SOUTH AFRICAN REVENUE SERVICE

BINDING PRIVATE RULING: BPR 023

DATE : 9 February 2009

ACT : VALUE-ADDED TAX ACT, NO. 89 OF 1991 (the VAT Act)
SECTION : SECTION 1 - DEFINITIONS (ENTERPRISE AND INPUT TAX), SECTIONS 7(1)(*a*), 12(*c*), 16(2) AND (3), 18(1) AND 23(1)
SUBJECT : VALUE-ADDED TAX (VAT) IMPLICATIONS TO THE PARTIES RELATING TO THE ESTABLISHMENT OF A RESIDENTIAL TOWNSHIP DEVELOPMENT

1. Summary

A property owning company, Propco, will acquire vacant land for purposes of establishing a residential township development ("the development").

This ruling deals with the VAT implications of the proposed transactions to be undertaken by Propco, the trust, Holdco, Subco and Devco (the developer).

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 76Q of the Income Tax Act, No. 58 of 1962.

All legislative references are to sections of the VAT Act applicable as at 31 July 2007 and unless the context otherwise indicates, any word or expression in this ruling bears the meaning ascribed to them in the VAT Act.

This ruling has been requested in relation to the provisions of–

- section 1 – definitions of "enterprise" and "input tax";
- section 7(1)(*a*);
- section 12(*c*);
- section 16(2) and (3);

- section 18(1); and
- section 23(1)

of the VAT Act.

3. Parties to the proposed transaction

The Applicants:	Property Owning Company ("Propco")
	Property Development Company ("Devco")
	Holding company of Propco ("Holdco")
	Fellow subsidiary of Propco ("Subco")

4. Description of the proposed transaction

The land is burdened with a perpetual lease in favour of a trust. Propco and the trust are connected persons for VAT purposes. The owner of the land will subdivide the land and each subdivision will be sold to Propco subject to the lease and thereafter the perpetual lease, in respect of each subdivision sold, will be cancelled accordingly for a fee.

Propco will engage a developer to provide the development infrastructure, which includes the provision of roads, electricity and water as well as subdividing the land into residential stands ("serviced stands") and disposing of the serviced stands to End Lessees ("End Users") in terms of 99 year leases. The End User will pay an upfront amount equal to the lease premium for the 99 year period. The End User, upon concluding the lease, will simultaneously conclude a building contract with the developer or a third party whereby a residential building will be erected on the serviced stand.

The end user can elect to extend the lease, after expiration of the lease or dispose of the leasehold rights to a third party, either before or after expiration of the lease.

The transaction entails the development of a portion of a farm for the purposes of establishing a development. This development encompasses the installation of infrastructure, completion of the buildings and common facilities and buildings on the township land and the disposal of serviced stands to End Lessees, including the conclusion of a Residential Building Construction Agreement ("RBC Agreement") by each End Lessee to construct a residential building on the serviced stand.

Transaction Details

Step 1: The farm is leased by Subco to Holdco in perpetuity. The farm will be subdivided into various distinct portions or subdivisions.

Step 2: A subdivided portion will, while it is still subject to the "Notarial Deed of Lease/Perpetual Lease", be sold to Propco. The amount payable for the subdivided portion will be minimal due to the fact that the farm is burdened with the Perpetual Lease in favour of Holdco and the bare dominium which is held by Subco will therefore hold minimal value. The selling price for that subdivided portion will be debited and credited to loan accounts in the books of Subco and Propco respectively, (that is, debit to loan account – Propco and credit to the loan account – Subco). Propco will be registered as a vendor for VAT purposes.

Step 3: The Perpetual Lease will be cancelled in respect of the subdivision sold to Propco. Propco will pay an amount to Holdco for the release of the rights in terms of the Perpetual Lease.

Step 4: Propco will enter into a "Main Lease" with a Devco, whereby Propco will lease each subdivision to Devco at a nominal rental of R100 per annum to provide security to Devco in respect of Devco's development costs. In terms of the Main Lease Devco is under obligation to effect the development. Devco is registered as a vendor for VAT purposes.

Step 5: Propco will enter into a "Construction and Development Agreement" ("C&D Agreement") with Devco for the purpose of the development, including a further division (of the subdivision) into serviced stands.

Step 6: Propco will, in terms of the “Lease Agreement” (herein after referred to as the “End Lease”) lease the serviced stands to End Lessees after Devco agreed to release the relevant stands from operation of the Main Lease, for a period of 99 years renewable at the option of the End Lessee. The proceeds received by Propco in terms of each End Lease shall accrue to Propco and Devco in the agreed ratio set out in the C&D Agreement and will become payable to Propco and Devco upon registration of an End Lease. The End Lease is subject to the End Lessee concluding a separate RBC Agreement with Devco or an approved developer, to erect a residential building on the serviced stand. Devco will facilitate the conclusion of the End Lease, on behalf of Propco.

Step 7: Once the End Leases and RBC Agreements are concluded, the Main Lease will be cancelled.

Step 8: Devco or the approved developer chosen by the End Lessee will erect residential buildings on the serviced stands in terms of the RBC Agreement entered into with End Lessee. In terms of common law accession, the residential building will accede to the stands and Propco will become the owner of the residential building. No amount is payable to the End Lessees by Propco in respect of the accession.

Step 9: The proceeds from the ”disposal” will accrue to each party according to the agreed ratio and will become payable to Propco and Devco upon registration of an End Lease. Development costs plus a margin will be recovered by Devco through receiving a portion of the disposal price of serviced stands (effectively as a fee for developing the property) from Propco.

