

The Value-Added Tax implications of a foreign-take-over of a South African resident VAT vendor with specific reference to patents registered in the name of the South African vendor

by

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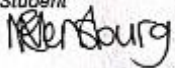


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ABSTRACT

This study focuses, in the main, on the Value-Added Tax (“VAT”) consequences of a foreign takeover of a South African resident VAT vendor. One of the requirements for registration as a VAT vendor is that the vendor must carry on an enterprise.¹ This study considers whether the foreign takeover results in the local company ceasing its business activities in South Africa and no longer meeting the requirements for conducting an ‘enterprise’ for purposes of VAT. The effective date of the foreign takeover plays a key role in determining the local company’s output VAT liability upon deregistering for VAT.

This study further focuses on the accessibility and VAT implications of a patent registered in the local company. Patents are protected only in the country in which they are registered.² If a South African patentee seeks protection for a patent outside South Africa, the patent must be registered in that country.³ When a foreign takeover happens it must be established whether the foreign entity automatically has access to the patent. The question then arises as to the VAT implications of the foreign takeover on the patent rights and whether an output VAT liability rests on the local VAT vendor in respect of the patent rights upon ceasing to be a VAT vendor as a result of the foreign take over.

¹ Section 7(1)(a) of the Value-Added Tax Act 89 of 1991.

² Dean *Introduction to Intellectual Property Law* 239.

³ *ibid.*

CHAPTER ONE: INTRODUCTION

1.1 Introduction and background

In the main, enterprises – and specifically companies – are formed to generate a profit.⁴ Moreover, companies may merge to increase their profits, to diversify their activities, to enable them to enter new markets, to acquire additional assets or money, or to reduce their tax liability.⁵

A merger can be variously structured. One way to effect a merger, is by two or more companies deciding to form a new company which will hold all the assets and liabilities previously held by the respective companies.⁶ The two or more companies then dissolve.⁷ Another way to merge is for two (or more) companies to decide that one company will survive while the other(s) merge into the surviving company.⁸ In other words, the one company disappears in the course of merging.⁹ The new or surviving company is the owner of the respective companies' assets and liabilities by operation of law, with no need to comply with transfer formalities, such as cession etcetera.¹⁰

A takeover (acquisition) occurs when one company makes an offer to acquire or control a part of another company.¹¹ This typically happens when a larger company seeks to acquire a smaller company.¹² If a company holds more than fifty per cent of the shares in the company it has acquired, the acquiring company has a controlling interest in that company and consolidated financial statements must be submitted.¹³ A company can also acquire all the shares in a company and become the new owner.

However, this study is not concerned with the legal process of mergers and acquisitions save to consider the Value-Added Tax ("VAT") consequence of a foreign takeover of a South African registered company with regard to patents registered in the name of the South African company. As such, the legal requirements and

⁴ Bernd Geropp 'LME022 – What is the purpose of a company?' (accessed: 24 September 2021).

⁵ Corporate Finance Institute 'Motives for Mergers' (accessed: 24 September 2021).

⁶ Section 1 of the Companies Act 71 of 2008.

⁷ *ibid.*

⁸ *ibid.*

⁹ Cassim *Business Structures* 381.

¹⁰ *ibid* at 383.

¹¹ Kenton 'Takeover' (accessed: 24 September 2021).

¹² *ibid.*

¹³ *ibid.*

procedures for mergers and acquisitions are not considered in detail. Rather, this study focuses on whether the foreign takeover results in the local company ceasing its business activities in South Africa and no longer meeting the requirements for conducting an 'enterprise' for purposes of VAT. The effective date of the foreign takeover plays a key role in determining the local company's output VAT liability upon deregistering for VAT.

1.2. Research problem

Mergers are an everyday feature of business.¹⁴ From the discussion above, it is clear that mergers are formed for a variety of reasons and one of the reasons may be to reduce the company's tax liability.

This study focuses on the VAT consequences when there is a merger and/ or takeover involving a South African company and a foreign company in which the foreign company is the holding company, and the South African company acts as the subsidiary company.

Further, if the South African company's enterprise consists of earning an income from a patent registered in the companies' name, and the South African company disposes of its enterprise by transferring the patent rights to the foreign company, do any VAT consequences arise?

This study focuses on the following probable issues pertaining to a merger or takeover between a foreign company and a South African company –

1. The VAT implications of the merger and/or takeover.
2. The access to a South African registered patent by a foreign company.
3. The VAT consequences of the transfer of the patent rights as a result of a merger and/or takeover.

1.3. Research questions

This study seeks to address the following question:

¹⁴ Kelly *Competition Law* 162.

What are the VAT consequences of a foreign takeover of a South African registered company regarding patents registered in the name of the South African company?

The study is guided by the following research questions:

1. What is the difference between a merger and a takeover (acquisition)?
2. What is the position in law when a South African company which has merged or is taken over by a foreign company holds a registered patent?
 - 2.1 Does the new or surviving company automatically have access to the patent and its fruits?
3. What are the VAT implications in the case of a merger and takeover (acquisition), when the holding company is a foreign company, and its subsidiary is operating in South Africa?
 - 3.1 Does the local company cease to be a VAT vendor upon the effective date of the takeover?
 - 3.2 Is the requirement of carrying on an enterprise for purposes of VAT still met when the local company ceases its business activities in South Africa?
 - 3.3 Does the local company need to account for output VAT on the patents registered in the company when it ceases to be an enterprise for purposes of VAT?

1.4. Research methodology

This study is descriptive and follows a literature-based approach through a study of textbooks, legislation, case law, and academic journal articles. Electronic sources relevant to the study are also considered. This study is comparative in a sense in that the position in law relating to a merger is compared to the same position in law relating to a takeover.

1.5. Structure of the study

The study consists of five chapters aimed at analysing the VAT consequence of a foreign takeover of a South African registered company with reference to patents registered in the name of the South African company.

Chapter one is a general introduction and presents a brief introduction to the study, the problem statement, research questions, and the research methodology adopted in the study.

Chapter two is an in-depth description of a merger, a takeover, and a patent. Under these terms a company has different rights and responsibilities. Therefore, it is important to understand the precise meaning of the aforesaid terms before one can analyse other related issues. Furthermore, the chapter discusses the definition of a patent in general as opposed to the definition of a patent for VAT purposes.

Chapter three deals with the process followed by a foreign country to acquire a patent through the merger and whether the foreign company has automatic access to the patent.

Chapter four discusses the VAT implications that may apply to the merger and/or takeover. The requirements prescribed for VAT registration are set out and applied, to a limited extent, to establish whether the foreign company need to register for VAT.

The chapter also addresses the different scenarios as regards VAT implications of a foreign takeover. The chapter discusses if the local company, upon ceasing its business activities in South Africa, no longer carries on an enterprise for purposes of VAT. Alternatively, whether the takeover must be treated as a sale of a going concern, if possible, or as a sale of the assets to the foreign company.

Chapter five summarises the scope of the study and offers recommendations.

1.6. Terminology

The study uses technical terms which are defined in what follows.

Enterprise means “in the case of any vendor other than a local authority, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or

services are supplied to any other person for a consideration, whether or not for profit...”.¹⁵

Output tax means “in relation to any vendor, means the tax charged under section 7(1)(a) in respect of the supply of goods and services by that vendor”.¹⁶

Patent means “letters patent for an invention granted in the Republic”.¹⁷

Republic means “in the geographical sense, means the territory of the Republic of South Africa and includes the territorial waters, the contiguous zone and the continental shelf referred to respectively in sections 4, 5 and 8 of the Maritime Zones Act, 1994 (Act 15 of 1994)”.¹⁸

Supply includes “performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and any derivative of 'supply' shall be construed accordingly”.¹⁹

Taxable supply means “any supply of goods or services which is chargeable with tax under the provisions of section 7(1)(a), including tax chargeable at the rate of zero per cent under section 11”.²⁰

Vendor means “any person who is or is required to be registered under this Act: Provided that where the Commissioner has under section 23 or 50A determined the date from which a person is a vendor that person shall be deemed to be a vendor from that date”.²¹

¹⁵ Section 1(xvii) of the Value-Added Tax Act 89 of 1991.

¹⁶ *ibid* s 1.

¹⁷ Section 2(xiii) of the Patents Act 57 of 1978.

¹⁸ Section 1 of the Value-Added Tax Act 89 of 1991.

¹⁹ *ibid* s 1(lv).

²⁰ *ibid* s 1(lvii).

²¹ *ibid* s 1.

CHAPTER TWO: MERGERS AND TAKEOVERS (ACQUISITIONS)

2.1 Introduction

The purpose of this chapter is to distinguish between merger and acquisition arrangements in law. The chapter briefly explains the process followed in a merger and an acquisition. A comprehensive discussion of all the legal and tax requirements for mergers and acquisitions falls outside the scope of the study.

Mergers and acquisitions are regulated by the Companies Act 71 of 2008 (“Companies Act”) read with the Income Tax Act 58 of 1962 (“IT Act”). This chapter is a mere overview of merger and takeover transactions to set the scene for the discussion of the VAT consequences of the transfer of intellectual property in the event of both a merger and a takeover.

It is important to note that mergers and takeovers are possible between South African companies and/or between a South African company and a foreign company. However, the statutory merger provisions as set out in the Companies Act do not apply to foreign companies.²² In the case of a merger between a South African and a foreign company where the merging company is registered in a foreign jurisdiction, the South African Companies Act does not apply unless the merging company has a branch conducting business in South Africa. The South African branch will need to register with the Companies and Intellectual Property Commission as an external company.²³

Section 23 of the Companies Act sets out the registration requirements for an external company. A foreign company is regarded as an external company if it maintains an office in South Africa, conducts meetings in South Africa, maintains a bank account and enters into contracts in South Africa.²⁴

Before reaching a conclusion on the registration of a foreign company as an external company in terms of South African law, it is important to define a merger and a takeover.

²² Cassim MF (2008) 20 *South African Mercantile Law Journal* 8.

²³ Companies & Intellectual Properties Commission ‘Foreign Company’ https://www.cipc.co.za/?page_id=2185 (accessed: 9 November 2023).

²⁴ Section 23(2) & (3) of the Companies Act 71 of 2008.

2.2 Mergers

A merger can be defined as an easy and practical procedure whereby at least two companies, including the companies' assets and liabilities, are joined to form a single company or a totally new company.²⁵ The transfer of the assets and liabilities of the 'non-surviving' entity to the newly-merged company can take place without formally liquidating the 'non-surviving' company.²⁶

In *Municipal Employees Pension Fund and Others v Chrisal Investments (Pty) Ltd and Others*²⁷ the Supreme Court of Appeal emphasised the definition of a merger as set out in section 12 of the Competition Act 71 of 2008 ("the Competition Act"). Accordingly, a merger is formed where one company, either directly or indirectly, acquires control over another company.²⁸ The control over another company can be over either the whole company or a part of it.²⁹

The case deals with the sale of shares in a business by the three respondents.³⁰ The fourth respondent was the holding company of the first to third respondents.³¹ After the sale of the shares by the three respondents, the fourth respondent concluded an agreement to manage the co-ownership of the business.³² After the conclusion of the agreement, the fourth respondent demanded the termination of the co-ownership based on the *actio communi dividundo*.³³ The High Court decided in favour of the fourth respondent and the appellant approached the Supreme Court of Appeal in this regard.³⁴ The Supreme Court of Appeal considered various forms of agreement including a merger agreement.

Sections 113 to 116 of the Companies Act regulate the process for approving and implementing a merger. The requirements for a statutory merger are:

²⁵ Nicol (2013) 25 *Mercantile Law Journal* 30.

²⁶ Chong and van der Linde (2014) 25 *Stellenbosch Law Review* 477.

²⁷ 2022 (1) SA 137 (SCA) para 6.

²⁸ *Municipal Employees Pension Fund and Others v Chrisal Investments (Pty) Ltd and Others* 2022 (1) SA 137 (SCA) para 6.

²⁹ *ibid.*

³⁰ *ibid* 137.

³¹ *ibid.*

³² *ibid.*

³³ *ibid.*

³⁴ *ibid.*

1. the conclusion of a merger agreement;
2. the adoption of a special resolution by the shareholders in the company;
3. that the newly-formed company pass the solvency and liquidity test; and
4. notice to creditors of the respective companies to the merger.³⁵

2.2.1 First requirement: Merger agreement

The process of forming a merged company is based on the consensus between the merging companies.³⁶ The merging companies can conclude a written contract to reflect the terms upon which the merger is concluded.³⁷ The contract can include the estimated costs of the merger; the identity details of the directors; the way in which the shares are to be structured; how the assets and liabilities are to be allocated between the merging companies; and other aspects.³⁸

2.2.2 Second requirement: Shareholder approval

In its simplest form, a merger is a court-free process which requires only the affirmative votes of the majority of the shareholders to approve the merger.³⁹ At least 75 per cent of the shareholders' votes are required to approve the merger – in other words, the shareholders must pass a special resolution.⁴⁰

2.2.3 Third requirement: Solvency and liquidity test (“the test”)

To satisfy the solvency aspect of the test, the company's assets must exceed its liabilities.⁴¹ The liquidity aspect requires that, within 12 (twelve) months after the application of the test, the company must be able to settle the companies' debts as they become due and payable.⁴²

The test is regarded as an objective test, as the solvency and liquidity of the company are established on the basis of the “reasonable foreseeable financial circumstances” of the company.⁴³ However, the directors of the respective companies must still

³⁵ Cassim *Business Structures* 384.

³⁶ Delpont *Henochsberg* 411.

³⁷ *ibid.*

³⁸ Cassim *Business Structures* 384 – 385.

³⁹ Cassim *Business Structures* 380.

⁴⁰ Cassim *Business Structures* 386.

⁴¹ Delpont *Henochsberg* 33.

⁴² *ibid.*

⁴³ *ibid.*

believe that the new or surviving company will satisfy the solvency and liquidity test before the merger may be approved.⁴⁴

2.2.4 Fourth requirement: Notice to creditors

If the merger is approved, the new or surviving company must notify its creditors of the merger to allow them an opportunity to apply to a court to review a merger if they feel they may suffer prejudice.⁴⁵

Upon compliance with all four of these requirements and provided that the companies have received no objection from their creditors, the merger may go ahead.

2.3 Takeovers

A takeover is defined as the act of one company which makes an offer to acquire another company, in full or partially, or which offers to take control over the company.⁴⁶ The key element in a takeover is control. The acquiring company takes control over the target company.⁴⁷ There are various forms of takeover, for example, a friendly takeover in which the takeover is structured in the same way as a merger;⁴⁸ or hostile takeover in which the acquiring company uses unfavourable tactics to secure control over the target company without the target company realising what is happening in the market.⁴⁹ Other forms include a reverse takeover and activist takeovers.⁵⁰ For purposes of this study the discussion is limited to the definition of a takeover.

The Companies Act and the Takeover Regulations control takeovers in South Africa when the companies qualify as public, state-owned, or private companies.⁵¹ The Takeover Regulations govern the interpretation of take-over provisions, regulate the negotiations, offer procedures, and assist the TR Panel.⁵²

⁴⁴ Cassim *Business Structures* 386.

⁴⁵ *ibid* 388.

⁴⁶ Kenton 'Takeover' (accessed: 17 May 2023).

⁴⁷ *ibid*.

⁴⁸ *ibid*.

⁴⁹ *ibid*.

⁵⁰ *ibid*.

⁵¹ Cassim *Business Structures* 409.

⁵² *ibid* 411.

The Takeover Regulations established a Takeover Regulation Panel (“TR Panel”) that is responsible for the regulation of affected transactions, examining complaints regarding offers or affected transactions, consulting with the Minister to effect amendments to the Takeover Regulations, and other aspects.⁵³ The TR Panel is classified as a juristic person and has authority throughout South Africa.⁵⁴ This study is not concerned with the legality of takeovers beyond a discussion of a takeover as a phenomenon in the South African dispensation.

2.4 Differences between a merger and a takeover

The principal difference between a merger and a takeover is the ownership and division of the respective companies’ assets and liabilities. In the case of a merger the different companies’ assets and liabilities become one and the two companies operate as a single company. In the case of a takeover of a part of a company’s shares, the acquiring company is only entitled to the amount of income etcetera, in relation to its percentage of shares held in the company.

A further difference between the two is the conclusion of an agreement. In a merger there is mutual agreement between the two or more companies to form a single company; while in a takeover there is not always an agreement between the parties to obtain control over the target company.⁵⁵

2.5 Conclusion

As we have seen, a merger between two companies and a takeover of companies are two distinct processes. The distinction between the two terms is essential as the effects on the ownership and/or transfer of the assets and liabilities in the respective companies differ. As there is transfer of assets between two or more companies, the next chapter deals with the transfer of a patent registered in one company and which forms part of that company’s assets, to the company resulting from the merger or takeover.

⁵³ *ibid.*

⁵⁴ *ibid.*

⁵⁵ Gallant ‘Merger vs. Takeover’ (accessed: 17 May 2023).

CHAPTER THREE: THE CREATION AND TRANSFER OF PATENT RIGHTS

3.1 Introduction

A merger between companies or the acquisition of a company through a takeover, involves the transfer of assets between the respective companies. It is, therefore, important to focus on the transfer of the assets between the respective companies. The study is limited to the transfer of intellectual property between the companies, more specifically, the transfer of a patent between them.

This chapter focuses on the creation of a patent, the transfer of patent rights between a South African and a foreign company, the use of the patent outside South Africa, and whether the assignment of a patent to another entity may be denied.

3.2 Patents in general

An Intellectual property right is a property right that enables the holders of intellectual property to benefit and earn an income from their own work.⁵⁶ Forms of intellectual property include patents, copy rights, and trademarks. This study is restricted to patents.

Patents are governed by the Patents Act 57 of 1978 (“Patents Act”). The Patents Act⁵⁷ defines a patent as “a certificate in the prescribed form to the effect that a patent for an invention has been granted in the Republic”. The most important requirement for a patent is the existence of an invention. Section 25(1) of the Patents Act⁵⁸ provides that “a patent is granted for a new invention”. The Act does not define the term invention but provides a list of exclusions that cannot be classified as an invention.⁵⁹ An invention can include a device, machinery, a process, a method for the development of a product, etcetera.⁶⁰

An invention must meet the following requirements to be patentable:

- 1.) novelty;

⁵⁶ Dean *Introduction to Intellectual Property Law* xxvii.

⁵⁷ 57 of 1978, s 1.

⁵⁸ 57 of 1978.

⁵⁹ Dean *Introduction to Intellectual Property Law* 241.

⁶⁰ *ibid.*

- 2.) usefulness; and
- 3.) inventiveness.⁶¹

3.2.1 First requirement: Novelty

Sections 25(5) to 25(8) set out the requirements for novelty. Novelty requires the invention to be new and never before to have existed in the public domain.⁶² 'New' means that the patent does not form part of the 'state of art'.⁶³ State of the art is closely linked to the public domain in that it must not have been made available to the public in any way before or that it has not before come to the attention of the public.⁶⁴

There are exceptions to the requirement of novelty. First, when the invention is used in secret in the commercial field within the Republic, the invention is deemed to fall within the public domain and therefore does not qualify as new.⁶⁵ Second, when the invention comprises of a substance or composition that is used in the process of treatment in surgery or therapy – involving both animal or human bodies – and forms part of the state of the art before the priority date, the invention will not satisfy the novelty requirement.⁶⁶ The priority date is the date on which the patent application is filed for the first time.⁶⁷

3.2.2 Second requirement: Usefulness

The patent must be capable of being used by an individual or company. Section 25(1) of the Patents Act⁶⁸ states that an invention may be granted if, *inter alia*, it can be used or applied in business.

3.2.3 Third requirement: Inventiveness

Section 25(10) addresses the requirement of inventiveness which it defines as follows: "An invention shall be deemed to involve an inventive step if it is not obvious to a person skilled in the art..".⁶⁹ It is important to establish the art or science to which the

⁶¹ *ibid.*

⁶² *ibid* 245.

⁶³ Section 25(5) of the Patents Act 57 of 1978.

⁶⁴ Dean *Introduction to Intellectual Property Law* 245.

⁶⁵ Section 25(8) of the Patents Act 57 of 1978.

⁶⁶ *ibid* s 25(9).

⁶⁷ Dean *Introduction to Intellectual Property Law* 245.

⁶⁸ 57 of 1978.

⁶⁹ *ibid* s 25(10).

patent relates so as to determine whether the invention is obvious to the person skilful in the art.⁷⁰

In *Ascendis Animal Health (Pty) Limited v Merck Sharpe Dohme Corporation and 2 Others*,⁷¹ the Constitutional Court stated that the requirement of obviousness is not determined on the basis of theoretical definitions and legal doctrines submitted by the courts, but rather by the particulars and circumstances relating to the patent. The Constitutional Court further held that before one can consider whether the invention satisfies the requirement of obviousness, the invention must satisfy the requirement of novelty.⁷²

If the invention complies with all three of the requirements above, it is patentable. A patent is deemed to have been granted upon publication in the Patent Journal.⁷³

3.3 Patent holder

A patent applicant is named on the application and is also classified as the legal owner or patent holder.⁷⁴ The patent holder may be either an individual or a company.⁷⁵ An individual files the patent application in his or her own name as opposed to a company where the company files the application in its name, but the inventor is the name of an employee.⁷⁶

3.4 The lifespan of a patent

A patent grants the patent holder (“patentee”) a monopoly right over his or her invention for a period of twenty years.⁷⁷ The right prevents others from abusing the invention for that period.⁷⁸ A patent’s lifetime is twenty years on condition that an annual renewal fee is paid.⁷⁹ After the expiry of the twenty years, the patent is no

⁷⁰ Dean *Introduction to Intellectual Property Law* 249.

⁷¹ [2019] ZACC 41 para 58.

⁷² *Ascendis Animal Health (Pty) Limited v Merck Sharpe Dohme Corporation and 2 Others* [2019] ZACC 41 para 61.

⁷³ Dean *Introduction to Intellectual Property Law* 259.

⁷⁴ Neilson ‘Patent ownership and inventorship (accessed: 25 November 2023).

⁷⁵ *ibid*

⁷⁶ *ibid*.

⁷⁷ Dean *Introduction to Intellectual Property Law* 239.

⁷⁸ *ibid*.

⁷⁹ Companies & Intellectual Properties Commission ‘Register Patent’ https://www.cipc.co.za/?page_id=4184 (accessed: 12 September 2023).

longer protected and the invention falls into the public domain where any person or company may use the invention without having to pay royalties or a licence fee.⁸⁰

3.5 Remuneration

A patentee is entitled to earn an income for his or her invention. A patentee may grant a licence to a third party to manufacture, sell, or promote the patented invention.⁸¹ The licence grants a third-party permission to use the patent. To obtain a licence, a third party pays the patentee a royalty for the use of the patent.⁸² The amount and payment of the royalties are subject to agreement between the patentee and the third party using the patent.⁸³ The payment may be a once-off or continuing payments to the patentee.⁸⁴

3.6 Patent application and the assignment of rights to the patentee

A patentee must file a patent application to register a patent over its invention with the Patent Office.⁸⁵ South Africa's patent system is known as a 'non-examination' patent system, meaning that the Companies and Intellectual Property Commission (the "CIPC") only assesses whether all documents have been completed and the supporting documents are annexed to the patent application as prescribed by the Patents Act.⁸⁶ The CIPC does not perform a comprehensive examination on the content of the patent application.⁸⁷ Upon submission of all the required documents and payment of the prescribed fee, the CIPC will award the patent application to the patentee.⁸⁸

The South African patent system is also classified as a 'first-to-file' registration system.⁸⁹ The 'first-to-file' approach involves the patent being granted to the first

⁸⁰ Department of Trade and Industry 'The World of Intellectual Property' 9 (accessed: 12 September 2023).

⁸¹ Department of Trade and Industry 'Intellectual Property Policy of the Republic of South Africa Phase I' 27 (accessed: 17 September 2023).

⁸² Patent PC 'What are Royalties?' (accessed: 19 September 2023).

⁸³ *ibid.*

⁸⁴ *ibid.*

⁸⁵ Dean *Introduction to Intellectual Property Law* 253.

⁸⁶ Lesofe (2017) 29 *South African Mercantile Law Journal* 455.

