DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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IN THIS ISSUE

- **Supply of a going concern 'down under'**
- **Lost or stolen cheques – who assumes the risk?**

SUPPLY OF A GOING CONCERN "DOWN UNDER"

In general, under South African VAT law, the disposal of properties by a property developer is a taxable supply subject to VAT at the standard rate of 14%. The property developer will likely be entitled to a deduction of input tax in respect of VAT paid on the acquisition of goods and services in the course of supplying the properties.

In a recent Australian federal court case dealing with Goods and Services Tax (GST) the Administrative Appeals Tribunal of Australia (AAT) dealt with the taxpayer's liability to "increase its adjustments" pertaining to the sale of certain units in a serviced apartment complex subject to leases under a management company and the purchase had been treated as a going concern.

The relevant facts stated in the AAT judgment were:

- On 8 December 2000, South Steyne Hotel Pty Ltd (South Steyne) purchased the Sebel Manly Beach Hotel.
- On 10 August 2006, each of the 83 individual apartments in the hotel, together with the 'management lot' (consisting of the reception area, offices and car parking spaces), became separate lots of a strata plan (the Strata Plan).
- On 29 September 2006, South Steyne transferred to Mirvac Hotels Pty Ltd (Mirvac Hotels) the management lot of the Strata Plan. On the same day, South Steyne granted to Mirvac Management Pty Ltd (Mirvac Management) a separate lease in respect of each of the 83 apartment lots of the Strata Plan. Each lease was in identical terms. Under each lease Mirvac Management was obliged to operate a scheme whereby each apartment was, together with all other apartments, to be operated as part of a serviced apartment business.
- Pursuant to a separate Serviced Apartment Management Agreement entered into by Mirvac Hotels and Mirvac Management on 11 January 2006, Mirvac Hotels assumed exclusive control of the operation of the serviced apartment business. Also pursuant to the terms of the agreement Mirvac Management conferred upon Mirvac Hotels the benefit of its rights under the leases entered into on 29 September 2006.
- By Contract for the Sale of Land dated 1 September 2006, South Steyne sold one of the 83 apartments (the First Apartment) to the Applicant for $508,000. The First Apartment was sold subject to the applicable lease that had been granted to Mirvac Management. The contract of sale permitted the Applicant to participate in a 'Management Rights Scheme' (the Scheme) which mirrored the scheme provided for under the leases granted to Mirvac Management.

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- A Product Disclosure Statement (PDS) dated 16 March 2006 – which marketed the Scheme under the heading "The Sebel Manly Beach" – identified the following characteristics of the Scheme:
  - Owners of apartments that were the subject of a lease to Mirvac Management could elect to participate in the Scheme by allowing Mirvac Management to use the apartment for "letting purposes in a Serviced Apartment Business'.
  - Owners who elected to participate in the Scheme would receive a 'Fixed Owner's Return Amount' for a period up to two years from 1 July 2006 until 30 June 2008, calculated by reference to a 'percentage of the Purchase Price'.
  - After the Fixed Return Period owners would receive income from the 'Gross Pooled Apartment Revenue generated by the Serviced Apartment Business'.
- The Applicant elected to participate in the Scheme.
- By Contract for the Sale of Land dated 18 January 2008, South Steyne sold a second apartment (the Second Apartment) to the Applicant, also for $508,000. Like the First Apartment, the Second Apartment was sold subject to the applicable lease that had been granted to Mirvac Management. As with the First Apartment, the Applicant elected to participate in the Scheme.
- Each contract of sale provided that the parties agreed that the Property comprised a supply of a going concern for the purposes of s 38-325 of the GST Act

The issues arising were:

- Whether there had been an increasing adjustment which is where you are the recipient of a supply of a going concern or where the supply is GST free and if so, whether the supplier had carried on a relevant enterprise until the day of the supply of each of the apartments to the applicant.
- What the nature of the enterprise was.
- Whether the supply to the applicant was sufficient to carry on the continued operation of the enterprise.
- Whether the parties had agreed in writing that the supply was that of a going concern.

