DLA CLIFFE DEKKER HOFMEYR

TAX

ALERT

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IN THIS ISSUE

RULING ON AMALGAMATION TRANSACTION

The South African Revenue Service (SARS) released Binding Private Ruling 171 (Ruling) on 9 June 2014.

The facts were as follows. Two individuals, A and B, were each the sole members of close corporations C and D, respectively. C and D each held half of the issued share capital of a company E. It appears that C and D also each had a loan claim against company E, while A and B each had a loan claim against C and D, respectively.

A and B no longer wished to hold their respective interests in company E through the close corporations C and D.

It was proposed that close corporations C and D each amalgamate with company E. This would be accomplished by C disposing of its shares in and loan claim against company E, to company E. In exchange, company E would issue new shares to C. The market value of the new shares would be equal to the base cost of the shares and claim in the hands of C. C would then liquidate, wind-up or deregister and distribute the new shares in E as a dividend in specie to A.

The same steps would be taken with reference to D and B.

In the result, A and B would directly hold the issued share capital of E in equal portions.

SARS ruled that:

- Section 44(2)(a) of the Income Tax Act, No 58 of 1962 (Act) would apply to the disposal of C and D's assets to E, and that no capital gain would arise.
- On receipt by E of its own shares, the shares would be cancelled and such cancellation would not constitute a disposal for purposes of paragraph 11 of the Eighth Schedule to the Act.
- As a result of the issue of the new shares by E, its contributed tax capital would increase by an amount equal to the contributed tax capital of C and D, seemingly in accordance with s44(4A) of the Act.
- A and B would be deemed to have disposed of their members' interests in C and D at their base cost and their shares in E would be deemed to have a base cost equal to the said members' interests (s44(6) of the Act).
- The transfer of the shares in E to A and B would also not be regarded as a dividend (s44(6)(c) of the Act) paid by C and D for tax purposes.

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- The disposal of the shares in E by C and D would be disregarded for determining the taxable income or losses of C and D (s44(8) of the Act).
- No securities transfer tax would be payable in respect of the transfer of shares in E or members' interests in C and D.

It appears that the parties could not have made use of a liquidation transaction in terms of s47 of the Act to liquidate C and D because of the group company requirement, even though that would arguably have constituted a less complicated transaction.

It is interesting to note that as a result of the asset for share transactions between the close corporations and company E, the loans owing by E to C and D would effectively be capitalised. Unfortunately the Ruling is not clear on the treatment of the loans owing by C and D to A and B respectively.

Heinrich Louw

VAT CONSIDERATIONS BETWEEN DEVELOPERS AND OWNERS OF LAND

Where a registered vendor for Value-added Tax (VAT) purposes disposes of vacant subdivided land or developed properties in the course and furtherance of conducting an enterprise as a property developer, such disposal would ordinarily constitute a taxable supply subject to VAT at the standard rate of 14%.

Such property developer would further be entitled to a deduction of input tax incurred on the acquisition of goods and services in the course of making the taxable supplies.

If the recipient is a VAT vendor, it would be entitled to an input tax deduction in respect of the VAT paid to the property developer, to the extent that the property will be used in the course and furtherance of its enterprise. 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 its enterprise.

Consider the position where the owner of land enters into a lease agreement with a developer or property company in terms of which the property company leases the land from the owner. As part of the agreement, the property company will subdivide the land and develop residential units on it. The residential units will be let by the property company to tenants.

In principle, the property company needs to account for output VAT in respect of supplies made in the course and furtherance of its enterprise. However, in terms of s12(c) of the VAT Act No 89 of 1991 (VAT Act), the letting of residential accommodation is regarded as an exempt supply. The property company would therefore not have to account for any VAT in respect of letting the residential units, but it is also unlikely that it would be able to claim any input tax in respect of any VAT that it had paid in respect of developing and supplying the residential units, including any VAT paid to the owner of the land in respect of the lease agreement.

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It is however not necessarily the case that the owner of the land would need to account for VAT in respect of leasing the land to the property company. One such example is where the owner of the land is a constitutional institution listed in schedule 1 of the Public Finance Management Act, No 29 of 1999. In terms of the definition of an 'enterprise' in s1 of the VAT Act, such constitutional institutions are deemed not to carry on an enterprise, and would therefore not need to account for output VAT. Another example is where the supply by the owner of the land to the property company is itself regarded as the supply of residential accommodation as contemplated in s12(c) of the VAT Act. In such circumstances the supply would be exempt and the owner of the land would not need to account for output VAT.

The VAT consequences arising out of property transactions should always be carefully considered with reference to the supplies made by the owner and/or developer of the land.

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