⁸⁷ *ibid.*

⁸⁸ *ibid.*

⁸⁹ Tong '(2015) 36 *Industrial Law Journal* 879.

patentee who files for a specific patent.⁹⁰ The patentee's patent application will enjoy precedence over other patent applications submitted.⁹¹

Once the patent has been registered, the intellectual property owner has the right to exclude others from the use of the patent for economic benefit.⁹² There is no specific authority that observes patent infringement and it usually comes to the attention of the patentee through advertisements, clients, retailers, and others.⁹³ If the patentee becomes aware of the infringement by a third party, he or she may claim damages or a fair royalty, or obtain an interdict from the court to restrain the third party from using the patent.⁹⁴

3.7 Assignment of a patent or rights under a patent application

A patentee may assign a patent, either partially or in whole, to an assignee or assign the patent application, in whole or partly, to one or more countries.⁹⁵ To assign a patent legally, the patentee and assignee must conclude a written assignment agreement, whether for consideration or not.⁹⁶ The patent assignment agreement may be recorded in the Patent Register, but this is not a requirement.⁹⁷ However, the assignment application must be filed with the Patent Office.⁹⁸ If the assignment application is not recorded in the Patent Office, the assignee will not be able to initiate proceedings for an infringement of the patent by a third party as the assignee will not be regarded as the patent holder.⁹⁹

Where a South African patentee assigns intellectual property to a foreign resident or company, the assignment is subject to the approval of the South African Exchange Control Authorities.¹⁰⁰

⁹⁰ *ibid.*

⁹¹ *ibid.*

⁹² *ibid* 870.

⁹³ Foster 'Intellectual Property Transactions' (accessed: 13 September 2023).

⁹⁴ *ibid.*

⁹⁵ *ibid.*

⁹⁶ *ibid.*

⁹⁷ Dean *Introduction to Intellectual Property Law* 361.

⁹⁸ *ibid.*

⁹⁹ *ibid* 362.

¹⁰⁰ Foster 'Intellectual Property Transactions' (accessed: 13 September 2023).

3.7.1 Approval by the South African Exchange Control Authorities

Before South African intellectual property may be transferred, assigned, or ceded to a foreign company, the South African intellectual property owner needs the authorisation of the Financial Surveillance Department (“the Authorised Dealers”) to do so.¹⁰¹ The transfer of the intellectual property to a non-resident company may occur at arm’s length, at a reasonable market-related price, but on condition that the transfer has been presented to the Authorised Dealers.¹⁰² The South African company must also obtain a letter from an auditor, confirming the calculation of the royalty or licence fees, or a valuation certificate reflecting the value of the intellectual property and how the value was calculated.¹⁰³

It may happen that the Authorised Dealers decline the application to assign or transfer the patent rights to the foreign company. This decision may not always satisfy the South African company and as the Financial Surveillance Department is an organ of state, its decisions are reviewable if an applicant feels that there has been improper administrative action.

In deciding to authorise the transfer of intellectual property to a foreign company, the Authorised Dealers apply the following criteria:

1. they must be satisfied that the transfer is to an unrelated foreign party;
2. the transaction to transfer or assign the intellectual property must be at arm’s length; and
3. the price for the intellectual property must be reasonable and in line with market-related prices.¹⁰⁴

Administrative action includes a decision that either establish what a person’s right in the situation are or deprive an individual or a company of a right.¹⁰⁵ Where the Authorised Dealers decline a South African company’s application to transfer or assign a patent to a foreign company, and the South African company is aggrieved by the

¹⁰¹ South African Reserve Bank ‘Currency and Exchange Guidelines for business entities’ 25 (accessed: 27 November 2023).

¹⁰² *ibid.*

¹⁰³ *ibid* 26.

¹⁰⁴ Michalsons ‘Transferring intellectual property offshore’ (accessed: 27 November 2023).

¹⁰⁵ Department of Justice and Constitutional Development ‘Promotion of Administrative Justice Act, 2000 (Act 3 of 2000)’ (accessed: 27 November 2023).

outcome, the company must decide whether the administrative action of the Authorised Dealers warrants a review in terms of the Promotion of Administrative Justice Act 3 of 2000 (the “PAJA”). The decision by the Authorised Dealers qualifies as administrative action as it decides either to deprive the foreign company of the patent rights, or it establishes that the patent rights will remain with the patent holder.

If the South African company elects to take the administrative action of the Authorised Dealers on review, it may do so in terms of section 6(2) of PAJA. The South African company may take the decision of the Authorised Dealers on judicial review, *inter alia*, on the following grounds.

- a) The person who took the decision did not have the relevant authority or was biased in reaching his or her decision.¹⁰⁶
- b) The prescribed procedure was not followed, or the decision was procedurally unfair.¹⁰⁷
- c) The decision was made in bad faith or for an ulterior motive.¹⁰⁸
- d) The official involved failed to decide or the decision was unlawful or unconstitutional.¹⁰⁹

Section 6(2) of the PAJA provides an extensive list of grounds for the review of administrative action. However, an in-depth discussion of these PAJA provisions falls outside the scope of the study. It is important to note that when the South African company is aggrieved by the decision of the Authorised Dealers, the decision may be taken on review under section 6(2) of the PAJA.

The situation is the same for a merger and for a takeover, as the merging company in which the patent is registered may need to transfer ownership to the newly-formed company. The newly-formed company may be registered and operated in a foreign jurisdiction and, therefore, the relevant authorisation from the Authorised Dealers is required.

¹⁰⁶ Section 6(2)(a) of the Promotion of Administrative Justice Act 3 of 2000.

¹⁰⁷ *ibid* s 6(2)(b) & (c).

¹⁰⁸ *ibid* s 6(2)(e).

¹⁰⁹ *ibid* s 6(2)(g) & (i).

3.8 Territoriality of a patent

The main concern regarding patents is territoriality. A patent has protection in the country where it is registered, for example, when the patent is registered in South Africa it will enjoy a monopoly right only in South Africa.¹¹⁰ If a South African patentee seeks protection for his or her patent outside of South Africa, he or she will need to apply for the patent to be registered in that specific country.¹¹¹ In other words, the exclusive right shields events occurring in the territory where the patent is registered.¹¹²

So, essentially, where a foreign entity takes over a South African company, it can exploit the patent only in South Africa unless the patent is also registered in a foreign jurisdiction.

Only patents that are registered in terms of the South African intellectual property laws are acknowledged for enforcement purposes.¹¹³ However, foreign patents or foreign patent applications are still identifiable in South Africa and are used in establishing the novelty requirement for a patent and in claims where the priority of an application is in dispute.¹¹⁴

There are various multilateral treaties dealing with intellectual property, and South Africa's involvement in these treaties play a vital role in the protection of South African patentees' patents in foreign jurisdictions. We turn now to South Africa's status as signatory to the Paris Convention¹¹⁵ and the Patent Cooperation Treaty (the "PCT")¹¹⁶.

3.8.1 Multilateral treaties

South Africa is party to the Paris Convention for the Protection of Industrial Property (the "Paris Convention").¹¹⁷ An inventor in a country which forms part of the Union

¹¹⁰ Dean *Introduction to Intellectual Property Law* 239.

¹¹¹ *ibid.*

¹¹² *Gallo Africa Ltd and Others v Sting Music (Pty) Ltd and Others* 2010 (6) SA 329 (SCA) para 15.

¹¹³ Foster 'Intellectual Property Transactions' (accessed: 13 September 2023).

¹¹⁴ *ibid.*

¹¹⁵ 21 UST 1583; 828 UNTS 305.

¹¹⁶ 28 UST 7645; 1160 UNTS 231; (1970) 9 *ILM* 978.

¹¹⁷ Paris Convention for the protection of industrial property of 20 March 1883, as revised at Brussels on 14 December 1900, at Washington on 2 June 1911, at the Hague on 6 November 1925, at

under the Paris Convention, enjoys protection for his or her patent in other Union countries.¹¹⁸ The inventor can obtain international protection for his or her invention provided that international patent applications are lodged no more than one year after the filing of the patent application in South Africa.¹¹⁹ In terms of this Convention, it is suggested that an international search be conducted before filing patent applications in other countries.¹²⁰

The filing of an international patent application grants the patent holder the opportunity to protect his or her patent in a foreign jurisdiction. If the international patent application is granted, the patent holder can start earning remuneration, in the form of royalties, on his or her patent in the foreign jurisdiction. The filing of an international patent application, in my view, qualifies as an indirect export of the patent rights to the specific foreign jurisdiction although the patent holder remains the primary beneficiary of royalties earned on the patents.

South Africa is signatory to the PCT together with more than 125 other countries.¹²¹ The PCT allows a signatory to submit an international patent together with a national patent.¹²² The national patent refers to the patent application filed in South Africa. The international patent application should designate the countries in which the signatory seeks protection and where the patent should be registered.¹²³ An extra fee is payable for the filing of an international patent.¹²⁴

The PCT is not established to grant international patents but to rather assist in the filing of patent applications and conducting the international search and examination procedures against already existing patents.¹²⁵ The Patent Office is responsible for the granting of a patent after due consideration of the patent application and after

London on 2 June 1934, at Lisbon on 31 October 1958, and at Stockholm on 14 July 1967, and as amended on 28 September 1979, 21 UST 1583; 828 UNTS 305.

¹¹⁸ Doi (2002) 26 *Fordham International Law Journal* 378.

¹¹⁹ Moore IP 'Patents in South Africa: General Information' (accessed: 14 September 2023).

¹²⁰ *ibid.*

¹²¹ Department of Trade and Industry 'The World of Intellectual Property Law' 10 (accessed: 15 November 2023).

