registered details of the business (for example, name, registered address and VAT registration number), which would now reflect the purchaser's details. For instance, the seller's VAT registration number cannot be transferred or allocated to the purchaser as the purchaser will either already have a VAT registration number or it will receive a new VAT registration number. This change in the purchaser's details must be communicated to its suppliers who require time to update their records. Accordingly, these suppliers may issue tax invoices bearing the incorrect details when making supplies to the new owner.

Sections 20(5A) and 21(8) provide for a transitional arrangement for a vendor that has acquired an enterprise from another vendor that has subsequently deregistered as a vendor. In this regard, a tax invoice, debit or credit note issued by a supplier of goods or services may reflect the name, address and VAT registration number of the recipient (the seller of the enterprise in this instance) for a maximum of six months from the date of the supply of the enterprise. This transitional arrangement therefore allows a purchaser of an enterprise acquired as a going concern to deduct input tax despite the fact that the invoice or debit note reflects the details of the seller of the enterprise.

3.6 Documentary proof

The supply of an enterprise disposed of as a going concern which can be zero-rated under section 11(1)(e) is subject to the supplying vendor retaining certain documentary proof.

In Interpretation Note 31 (Issue 4) dated 9 March 2016 “Documentary Proof Required for the Zero-Rating of Goods or Services”, the documentary proof required for a supply contemplated in section 11(1)(e) is –

- (a) a copy of the contract of sale between the recipient and the vendor confirming in writing that –
 - (i) the enterprise or part of the enterprise –
 - (aa) is disposed of as a going concern; and
 - (bb) will be an income-earning activity on the date of transfer;
 - (ii) the assets necessary for carrying on the enterprise or part of this enterprise must be disposed of to the purchaser; and
 - (iii) the consideration for the supply includes VAT at the zero rate;
- (b) tax invoice; and
- (c) the recipient’s Notice of Registration.

4. Conclusion

A vendor making taxable supplies of goods or services in the course or furtherance of its enterprise, is required under section 7(1)(a) to levy VAT at the standard rate on these supplies. However, this levying of VAT is subject to the zero-rating provisions of section 11.

A vendor applying the zero-rate to a supply that does not comply with the requirements set out in **3.1** and **3.6** is liable for the tax, interest and penalties applicable to that supply.

To the extent that this Note does not provide for a specific scenario regarding the disposal of a going concern, vendors may apply for a VAT ruling or VAT class ruling in writing by sending an e-mail to VATRulings@sars.gov.za or by facsimile to 086 540 9390. The application should consist of a completed VAT301 form, a clearly motivated application and must comply with the provisions of section 79 of the Tax Administration Act 28 of 2011 excluding section 79(4)(f), (k) and (6).

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Annexure – The law

Section 1(1) – Definitions

“enterprise” means—

- (a) in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club;

...

Provided that—

...

- (v) any activity shall to the extent to which it involves the making of exempt supplies not be deemed to be the carrying on of an enterprise;

...

“invoice” means a document notifying an obligation to make payment;

“VAT registration number”, in relation to any vendor, means the number allocated to that vendor by the Commissioner for the purposes of this Act;

Section 8 – Deemed supplies

(7) The disposal of an enterprise as a going concern, or a part thereof which is capable of separate operation, shall for the purposes of this Act be deemed to be a supply of goods made in the course or furtherance of such enterprise.

...

(16) (a) The supply by a vendor—

- (i) of any goods (other than fixed property acquired prior to the commencement date by a vendor who is a natural person if such property was used by him mainly as his private residence and no deduction of any amount has been made by him under section 16(3) in respect of such property); or

(ii) of services,

where such goods or services were acquired or imported by him partly for the purpose of consumption, use or supply in the course of making taxable supplies (including supplies which would have been taxable supplies if section 7 of this Act had been applicable prior to the commencement date) and were held or utilized by him partly for the said purpose immediately prior to the supply by him of such goods or services, shall be deemed to be made wholly in the course or furtherance of his enterprise.

(b) The supply by any vendor of fixed property acquired prior to the commencement date by such vendor, being a natural person, shall be deemed to be made otherwise than in the course or furtherance of his enterprise provided—

- (i) such property was used by him prior to such supply mainly as his private residence; and

(ii) no deduction of any amount has been made by him under section 16(3) in respect of such property.

Section 9 – Time of supply

(1) For the purposes of this Act a supply of goods or services shall, except as otherwise provided in this Act, be deemed to take place at the time an invoice is issued by the supplier or the recipient in respect of that supply or the time any payment of consideration is received by the supplier in respect of that supply, whichever time is earlier.

Section 10 – Value of supply

(1) For the purposes of this Act the following provisions of this section shall apply for determining the value of any supply of goods or services.

(2) The value to be placed on any supply of goods or services shall, save as is otherwise provided in this section, be the amount of the consideration for such supply, as determined in accordance with the provisions of subsection (3), less so much of such amount as represents tax: Provided that—

- (i) there shall be excluded from such consideration the value of any postage stamp as defined in section 1 of the Post Office Act, 1958 (Act No. 44 of 1958), when used in the payment of consideration for any service supplied by the postal company as defined in section 1 of the Post Office Act, 1958;
- (ii) where the portion of the amount of the said consideration which represents tax is not accounted for separately by the vendor, the said portion shall be deemed to be an amount equal to the tax fraction of that consideration.

(3) For the purposes of this Act the amount of any consideration referred to in this section shall be—

- (a) to the extent that such consideration is a consideration in money, the amount of the money; and
- (b) to the extent that such consideration is not a consideration in money, the open market value of that consideration.

Section 11 – Zero-rating

(1) Where, but for this section, a supply of goods would be charged with tax at the rate referred to in section 7(1), such supply of goods shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent where—

- (e) the supply is to a registered vendor of an enterprise or of a part of an enterprise which is capable of separate operation, where the supplier and the recipient have agreed in writing that such enterprise or part, as the case may be, is disposed of as a going concern: Provided that—
 - (i) such enterprise or part, as the case may be, shall not be disposed of as a going concern unless—
 - (aa) such supplier and such recipient have, at the time of the conclusion of the agreement for the disposal of the enterprise or part, as the case may be, agreed in writing that such enterprise or part, as the case may be, will be an income-earning activity on the date of transfer thereof; and
 - (bb) the assets which are necessary for carrying on such enterprise or part, as the case may be, are disposed of by such supplier to such recipient; and
 - (cc) in respect of supplies on or after 1 January 2000, such supplier and such recipient have at the time of the conclusion of the agreement for the disposal of such enterprise or part, as the case may be, agreed in writing that the consideration agreed upon for that supply is inclusive of tax at the rate of zero per cent;

- (ii) where the enterprise or part, as the case may be, disposed of as a going concern has been carried on in, on or in relation to goods or services applied mainly for purposes of such enterprise or part, as the case may be, and partly for other purposes, such goods or services shall, where disposed of to such recipient, for the purposes of this paragraph and section 18A be deemed to form part of such enterprise or part, as the case may be, notwithstanding the provisions of paragraph (v) of the proviso to the definition of “enterprise” in section 1; or

Section 16(3)(h) – Input tax deductions

in the case of a vendor who has supplied goods or services during that tax period otherwise than in terms of section 18(2), an amount determined in accordance with the formula

$$A \times B \times C,$$

in which formula—

“A” represents the tax fraction;

