

Business deal needs careful structuring

WHEN an entity intends to purchase a partial interest in a business, it has the option to purchase either a partial equity interest in the company operating the business, or it can purchase an undivided interest in the business operation itself.

When an undivided interest is acquired, the purchaser becomes a partial owner of all parts of the business.

Buying an undivided interest in a business as opposed to an equity interest is sometimes preferred in black economic empowerment transactions.

The purchase of an equity interest does not have any Value-Added Tax (VAT) implications, because the issue or the transfer of ownership in shares is exempt from VAT.

However, an undivided interest in a business falls outside the scope of the VAT exemption because it does not comprise a share in the capital of a company. As a result, there are a number of VAT consequences which the purchaser must consider to avoid any unexpected VAT cost.

If the business in which an undivided interest is acquired involves the making of taxable supplies for VAT purposes, the owner of the business would be registered for VAT.

The owner is then required to account for VAT on the sales consideration. The view of the South African Revenue Service (SARS) is that the sale of an undivided interest does not comprise the sale of a business as a going concern, because the purchaser is not able to trade with only an undivided interest in the business.

The sale of the undivided interest does not qualify for the zero rate and the seller is obliged to levy VAT at the standard rate of 14% on the sales consideration.

When the owner sells the undivided interest in the business, an unincorporated "body of persons" comprising of the jointly owned business comes into existence and such "body of persons" is obliged to register separately for VAT purposes in terms of section 51 of the VAT Act. The VAT on the business op-



erations will therefore be accounted for by the "body of persons" separately from the undivided interest holders.

A prerequisite for claiming input tax on goods or services is that they must be acquired for the purpose of use, consumption or supply in the course of making taxable supplies.

The separate VAT registration and VAT accounting by the "body of persons" means that the VAT which the purchaser paid on the acquisition of the undivided interest is then not claimable as input tax, because the undivided interest holder is not making taxable supplies; the separately registered "body of persons" is.

The purchaser of the undivided interest is not even entitled to register for VAT purposes, which is another reason why the zero rate cannot apply.

If the purchaser cannot claim the VAT on the purchase of the undivided interest, it obviously has disastrous consequences for the purchaser.

To avoid the non-claimable VAT cost for the purchaser, the parties should structure the transaction that they earn income that attracts VAT from their undivided interests.

This can be achieved by agreeing that the undivided interest holders will make their undivided interests available to the "body of persons" for a consideration. The profit share or a portion thereof which is paid by the "body of persons" to the undivided interest holders can therefore be considered to be taxable consideration for the granting of the use of the undivided interests.

The undivided interest holders would be required to register and account for VAT on this consideration, and the "body of persons" will be entitled to claim such VAT as input tax.

The VAT on the profit share payment is then neutral, but will enable the purchaser to register for VAT purposes and to claim the VAT it paid on the purchase of the undivided interest as input tax.

This is, of course, all artificial because the "body of persons" is not a separate legal entity. However, if the underlying agreements do not provide for the undivided interest holders to make their undivided interests available to the "body of persons" for a consideration, then no input tax may be claimed by the purchaser on the purchase of his undivided interest.

The structure in terms of which the profit share or at least a portion thereof is considered to be consideration for the use of the undivided interest, has been accepted by SARS. SARS has ruled (in general published ruling 431) that where a joint-venture partner makes a contribution of goods to the joint venture, then the joint venture partner must account for VAT thereon.

A better solution would of course be for the legislation to be amended to provide for the zero rating of the sale of an undivided interest in a taxable business, irrespective of the fact that the purchaser is not required to register for VAT as a consequence of section 51.

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