

VAT, TRANSFER DUTY AND FIXED PROPERTY – SEPTEMBER 2018

Value Added Tax is a tax on the value added by each Vendor in the production chain and is imposed each time a taxable supply of goods or services takes place. Each Vendor is required to account for the Vat on the value added by the Vendor. A Vendor is required to account for output tax on any taxable supplies made by the Vendor but is also entitled to deduct from this accounting any input tax incurred by the Vendor.

Fixed Property is defined in the Value Added Tax Act of 1991 ("the Act") as land, a sectional title unit, a share in a share block company and any timesharing interest. The definition of goods in the Act includes fixed property and any real right in fixed property.

Section 23(1)(a) of the Act makes it obligatory for a person who carries on an enterprise to register as a Vat Vendor if the total value of taxable supplies made by that person in a period of twelve months exceeds R1 million, or in terms of subparagraph (b) if there are reasonable grounds for believing that the threshold will be exceeded.

Notwithstanding the foregoing, section 23(3)(d) stipulates that any person who is continuously and regularly carrying on an activity which activity reasonably can expect to result in taxable supplies in excess of R50 000,00 being made in a period of twelve months may apply to the Commissioner for registration as a Vat Vendor. A note on the SARS website however states that "a person may choose to register voluntarily provided the minimum threshold of R50 000,00 has been exceeded in the past twelve month period." In other words, by directive, SARS first requires taxable supplies of R50 000,00 to be made before registration can be effected. This is contrary to the provisions of the Act.

The guidance document published by SARS stipulates that it is sufficient in the Vat 101 application form to furnish the expected total value of taxable supplies for a period of twelve months based upon expected financial information embodied in a business plan. Estimations in the form of business plans have in the past been sufficient to achieve registration. Requirements for registration seem to differ from office to office. Some have stipulated that before registration there must be compliance with section 23(1)(a)

of the Act (the R1 million threshold) which is the obligatory section and not the voluntary registration section. However Section 23(3)(c) allows voluntary registration if it can be proved that the person or entity will acquire an existing qualifying letting enterprise.

If a Vat Vendor conducts business operations from fixed property which is used for the furtherance of the Vendor's Enterprise, the sale of that property by the Vendor will attract liability for Vat. The price is increased by the rate of Vat ruling at the time. The Vat is collected together with the purchase price and paid to SARS with the first VAT return submitted by the Vendor after registration of the property.

A sale of Fixed Property is subject to Vat only if the seller is registered as a Vendor in terms of the Vat Act. This is the rule of thumb to determine whether a transaction attracts liability for Vat or for transfer duty. It is one or the other. If the seller is not a Vendor then Vat is not payable and the purchaser will pay transfer duty. However if Vat is payable, transfer duty is not.

Fixed Property transactions can be categorised in the following manner:-

1. A sale by a Vendor to a Vendor: The seller pays output tax of 15 % of the purchase price and the purchaser claims an input tax credit of 15 % of the purchase price. No transfer duty is payable. For example, the sale by a developer of sectional title units comprising mini factories or subdivisions of industrial land.
2. A Sale by a Vendor to a Vendor of a business, or as termed in the Act, an enterprise, as a going concern: The transaction is zero-rated for VAT purposes. The sale price is recorded to be inclusive of Vat at 0%. The type of enterprise must be stated, such as a farming enterprise. The most common form of a zero-rated transaction is the sale of commercial property subject to an existing lease, namely a letting enterprise. However the sale of the property to the lessee would extinguish the lease and would not qualify as the sale of an enterprise as a going concern. If the lessee formed a separate legal entity to take transfer of the property subject to the lease then the transaction can be zero rated. Similarly if a purchaser wishes to occupy a property through a separate entity, that entity should conclude a lease with the seller and thereafter the property and lease can

be sold to the purchaser as a letting enterprise.

A purchaser must intend at the time of sale to continue the rendering of supplies even though the manner of supply may change. For example a Vendor could purchase a factory comprising ten mini factories and ten leases as a going concern but then elect to sell the factories with or without the leases on a sectional title or share block basis. The purchase would still qualify for zero-rating. The sale can also be of a part of an enterprise.

A prudent seller should insist on a clause in an agreement to record that should the seller become liable for the payment of Vat that the seller will be able immediately to recover payment of the Vat, interest and penalties from the purchaser. A purchaser should not object to the insertion of such a clause as the purchaser would be entitled to claim back an input tax credit. If the clause were not inserted, SARS could, after transfer, resolve that the transaction did not qualify for zero-rating. The Seller would then be called upon to pay VAT of 15% on the purchase price. SARS has issued an Interpretation Note No. 57 date 31 March 2010 which specifies the criteria which must be met for the sale of an enterprise as a going concern to be zero rated. This has been superceded by Issue 2 which is followed even though it is termed a Draft.

3. A Sale by a Vendor to a Non-Vendor: The seller pays output tax of 15% of the purchase price but the purchaser is not entitled to claim an input tax credit. No transfer duty is payable. A typical example is the sale of a residential unit constructed by a property developer. The purchaser is the end-user and is liable for the Vat. If a property developer is unable to sell due to a lack of demand and is obliged to let the units, the Vat becomes payable prior to the date of transfer. The temporary relief for a maximum period of 36 months has been withdrawn.

4. A Sale by a Vendor of an exempt supply being fixed property which previously had been let for residential purposes: No Vat is payable but the purchaser is liable for transfer duty. The exemption would not apply if the Vendor had claimed an input tax credit when buying the property or if the Vendor were to claim input tax in respect of expenses incurred with regard to the property. Caution would need to be exercised if portion of the letting had amounted to “commercial

accommodation” for example let to a university for the purpose of providing accommodation to students.

5. A Sale by a Vendor to a Vendor of a building comprising primarily residential units but including commercial units. Section 18A has application. Vat must be added to the purchase price but the purchaser will be entitled to claim an input tax credit limited to the fraction which the square meterage of the commercial units bears to the total square meterage. (It may be possible to persuade Revenue to accept the apportionment on a rental basis, rather than on an area basis.)
6. A Sale by a Non-Vendor to a Vendor: No Vat is payable but the purchaser will be liable for the payment of transfer duty. Fixed properties are classed as "second hand goods" and the purchaser is entitled, after registration of transfer, to claim a notional or deemed input tax credit equal to 15% of the purchase price. The purchaser pays a maximum of 13% transfer duty but is entitled to claim 15%.
7. A Sale by a Non-Vendor to a Non-Vendor: No Vat is payable or claimable but the transaction is subject to payment of transfer duty by the purchaser.
8. A sale by a Vendor of a shareblock and loan account in a shareblock company will attract Vat but the transfer of the shares will be exempt from the payment of securities transfer tax. The subsequent conversion of the shareblock to sectional title will be exempt from transfer duty if the current market value of the unit at the time of transfer is the same as the purchase price. Transfer duty will however be payable on the difference between the purchase price and the current market value of the unit if the value of the unit at the time of conversion to sectional title is higher than the purchase price paid for the shareblock and loan account.
9. A sale by a Non-Vendor of a shareblock and loan account in a shareblock company will not attract Vat but transfer duty. When converting to sectional title, the purchaser will then be exempt from payment of transfer duty on the market value of the unit.
10. A sale in execution of fixed property attracts Vat unless the Deputy Sheriff, after

making enquiries, is satisfied that the execution debtor (whose property is being sold) is not a Vendor. In that event the purchaser will pay transfer duty.

Output tax is payable at the time of supply which for fixed property is the date of registration of transfer of the property or the date upon which portion of the purchase price is paid to the seller, whichever is the earlier. Payment of a deposit in trust to a Conveyancer or to an Estate Agent is not regarded as a payment and does not trigger liability for the payment of Vat. However if payment is deferred, then Vat is deferred and the input tax credit is not claimable.

If output tax is not paid timeously the Vendor could be liable for the payment of penalty tax of 1 % of the purchase price, interest on the unpaid Vat and an evasion tax.

To claim an input tax credit or a notional input tax credit, the purchaser must be registered as a Vendor at the time of supply which is the date of registration of transfer or the date upon which portion of the purchase price is paid, whichever is the earlier. If the transaction is zero rated, the purchaser must be registered as a Vendor at the date of signature of the agreement unless the agreement is subject to the fulfilment of a suspensive condition. It is preferable to register as a Vendor prior to signature of an agreement.

Considerable difficulty is experienced in applying for registration as a Vat vendor. In property transactions SARS requires to see the signed sale agreement before allowing registration as a Vat vendor. This presents difficulties if the transaction is to be zero rated. Accordingly the Draft Interpretation Note No. 57 has been amended to provide that a purchaser can sign a sale agreement to allow for zero rating provided that within ninety (90) days the purchaser is registered as a Vat vendor with retrospective effect to the date of signature.

The same principle applies if a purchaser signs a purchase and sale agreement as trustee for a company to be formed. Application for registration must be made as soon as the Company has been incorporated.

It is not permissible in law to sign as Trustee for a company which has already been

formed. In such a case the company should be cited as the purchaser and must be represented by a director. Because of delays in registering companies, it is quicker to buy a shelf company than to form a company.

The use of the term "or nominee" should be avoided if transfer duty is payable. Unless there is strict compliance with the Transfer Duty Act, SARS regards a nomination as a second transaction and transfer duty is payable. The term can be used if the transaction is subject to Vat but it is preferable not to do so because of the risk that double Vat could be imposed. However if an option is granted to an option holder or nominee, the nomination can be made by the option holder prior to the exercise of the option so that the nominee will conclude the transaction. The risk of SARS deeming there to have been two sales then falls away.

Caution must be exercised when a property developer who is registered as a Vendor for Vat purposes sells fixed property to a "connected person" as defined in the Vat Act. If the price is less than the open market value of the property and the purchaser is not a Vendor, SARS may deem the purchase price to be the open market value of the property and Vat will be payable calculated on that value. In addition SARS will regard the difference between the purchase price and the value to be a deemed donation on which donations tax of 20% would be payable by the seller (less the exemption of R100 000,00 per annum). If a donation exceeds R30 000 000.00 then the rate of donations tax increases to 25%.

A Vendor who carries on business from his home should not claim input tax credits in respect of the portion of his home which is used for business. If he does, the subsequent sale of his home could attract liability for Vat on the purchase price.

A Vendor who decides to deregister as a Vendor will be obliged to pay Vat of 15% on the ceasing value of the assets in the enterprise. It is preferable therefore first to dispose of the assets in the enterprise to another Vendor before applying for deregistration as a Vendor.

If a Seller is not a Vendor and the purchase price of residential property is less than R900 000,00, the transaction will be exempt from the payment of transfer duty. If transfer duty is payable (on commercial or residential property), the transfer duty is calculated at

the rate of 3% on the value above R900 001,00 up to R1 250 000,00, whereafter the rate increases to 6% up to R1 750 000,00, 8% up to R2 250 000,00, 11% up to R10 000 000.00 and thereafter up to 13% on the value above R10 000 000.00.

If a Non-Vendor sells fixed property to a relative or friend which sale is not at arms length and not concluded through an estate agent, the seller must obtain letters from two independent estate agents or valuers to indicate to SARS what the agents consider to be the current market value of the property. A seller may dispose of fixed property at any price but if the price is less than the current market value SARS will require payment of transfer duty on the current market value determined by the two estate agents or by SARS itself. In addition SARS will require donations tax of 20 % on the deemed donation being the difference between the purchase price and the current market value of the property. If the seller has made no other donations during the financial year, the seller will be entitled to claim an exemption of R100 000,00 being the annual amount exempt from donations tax.

The sale of shares and loan accounts in a residential property company or the sale of the interest in a close corporation which owns residential property attracts liability for transfer duty. Similarly a sale of the beneficial interest in a trust which owns residential property will attract transfer duty. The latter sale should not be attempted because of other fiscal complications. Commercial property sometimes is held in a non-discretionary inter-vivos trust where the benefits vest in the beneficiaries. If the right to the property held by the trust vests in the beneficiaries then a cession of the beneficial interest in the trust would attract transfer duty. Where the right of the beneficiary vests in the proceeds arising from the sale by the trust of the property, it can be argued that the sale and cession of the beneficial interest in such a trust should be exempt from the payment of transfer duty. SARS does not agree.

Vat must be taken into account in every property transaction. The Vat Act stipulates that if Vat is not mentioned, the price is deemed to include Vat. That can have expensive consequences for an unwary seller. In one case the court held that as the buyer had expected to pay transfer duty he should at least pay the transfer duty to the seller as a contribution towards the Vat. That case was criticised and has not been followed. The reason being that a purchaser can argue that he was aware of the fact that the seller was a Vendor and accordingly understood the price to be inclusive of Vat. He did not anticipate being required to pay transfer duty in addition to the purchase price.

ROGER GREEN

COX YEATS

rgreen@coxyeats.co.za

For assistance contact:

Robin Westley - E-mail: rwestley@coxyeats.co.za,

Tina Halstead - thalstead@coxyeats.co.za,

Lazelle Paola - lpaola@coxyeats.co.za,

Carol McDonald - E-mail: cmcdonald@coxyeats.co.za

Thabo Vilakazi - E-mail: tvilakazi@coxyeats.co.za

Kim Edwards - E-mail: kedwards@coxyeats.co.za