Renewal options available to End Lessees:

- The End Lessee can elect to extend the End Lease without effecting a cancellation, as envisaged in the End Lease, in which case the End Lessee is required to pay an amount equal to 5% of the fair market value of the serviced stand (including improvements thereon) plus VAT. The End Lessee will be required to enter into an agreement recording such extension, which agreement is to be notarially executed and registered in the office of the Registrar of Deeds.

- The End Lessee can also elect to extend the End Lease by cancelling the End Lease and entering into a proposed Replacement End Lease ("Replacement End Lease") with Propco, as envisaged in the Replacement End Lease.

Disposal of leasehold rights by the End Lessee:

- The End Lessee can further elect to dispose of the leasehold rights by ceding and delegating the rights and obligations to a Third Party, as envisaged in the "Agreement in respect of the Cession of Rights and Delegation of Obligations under a lease agreement" ("Cession Agreement"). No amount is payable by the Third Party to Propco if the Third Party elects to register the new End Lease for the balance of the term of the initial End Lease (that is, no cancellation of the End Lease).

- The Third Party, in buying the End Lease, can elect to cancel the End Lease and a Replacement End Lease will be granted by Propco to the Third Party, as envisaged in the Replacement End Lease. The Third Party will not have to pay any amount to Propco, where the End Lease is cancelled within three (3) years after the date of the first registration. The Third Party will have to pay an amount equal to 5% of the greater of the disposal price or fair market value of the serviced stand (including improvements thereon), plus an amount equal to the VAT payable by Propco in terms of section 18(1).

5. Conditions and assumptions

This ruling is made subject to the following conditions and assumptions:

- The proposed transaction, in its entirety, is not part of or connected with any other transaction, operation or scheme.
- Holdco makes taxable supplies at present. The religious educational services provided by Holdco do not fall within the exemption from VAT provided for in section 12(*h*).
- The sale of the various portions of the farm by Subco will not result in Subco exceeding the compulsory VAT registration threshold in any period of 12 months as contemplated in section 23(1).
- The activities of Subco do not involve the making of exempt supplies as contemplated in section 12.

6. Ruling

The ruling made in connection with the proposed transaction is as follows:

Subco

- Subco is not required to register as a vendor, as envisaged by section 23(1), as a result of supplying the farm by way of a Perpetual Lease to Holdco at a consideration less than the open market value. This is based on the condition that Holdco makes wholly taxable supplies.
- Subco is not required to register as a vendor, as envisaged by section 23(1), in respect of the supply of the subdivisions of the farm by way of sale to Propco, as the amounts received from Propco will not exceed R300 000 in a twelve month period.

Holdco

- The supply by Holdco in respect of the release of each subdivision from the operation of the Perpetual Lease in terms of the C&D Agreement is subject to VAT at the standard rate, in terms of section 7(1)(*a*).

Propco

- The supply by Propco of the land, in terms of the Main Lease entered into with Devco is subject to VAT at the standard rate in terms of section 7(1)(*a*).

- The supply by Propco of a vacant serviced stand, in terms of each End Lease entered into with a End Lessee is subject to VAT at the standard rate in terms of section 7(1)(*a*).

- The extension by Propco of an End Lease prior to a residential building having been erected on the vacant serviced stand is subject to VAT at the standard rate in terms of section 7(1)(*a*).

- The extension by Propco of an End Lease after a residential building having been erected on the vacant serviced stand is subject to VAT at the standard rate in terms of section 7(1)(*a*), provided that the End Lease has not been cancelled.

- The supply by Propco to an End Lessee, in terms of a Replacement End Lease, of a serviced stand where a residential building has been erected on the stand, is a supply of a dwelling and is exempt from VAT in terms of section 12(*c*).

- Propco is, in terms of section 18(1), deemed to make a taxable supply, in respect of the change in use of the serviced stand initially acquired for purposes of making taxable supplies. The value of the supply will, in terms of section 10(7), be the open market value of the serviced stand and the improvements thereon. It is accepted that the open market value of the stands is equal to 5% of the fair market value of the serviced stands including improvements thereto. The time of supply will, in terms of section 9(6), be the time the change in use occurs.

- Propco will, subject to the definition of "input tax" in section 1 read with sections 16(2) and (3), 17 and 20, be entitled to input tax on the purchase price of the proposed subdivision, the VAT incurred on the cost of cancellation of the Perpetual Lease in respect of the proposed subdivision to be developed and the VAT incurred on the cost of Devco's development services, that is, Devco's share of the lump sum rental.

Devco

- The supply by Devco to Propco, of the release of the serviced stands from the operation of the Main Lease, when Propco disposes of the serviced stands to the End Lessees is subject to VAT at the standard rate in terms of section 7(1)(*a*).

- The supply by Devco to Propco of the development of the serviced stands for a consideration equal to its share of the disposal consideration (for the disposal of a vacant serviced stand to the End Lessee) is subject to VAT at the standard rate in terms of section 7(1)(*a*).

- The supply by Devco to the End Lessee of the development of each serviced stand, in terms of the RBC Agreement is subject to VAT at the standard rate in terms of section 7(1)(*a*).

- Devco will, subject to the definition of "input tax" in section 1 read with sections 16(2) and (3), 17 and 20, be entitled to input tax in respect of the VAT incurred on the cost of the development of the subdivision, the VAT incurred on the cost of the Main Lease, the VAT incurred on the cost of erecting the residential building, including the VAT incurred on the costs of consultants, contractors and other persons.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five (5) years as from 11 May 2007 or until the end of the applicants' year of assessment during which the development is completed, as contemplated in the C&D Agreement, whichever is the earlier.

Issued by:

Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE