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VAT AND PROPERTY

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The tax authorities levy a tax on transfers of immovable property either in the form of VAT or transfer duty.

It is not always clear in which cases VAT and in which transfer duty will be payable. The question arises as to which is payable : VAT or transfer duty? The answer will depend on the nature of the particular transaction and the status of the parties.

If a person is registered for VAT, such a person is called a VAT VENDOR. He, she or it is then obliged to levy a premium of 14% on every sale / service rendered in his business and to pay this premium (called "VAT OUTPUT TAX") over to the Receiver at the end of the relevant VAT cycle. For most taxpayers, every two consecutive months constitute a VAT cycle.

To determine whether VAT is payable in a property transaction, we need to ask 2 questions, namely:

1. Is the seller registered (or obliged to be registered) for VAT, and
2. Is this transaction in the course and furtherance of the seller's business?

If the answer to both questions is yes, VAT related questions should be asked (VAT will likely be payable). If the answer is no, transfer duty will be payable on the transaction.

For example: If A, who sells a house for R600 000,00 to B and A is a property developer whose business it is to build and sell houses, and the house he is selling to B is sold in the scope and furtherance of his business, then, provided he is also a VAT vendor, VAT will be payable by him in the transaction and not transfer duty.

However, if A sold his private residence (not a house he built with the intention of selling it), it is not part of his business. Even if he is a registered VAT vendor, in this case he is not a vendor for purposes of this transaction. Transfer duty will therefore be payable, not VAT.

It is important to note that, in transactions where VAT is payable, the Receiver demands the amount due from the SELLER, not from the purchaser. The seller must therefore ensure that the sale price he negotiates includes the 14% VAT, alternatively he must expressly arrange with the purchaser that the purchaser will, in addition to the purchase price, also be liable to pay to the seller an additional 14%. The ultimate responsibility to pay the Receiver vests with the seller, and he cannot pass this responsibility on to the purchaser.

In the case of transfer duty being payable, the purchaser (unless the parties agree otherwise) is liable, in addition to the purchase price, to pay the amount of transfer duty due. This amount is usually paid over to the conveyancer, who then ensures that the transfer duty is paid to the Receiver and a transfer duty receipt (which must be lodged in the deeds office) is obtained.

If it has been established that the seller is:

- a VAT VENDOR
 - for purposes of the transaction (in other words, he is selling the property as part of his business)
- then VAT is usually payable.

From a property point of view, there is only one type of transaction which has VAT exempt status: property that has previously been leased for residential purposes, and which property is now being sold.

For example:

C is a property developer and a registered VAT vendor. His business is to buy and sell property and also to lease property. Amongst other assets, he owns a flat which he rents out for residential purposes.

Although C, the lessor, is a VAT vendor, VAT is not levied on the rental income derived from the flat. The reason for this is that rental derived from residential tenants such as in this example, is an exempt supply in terms of the Act.

Not only is the rental of a property let out for residential purposes exempt from VAT, but the purchase price derived from a subsequent sale of the rental property itself is also exempt from VAT. So, notwithstanding the fact that he is a VAT vendor, if C sells the property which he previously let out for residential purposes, no VAT will be payable by the seller. The purchaser of the flat will however be liable for transfer duty on the acquisition.

If a transaction is not VAT exempt, the next question to ask is whether the transaction is perhaps zero rated. "Zero rated" means that VAT is payable on the transaction, but at the rate of 0%, not at the standard rate (currently 14%).

What is the difference between zero rating and VAT exempt? IF a transaction is VAT exempt, it falls outside of the "VAT net" altogether. Accordingly transfer duty is payable and the position with regard to the particular transaction is the same as if the seller were never registered for VAT.

If a transaction is zero rated, it still falls within the "VAT net" and all the provisions relating to VAT applies to the transaction, including the provision that the purchaser can still claim input tax credits in respect of the property concerned.

In order for a transaction to be zero rated, the following requirements have to be met :

- The seller must be a VAT vendor;
- The purchaser must be a VAT vendor;

- The thing that is sold must be a going concern (in other words, an existing, operating business);
- The agreement of sale must expressly state that a going concern (as opposed to merely an asset) is being sold.

Examples of transactions relating to property that will qualify for a zero rating are:

- Mr X sells his grocery store - he sells both the business and the building in which the shop is situated as part of the same transaction to the same purchaser.
- Mrs Y sells an office block owned by her. The offices are let out to various tenants and she effectively "sells" (cedes) the leases together with the building. The new purchaser will thus continue to derive rental income from the building.

It must be highlighted that unless there is a written agreement between the parties specifically stating that the enterprise is disposed of as a going concern, the zero rating cannot apply even if the transfer meets the requirements of a going concern. Should this be the case however, the VAT Act does make provision for the parties to enter into a separate agreement with the original agreement with the separate agreement referring to the disposal of an enterprise as a going concern.

The contracting parties have to agree in writing that the enterprise will be supplied as an income-earning activity. Notwithstanding the latter, the mere mention of the words "Income Earning Activity" will prove to be insufficient in certain instances. In the event of an Agreement of Sale that specifically states that a vacant building is disposed of as a going concern, the zero rate will not apply as the supply of a vacant building cannot constitute an income earning activity. It will therefore prove to be insufficient to merely make mention of the words "Income Earning Activity" and "Going Concern" in the Agreement of Sale if the object of sale is not capable of being an income earning activity.

Should it then subsequently be found that an enterprise was not disposed of as a going concern, the purchase price has to be adjusted accordingly and the amount of VAT paid will be claimed as input tax by the purchaser and accounted for as output tax on the part of the Seller.

Where a purchaser proposes to be a registered vendor and it was subsequently found on date of supply that he was not registered as such, the Receiver will then require the Seller to pay over VAT on the proceeds of this transaction as for purposes of the Receiver the purchase price includes VAT.

It is therefore vital that the Agreement of Sale make provision for the protection of the Seller and it is suggested that a clause along the following lines can form part of the Agreement of Sale as a precautionary measure:

"The Purchaser will deliver to the Seller a copy of the Purchaser's VAT 103 Notice of Registration form (within a specified amount of time). In the

event of the Purchaser not being a registered vendor at the time of conclusion of this Agreement, the application of the zero rate will be subject to the Purchaser being a registered vendor on date of supply. It is further recorded by the parties that if VAT is payable on the transaction the amount of VAT so claimed will be refunded to the Seller by the Purchaser".

If the PURCHASER is a VAT vendor and transfer duty is payable in a transaction, then the purchaser could qualify for a notional input tax credit (i.e. a deemed input tax credit). In other words, the purchaser could claim the transfer duty that it paid on the transaction back from the Receiver, as if the amount were VAT paid by the purchaser on the acquisition. The VAT status of the purchaser is not relevant in determining whether VAT or transfer duty is payable in any transaction. It is only relevant to determine whether the purchaser will be so fortunate as to be able to claim his transfer duty back from the Receiver.

With regards to the calculation of VAT payable, if a transaction is zero rated, 0% on the sale price will be payable - effectively no money will change hands. If not zero rated, 14% on the sale price will be levied on the transaction.

If property developer Z sold one of the flats in his development for R200 000,00, then the VAT payable by him on the transaction will be calculated as follows :

$$14/114 \times R 200\ 000 = R 24\ 561,40.$$