The AAT in reaching its conclusion followed similar principles enunciated in our law, namely, that the parties had agreed in writing that the sale was of a going concern and that therefore the parties could not, by virtue of including special conditions in their agreement, seek to make a supply that is essentially a zero–rated supply, into a taxable supply.

The recipient of the developed or undeveloped properties would be able to claim the VAT charged by the seller, but only to the extent that those properties will be used in the course or furtherance of making taxable supplies. The disposal to a person not registered as a vendor does not alter the fact that VAT must still be levied where a taxable supply is made by a vendor in the course or furtherance of his enterprise.

Based on the provisions of s11(1)(e) of the VAT Act, No 89 of 1991 (VAT Act) in order to dispose of a going concern at the zero rate of VAT, the following requirements must be met:

- The parties must agree in writing that the enterprise is disposed of as a going concern.
- The supplier and the purchaser must be registered VAT vendors.
- The supply must consist of an enterprise or part of an enterprise that is capable of separate operation.
- The supplier and the purchaser must, at the time of the conclusion of the agreement, agree in writing that the enterprise will be an income earning activity on the date of transfer thereof.
- The assets necessary for the carrying on of the enterprise must be disposed of by the supplier to the purchaser.
- The supplier and the purchaser must agree in writing that the consideration for the supply of the enterprise or part of the enterprise is inclusive of tax at the rate of 0%.

The requirements above essentially connotes what a 'going concern' entails for section 11(1)(e) of the VAT Act. In other words, where the requirements above are not met, one is not dealing with a 'going concern' and s11(1)(e) of the VAT does not apply. Where s11(1)(e) of the VAT Act does not apply, the zero rate cannot not be used, meaning the standard rate of 14% becomes applicable.

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Apart from the requirement that the parties agree in writing that the enterprise or part thereof shall be disposed of as a going concern, the parties must also specifically agree that the enterprise will constitute an income-earning activity at the date of transfer. Once again, in order for the agreement to have any force and/or effect, it must be reduced to writing.

Essentially what this requirement entails is that the supplier must ensure that the purchaser is placed in possession of a business that is in the same form as it was prior to its disposal as a going-concern, and thus giving an assurance that the business has the capacity to continue.

As such, the supplier must ensure that the purchaser is placed in possession of a business that can continue its previous operations without any further or minimal effort on the part of the purchaser. Therefore, the parties must agree and have the intention that the enterprise will remain active and operating until its transfer to new ownership.

However, it is not a requirement for the parties to agree that the activity should be earning profits at the date of transfer.

The general requirement that the enterprise or part must constitute a going concern, has come under consideration under the New Zealand courts (on which South Africa's VAT system is partially based) which have consistently confirmed that while the purchaser must be able to carry on the particular activity, it is not necessary that he actually carry on the enterprise subsequent to acquisition. Therefore, if the recipient merely receives developed and/or undeveloped properties and is not put in a position to seamlessly carry on the business without much intervention, it is unlikely that the zero rate will apply. This situation is to be contrasted with the position in the United Kingdom, where, unless the particular activity is actually carried on in the same form after transfer, the supply will not qualify for 'going concern' status.

Carmen Holdstock

LOST OR STOLEN CHEQUES – WHO ASSUMES THE RISK?

The principles to be applied in cases where cheques have been intercepted in the post and misappropriated by thieves have been summarised in previous case law, where it has been established that when a debtor tenders payment by cheque and the creditor accepts it, the payment remains conditional and is only finalised once the cheque is honoured.

Accordingly, where the cheque is misappropriated and someone other than the payee, by fraudulent means, converts the cheque into cash, the risk will lie with the debtor since it is the debtor's duty to seek out his creditor. However, where the creditor stipulates a particular method of payment and the debtor complies with it, any risk inherent in the stipulated method of payment is for the creditor's account.

