VAT Pitfalls When Buying a Business

The purchase of a business should be approached with caution from a VAT perspective.

When a business is sold as a going concern, the zero rate can be applied for VAT purposes if it is properly provided for in the sale agreement. However, there are a number of aspects that should be taken into account when such a sale occurs between two parties.

In order for the zero rate to apply both the seller and the buyer must be registered VAT vendors. It often happens that the purchaser is a new shelf company and is not yet registered for VAT at the time the sale agreement is signed. The buyer must be registered for VAT at the time the supply of the business takes place. This means, in terms of section 9(1) of the VAT Act, that the buyer must be registered at the date when any part of the purchase price is paid for or when an invoice in respect of the transaction is issued, whichever is earlier. Usually payment is made upon signature of the sale agreement.

The date of registration can be backdated in terms of section 23(4) of the VAT Act to the date the business was supplied. Therefore, if the purchaser is not registered for VAT at the date the sale agreement is signed, the zero rate can still apply, provided the purchaser's VAT registration is backdated in terms of section 23(4). It would be advisable, though for the sale agreement to make the application of the zero rate subject to the purchaser subsequently registering, but with effect from the date the business is supplied for VAT purposes.

Where the business is sold with effect from a retrospective effective date, further issues are evident with regard to the VAT implications of the transactions during the period from the effective date to the date the business is deemed to be supplied for VAT purposes. If the purchaser was not registered for VAT during this period, then technically no input tax may be claimed. However, section 23(1) of the VAT Act requires a person to register from the commencement of a month where there are reasonable grounds for believing that the registration threshold of R300 000 will be exceeded for the next 12 months. It can be argued that this is the month in which the retrospective effective date of sale falls, and the purchaser should register for VAT retrospectively from this date.

Another problem resulting from a retrospective effective date, is that VAT on the transactions between the effective date and the actual transfer date would have been accounted for on the seller's VAT returns. These transactions will, however, be reflected in the purchaser's financial records and the VAT thereon should, technically, have been accounted for on the VAT returns of the purchaser. There are accounting issues at hand her though and it can become complicated. It is advisable that proper accounting records are kept in line with the requirements of SARS in order for the zero rate to remain applicable.

A VAT liability arises for the purchaser where a business comprising of both taxable and exempt activities is sold, for example a fixed property rental enterprise comprising of both commercial and residential accommodation. In this case the purchaser is obliged, in terms of section 18A of the VAT Act, to pay VAT to SARS on the portion of the purchase price which is attributable to the exempt activities of the enterprise, despite the fact that the zero rate is applied to the purchase consideration.

The VAT liability caused by section 18A is avoided where the business is transferred in terms of section 8(25) of the VAT Act between two VAT registered companies within a group of companies. Section 8(25) provides that where goods or services are supplied by a vendor to another vendor in terms of sections 42 (company formations), 44 (amalgamations), 45 (intra-group transactions) or 47 (liquidation, winding-up or deregistration transactions) of the Income Tax Act, then the seller and the purchaser are deemed to be one and the same person for purposes of the supply. This means that the transaction then falls outside the scope of VAT.

Where a partially taxable business is purchased from an unconnected

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company, the purchaser may consider buying the shares in the company first, and then to transfer the business into the purchasing company in terms of section 42, 44, 45 or 47 of the Income Tax Act for section 8(25) of the VAT Act to apply. The stamp duty payable on the purchase of the shares (0.25% of the consideration) could very well be much less than the non-deductible VAT payable on the purchase price attributable to the exempt enterprise activities.

The purchase of a business should be approached with caution from a VAT perspective and the VAT implications for both the seller and the purchaser on transactions immediately before and after the sale should be duly considered before the sale agreement is finalised.

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