“B” represents the lesser of—

- (i) (aa) the adjusted cost (including any tax forming part of such adjusted cost) to the vendor of the acquisition, manufacture, assembly, construction or production of those goods or services: Provided that where the goods or services were acquired under a supply in respect of which the consideration in money was in terms of section 10(4) deemed to be the open market value of the supply, the adjusted cost of those goods or services shall be deemed to include such open market value to the extent that it exceeds the consideration in money for that supply; or
- (bb) where the vendor was at some time after the acquisition of such goods or services deemed under section 18(4) to have been supplied with such goods or services, the amount which was represented by ‘B’ in the formula contemplated in section 18(4) when such goods or services were deemed to be supplied to the vendor; or
- (cc) where the vendor was at some time after the acquisition of such goods or services required to make an adjustment contemplated in section 18(2) or (5), the amounts then represented by ‘A’ in the formula contemplated in section 10(9) or ‘B’ in the formula contemplated in section 18(5) respectively, in the most recent adjustment made in terms of section 18(2) or (5) by the vendor prior to such supply of goods or services; and
- (ii) the open market value of the supply of those goods or services at the time those goods or services are deemed to be supplied; and

“C” represents the percentage that, immediately before the time of the supply, the use or application of the goods or services for the purpose other than that of making taxable supplies was of the total use or application of the goods or services;

Provided that where such goods consist of second-hand goods contemplated in the proviso to paragraph (b) of the definition of ‘input tax’ in section 1, the amount determined in terms of this subsection shall not exceed the amount of transfer duty or stamp duty, as the case may be, which was or would have been payable, less any amount which has previously been deducted in terms of the provisions of subsection (3)(a)(ii) or (b)(i) of this section or section 18(4) or (5), in respect of such acquisition, original issue or registration of transfer, as the case may be”.

Section 18A – Adjustments in consequence of acquisition of a going concern wholly or partly for purposes other than making taxable supplies

(1) Where—

- (a) an enterprise or part of an enterprise has been supplied to any vendor; and
- (b) the supply of such enterprise or part was charged with tax at the rate of zero per cent in terms of section 11(1) (e); and
- (c) such enterprise or part, as the case may be, or any goods or services which formed part of such enterprise or part are acquired by such vendor wholly or partly for a purpose other than for consumption, use or supply in the course of making taxable supplies,

such enterprise, part, goods or services, as the case may be, shall be deemed to have been supplied by him by way of a taxable supply by him in the course of his enterprise: Provided that where the intended use of such enterprise, part, goods or services, as the case may be, in the course of making taxable supplies is equal to not less than 95 per cent of the total intended use of such enterprise, part, goods or services, as the case may be, the enterprise, part, goods or services concerned may for the purposes of this Act be regarded as having been acquired wholly for the purpose of consumption, use or supply in the course of making taxable supplies.

(2) Notwithstanding anything in this Act, the value of the supply deemed by subsection (1) to have been made by the vendor, shall be the full cost to such vendor of acquiring such enterprise, part, goods or services, as the case may be, reduced by an amount which bears to the amount of such full cost the same ratio as the intended use or application of the enterprise, part, goods or services in the course of making taxable supplies bears to the total intended use or application of the enterprise, part, goods or services: Provided that—

- (i) the cost to such vendor of acquiring such enterprise, part, goods or services may be reduced by any amount which represents an appropriate allocation of such full cost to the acquisition of any goods or services which form part of such enterprise or part of an enterprise and in respect of the acquisition of which by the vendor a deduction of input tax would be denied in terms of section 17(2); or
- (ii) where such enterprise, part, goods or services were acquired—
 - (aa) by means of a supply made by a vendor for no consideration or for a consideration in money which is less than the open market value of the supply; and
 - (bb) in circumstances where the supplier and the recipient are connected persons,

the cost of such enterprise, part, goods or services shall be deemed to be the open market value of the supply of such enterprise, part, goods or services.

(3) Notwithstanding anything in this Act, the supply deemed by subsection (1) to have been made by the vendor shall be deemed to be made in the tax period in which the supply of the enterprise or part of an enterprise is made.

(4) For the purposes of this section and sections 10(9), 18(4) and (5), the cost to the vendor of any goods or services acquired by a vendor in the circumstances contemplated in subsection (1) shall be deemed to be an amount equal to the aggregate of an amount which represents an appropriate allocation of the full cost to the vendor of the enterprise or part of an enterprise to those specific goods or services and an amount determined by applying the rate of tax applicable at the time of supply contemplated in subsection (3) to the amount of such appropriate allocation.