In the recent decision of *Stabilpave v SARS (615/12) [2013] ZASCA 128*, the Supreme Court of Appeal (SCA) was asked to decide on a similar issue regarding the assumption of risk where a cheque was intercepted through the post and subsequently misappropriated by thieves.

The facts of the case are that Stabilpave (appellant) and the South African Revenue Service (SARS) agreed on a written statement of facts that SARS owed the appellant a tax refund of R724 494.29. This amount was reflected as the amount due to the appellant on the tax assessment form, dated 16 November 2006, which was issued to the appellant. The tax assessment form contained a specific notice to the creditor, which provided that unless banking details are provided to SARS in order for the payment to be effected by electronic transfer, the appellant elects or alternatively accepts that payment be effected by way of a cheque which would be collected at the nearest branch.

At the time of issuing the tax assessment form, the banking details of the appellant were not available to SARS and therefore a cheque, dated 12 November 2006, was made payable to the appellant for the sum of R724 494.29 plus interest that had accrued thereon. The cheque was drawn by SARS on ABSA Bank Limited and was crossed and marked "not transferable". The cheque was subsequently intercepted through the post and was misappropriated through fraudulent means, resulting in the proceeds of the cheque not being received by the appellant.

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In an attempt to recover the proceeds, the appellant instituted action against SARS for the payment of the tax refund that became due and payable to it on 16 October 2006, plus interests and costs. The appellant's contention was that the obligation of SARS to pay the tax refund had not been fulfilled because in law there is no payment where a cheque is posted and lost before it reaches the creditor.

SARS on the other hand admitted to the debt owing to the appellant but raised the defence of payment. SARS further argued in the alternative that on a proper construction of the tax assessment notice, the taxpayer was afforded a choice as to the mode of payment and that by the taxpayer failing to provide its banking details, so that payment could be effected electronically, the taxpayer chose to be paid by cheque through the post.

The court of first instance accepted the contention of SARS and dismissed the appellant's claim with costs. The matter was taken on appeal to the North Gauteng High Court, which also dismissed the appeal against the decision of the court of first instance.

The matter was finally taken on appeal to the SCA. The decisive question before the SCA was whether the notice contained in the tax assessment form gave the appellant a choice to select a mode of payment, and if it did, whether the appellant exercised the choice, whether expressly or by necessary implication, that SARS should effect payment by way of a cheque sent through the post.

The SCA held as follows:

- Upon a plain reading of the notice in the tax assessment form, the notice does not give the appellant an option to select a mode of payment to be followed by SARS. The notice simply informs the appellant of the manner of payment, namely, that payment will be effected by way of a cheque if valid banking details are not made available to SARS.

- There is no invitation, expressly or by necessary implication, to the taxpayer to furnish banking details should the taxpayer wish for payment to be effected by means of an electronic transfer.

- The mere fact that a creditor knows or expects to receive payment by cheque through the post and does not raise an objection thereto, does not give rise to an implied request or election by the creditor to be paid in such a manner.

- A clear indication that the notice does not afford the appellant a choice as to the manner of payment is the notice did not contain a cut-off date on or before which the taxpayer might furnish its banking particulars to SARS.

- Accordingly the notice simply serves to advise the appellant that banking particulars have not been presented to SARS and therefore payment would be effected by means of a cheque through the post.

In concluding, the SCA held that the notice issued to the appellant in the tax assessment form was merely for information purposes and clearly did not provide the appellant with any options for effecting method of payment. Instead, the method of payment was dictated to the appellant by SARS. Accordingly, based on previous case law and established principles, the risk of loss of the cheque was not assumed by the appellant but remained with SARS. SARS therefore did not discharge its indebtedness to the appellant by effecting payment by means of a cheque through the post.

Accordingly the appeal was upheld with costs and judgement was granted against SARS.

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