DLA CLIFFE DEKKER HOFMEYR

TAX

ALERT

18 JULY 2014

IN THIS ISSUE

VALUE-ADDED TAX AND THE DISPOSAL OF A PARTNERSHIP INTEREST TO THE REMAINING PARTNER

NEW TAX DISPUTE RESOLUTION RULES – THE WAIT IS FINALLY OVER!

VALUE-ADDED TAX AND THE DISPOSAL OF A PARTNERSHIP INTEREST TO THE REMAINING PARTNER

It appears that there is often uncertainty whether the transfer of an interest in a partnership from one partner to another (ie either a new or existing partner) should be subject to value-added tax (VAT).

The New Zealand Inland Revenue recently released a Tax Information Bulletin (Vol 26, No. 25, June 2014) (Bulletin) relating to this issue. The Bulletin confirms that most transfers of partnership interests will not be subject to Goods and Services Tax (GST) in New Zealand because the supply will generally not be made by a registered vendor or, if the transferor is registered, the supply will not be made in the course or furtherance of that registered vendor's enterprise. The position in South Africa is likely to be the same.

One issue which is specifically not covered in the Bulletin is the GST/VAT consequences of a final dissolution of a partnership, including the dissolution of a partnership as a result of a partner acquiring all the interests in the partnership from the other partners. The Bulletin's failure to deal with this issue may be an indication that there is some uncertainty on the correct GST/VAT treatment in these circumstances.

Consider a scenario where two partners, namely A and B, are equal partners in a partnership that is a registered VAT vendor. A acquires B's interest in the partnership and intends to carry on conducting the business of the partnership in its own name. As a result of the transfer of the partnership interest from B to A, the partnership will cease to exist and therefore cease to be a VAT vendor. Will the transfer of the partnership interest from B to A trigger any VAT consequences for the partnership itself?

To appreciate the potential VAT implications for the partnership, one must have regard to the following:

- S51(1) of the Value-Added Tax Act, No 89 of 1991 (VAT Act) provides that, a body of persons, whether corporate or unincorporated, which carries on an enterprise, is deemed to carry on the enterprise as a person separate from the members of such body of persons. A partnership is a body of persons, which is therefore regarded as a separate vendor for VAT registration purposes (ie separate from the partners).
- S51(2) of the VAT Act recognises that, in terms of partnership law, the introduction or withdrawal of a partner results in the dissolution of the old partnership and the creation of a new partnership, which could trigger the deemed supply rules in s8(2) of the VAT Act. To alleviate this deemed supply issue, s51(2) of the VAT Act provides that the old and the new partnership are deemed to be one and the same VAT vendor for purposes of the Act.
- However, s51(2) of the VAT Act is only applicable were a new partnership comes into being and continues to carry on the business of the old partnership as a going concern. S51(2) of the VAT Act is therefore not applicable

continued

where a partner (A) acquires the remaining interest in a partnership. In these circumstances the partnership ceases to exist as a result and no new partnership is created.

- On the basis that s51(2) of the VAT Act is not applicable, the acquisition of the partnership interest by the remaining partner would potentially trigger s8(2) of the VAT Act. In essence, s8(2) of the VAT Act provides that if a person (the partnership) ceases to be a vendor, any goods or a right capable of assignment, cession or surrender which forms part of the assets of the enterprise, will be deemed to be supplied by him in the course of his enterprise immediately before he ceased to be a vendor.

As a result of the termination of the partnership's existence, the partnership is deemed, in terms of s8(2) of the VAT Act, to have made a supply of all of its assets in the course or furtherance of its enterprise immediately before it ceased to exist. The deemed supply could therefore trigger an output VAT liability for the partnership.

However, even though there will be a deemed supply by the partnership of all of its assets immediately before it ceases to be a vendor, it appears that there may be an argument that the partnership will be deemed to have supplied all of its assets to the remaining partner as a going concern, which qualifies as a zero-rated transaction in terms of s11(1)(e) of the VAT Act.

We note that the South African Revenue Service (SARS) previously issued the following VAT ruling:

"Ruling 320 - Sale of partner's interest in a partnership

Question

Three partners namely A, B and C are equal partners in a partnership that is registered as a vendor.

Partners A and B wish to cease being partners of the partnership and intend selling their undivided interest in the partnership to the remaining partner C. Partner C is to continue conducting the business of the partnership as a sole proprietor. What are the VAT implications on the sale of A and B's undivided interest in the partnership if the provisions of section 51(2) cannot be applied?

Answer

The sale of the assets of the partnership to the remaining partner constitutes a taxable supply by the partnership. Section 11(1)(e) provides that the supply of an enterprise or part thereof which is capable of separate operation may be zero-rated, if the supply is made to a registered vendor and the enterprise is disposed of as a going concern. (Subject to all the requirements of sections 8(7) and 11(1)(e) read together with Practice Note No. 14 dated 20 January 1995 being met).

Where the transaction does not constitute the sale of an enterprise as a going concern and therefore not zero-rated, the provisions of section 7(1)(a) will be applicable. The vendor (partnership) has to account for output tax at the standard rate on the supply of the assets which formed part of the enterprise (other than any goods in respect of the acquisition of which a deduction of input tax under section 16(3) was denied in terms of section 17(2) or would have been denied if these sections had been applicable prior to the commencement date) upon supply to the remaining partner."

It appears that there is an argument that the deemed supply of the partnership assets to the remaining partner constitutes a taxable supply, which may be zero-rated if the supply is to a registered vendor and the enterprise is disposed of as a going concern (as contemplated in s11(1)(e) of the VAT Act). If this approach is adopted, the parties must ensure that all of the requirements of s11(1)(e) of the VAT Act are complied with and that the correct documentary proof required to substantiate the zero-rating is maintained (see SARS's Interpretation Note 31 (Issue 3) (22 March 2013)).

However, taxpayers must be aware that the VAT Rulings were withdrawn by SARS during 2009 and are not binding on SARS. In addition, it appears from the Bulletin that, internationally, this issue requires careful consideration, which is likely to depend on the particular facts and circumstances.

Andrew Lewis

continued

NEW TAX DISPUTE RESOLUTION RULES – THE WAIT IS FINALLY OVER!

On 11 July 2014, the new dispute resolution rules (new Rules) under s103 of the Tax Administration Act, No 28 of 2011 (TAA) were promulgated in Government Notice 550, published in Government Gazette No 37819.

These new Rules replace the rules promulgated under s107A of the Income Tax Act, No 58 of 1962 (old Rules) with immediate effect. The Rules essentially prescribe the procedures to be followed in respect of objection and appeal proceedings or certain administrative decisions by the South African Revenue Service (SARS). These decisions are listed under s104(2) of the TAA. The Rules also deal with the procedures to be followed in respect of alternative dispute resolution, and various other issues relating to the Tax Court.

Importantly the new Rules are a lot more comprehensive than the old Rules. Some of the most noteworthy departures, amongst others, relate to the following:

- A taxpayer who is aggrieved by an assessment may, prior to lodging an objection, request SARS to provide reasons for the assessment to enable the taxpayer to formulate an objection. In terms of the old Rules, SARS had 60 days within which to provide the taxpayer with such reasons. The new Rules now prescribe that SARS has 45 days to provide the taxpayer with reasons, where adequate reasons were not provided.

- Further, in terms of the TAA, when a taxpayer lodges an objection, SARS is required to notify the taxpayer of the allowance or disallowance of the objection and the basis thereof. In terms of the new Rules, SARS now has 60 days, after delivery of the taxpayer's objection, to notify the taxpayer of the outcome of the objection, whereas prior to the promulgation of the new Rules, SARS was afforded 90 days. SARS may extend the 60 day period for a further period not exceeding 45 days, if in the opinion of a senior SARS official, more time is required to take a decision on the objection due to exceptional circumstances, the complexity of the matter, or the principle or amount involved.

- Another important provision in the new Rules relates to 'test cases'. S106(6) of the TAA states that if a senior SARS official considers that the determination of an objection or an appeal, whether on a question of law or question of fact or both, is likely to be determinative of all or a substantial number of issues involved in one or more other objections or appeals, the official may:

  a. designate that objection or appeal as a test case; and

  b. stay the other objections or appeals by reason of the taking of a test case on a similar objection or appeal before the tax court.

- The aforementioned provision gives effect to s106(6) of the TAA and provides that a SARS official who designates an objection or appeal as a test case, must provide the taxpayer with a notice informing such a taxpayer of the common issues involved in the objections or appeals that the test case is likely to be determinative of, the questions of law or fact or both, and the importance of the test case to the administration of the relevant tax Act. The taxpayer involved may, within 30 days of receiving the notice, oppose the decision to designate an objection or appeal as a test case or alternatively oppose the staying of an objection or appeal pending the final determination of a test case. If the objection or appeal is to be stayed, the taxpayer may request a right of participation in the test case.

- One of the most notable changes brought about by the new Rules relates to the exchange of pleadings between SARS and a taxpayer who has lodged an appeal. According to the old Rules, after the taxpayer had delivered its notice of appeal, SARS was required to deliver to the taxpayer a statement of the grounds of assessment and opposing appeal.

- This statement would contain the consolidated grounds of appeal, the facts in the notice of appeal that were admitted and opposed to by

continued

SARS, and the material facts and legal grounds upon which SARS based its assessment. Thereafter the taxpayer would deliver its statement of grounds of appeal which listed the grounds upon which the taxpayer's appeal was based, the facts in the statement of grounds of assessment and opposing appeal that the taxpayer admitted and opposed, and the material facts and legal grounds the taxpayer relied on.

- The new Rules have added one further step to this process. Following the taxpayer's statement of grounds of appeal, SARS may deliver a reply to the statement of grounds of appeal setting out a clear and concise reply to any new grounds, material facts or applicable law.

Having regard to the above, it is interesting to note that the draft rules (released in February 2013) proposed that the taxpayer would first have to provide SARS with a statement of grounds of appeal and only thereafter would SARS be required to deliver a statement of grounds of assessment. SARS would therefore only be required to provide its statement after the taxpayer had provided its defence.

We welcome the decision by SARS to not follow through with the proposal to invert the order of the pleadings as that would have been to the prejudice of the taxpayer and most probably in breach of the principles of administrative justice.

The new Rules brought about some notable changes that could assist in ensuring that taxpayers are treated in an administratively fair manner when engaged in disputes with SARS. It will be interesting to see whether these rules, and specifically the prescribed time periods, will be adhered to in practice.

Nicole Paulsen and Gigi Nyanin

CONTACT US

For more information about our Tax practice and services, please contact:

Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@dlacdh.com

Andrew Lewis
Director
T + 27 (0)11 562 1500
E andrew.lewis@dlacdh.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@dlacdh.com

Ruaan van Eeden
Director
T +27 (0)11 562 1086
E ruaan.vaneeden@dlacdh.com

Lisa Brunton
Senior Associate
T + 27 (0)21 481 6390
E lisa.brunton@dlacdh.com

Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@dlacdh.com

Tessmerica Moodley
Associate
T +27 (0)21 481 6397
E tessmerica.moodley@dlacdh.com

Carmen Holdstock
Associate
T + 27 (0)11 562 1614
E carmen.holdstock@dlacdh.com

Nicole Paulsen
Associate
T + 27 (0)11 562 1386
E nicole.paulsen@dlacdh.com

BBBEE STATUS: LEVEL THREE CONTRIBUTOR

JOHANNESBURG

1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 Randburg and Dx 42 Johannesburg
T +27 (0)11 562 1000 **F** +27 (0)11 562 1111 **E** jhb@dlacdh.com

CAPE TOWN

11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town
T +27 (0)21 481 6300 **F** +27 (0)21 481 6388 **E** ctn@dlacdh.com