¹²² *ibid.*

¹²³ *ibid.*

¹²⁴ *ibid.*

¹²⁵ Department of Trade and Industry 'The World of Intellectual Property Law' 13 (accessed: 15 November 2023).

conducting searches to establish whether the invention meets the requirements for registration as a patent.¹²⁶ The International Searching Authority (the “ISA”), which is a Patent Office, investigates the available documents that may be significant to the patentability of the patent for which the international patent application is lodged under the PCT.¹²⁷

The ISA publishes an international search report and a written non-binding opinion on the patentability of the patent for which protection is sought.¹²⁸ The patentee uses the written opinion to evaluate the prospect of success in the procurement of a granted patent in the different contracting states.¹²⁹

Once the above process has been completed, the patentee needs to start with the national phase in the other contracting states to the PCT where protection of the patent is sought.¹³⁰ The national phase refers to the individual filing of national phase applications in the respective countries where the patentee seeks protection for his or her patent.¹³¹

A South African patent enjoys protection in the country where it is registered unless the South African patentee has filed an international application and the international application has been granted. As South Africa is a signatory to the PCT, the patent will enjoy protection in countries signatory to the PCT if the above procedure has been complied with.

3.9. The transfer of patent rights through a merger or takeover

In general terms, the assets and liabilities of the two or more merging companies are joined together and both companies have access to the various assets and liabilities.¹³² The transfer of all the assets and liabilities to the newly formed company occurs automatically through process of law once the merger is complete.¹³³

¹²⁶ *ibid.*

¹²⁷ Dean *Introduction to Intellectual Property Law* 257.

¹²⁸ *ibid.*

¹²⁹ *ibid.*

¹³⁰ *ibid.*

¹³¹ *ibid.*

¹³² Cassim *Business Structures* 380.

¹³³ *ibid* 381.

In a takeover the acquiring company assumes control of another company.¹³⁴ As opposed to a merger, there is no transfer of ownership of the assets or liabilities in the case of a takeover. The acquiring company merely holds a percentage of shares in the company and is only entitled to the proceeds of its percentage of shares.

As the study focuses on the accessibility of a patent through a foreign takeover or merger, it is important to note that access to the patent differs in the case of a merger and a foreign takeover. In the case of a foreign merger, the two companies' assets and liabilities are joined and both companies have access to the respective companies' assets and liabilities through the process of law.

However, a patent is an intangible asset, meaning the asset does not have a physical form and it grows in value over time.¹³⁵ A patent qualifies as an identifiable intangible asset as it can be separated from the company.¹³⁶ Even though the merging companies may have access to the respective companies' assets and liabilities, a patent is an exception to the automatic transfer of ownership.

The ownership of a patent does not automatically transfer upon effecting the merger, the owner of the patent must assign, cede, and/or transfer the patent to the owner of the merging company.¹³⁷ The position changes if the patent is registered in one of the company's employees' names and the employee continues to work at the newly-merged company. The newly-merged company has access to the patent with the approval of the employee.

If the merging company is still located in South Africa, the protection of the patent continues, and the provisions of the Patents Act apply. However, when the merger is between a South African company and a foreign company and the merging company is located abroad, it is important to establish whether the patent owner has filed an international patent application, and whether the patent enjoys protection in that specific country as discussed under the PCT applications. If the patent owner does

¹³⁴ Kenton 'What is a Takeover?' (accessed: 20 September 2023).

¹³⁵ Shopify Staff 'What is an Intangible Asset?' (accessed: 20 September 2023).

¹³⁶ *ibid.*

¹³⁷ Foster 'Intellectual Property Transactions' (accessed: 13 September 2023).

not file an international patent application, the patent will only enjoy protection under South African law even though the new patent owner is not living in South Africa on condition that the relevant assignment agreement is concluded.

In the case of a foreign takeover there is no transfer of the ownership of a patent as the foreign company (acquiring company) only assumes control over a percentage of another company and not necessarily specific assets of the company. The patent owner may grant a licence to the acquiring company for the use of the patent in return for the payment of royalties. In the case of a complete takeover of the company, the patent will form part of the sale of the company to the acquiring company. The same principles regarding the assignment, cession, and transfer of the patent as mentioned earlier will apply. There will be no automatic transfer of ownership of the patent. The patent will only enjoy protection in the foreign country if an international patent application has been filed under the PCT and the patent enjoys protection in that specific foreign country. If there is no international patent application, the patent will continue to enjoy protection in South Africa for twenty years. Thereafter, the patent falls within the public domain and is open to use by all.

3.10 A patent and liquidation proceedings

If the company in whose name the patent is registered is liquidated, what can be the effect on the patent? Insolvency proceedings entail the division or sale of the assets of the liquidated company to compensate the creditors who have claims against the liquidated estate.¹³⁸ A patent registered in the company forms part of the assets of the company and may, therefore, be sold or transferred to third parties to collect funds for the liquidated estate to compensate the creditors.¹³⁹

However, the patent holder has a right to object to the sale or transfer of the patent if he or she believes that the patent is being sold to the competition of the holder or the valuers have undervalued the patent.¹⁴⁰ Further, the patent holder has the right to retain ownership of the patent and may exclude the patent from the assets of the

¹³⁸ Barter 'Insolvency and Intellectual Property Rights in South Africa' (accessed: 26 November 2023).

¹³⁹ *ibid.*

¹⁴⁰ *ibid.*

insolvent estate.¹⁴¹ In the case of retention of ownership of the patent, the patent holder may need to provide proof that the patent is separate from the rest of the assets in the liquidated estate.¹⁴²

In a foreign takeover, the foreign acquiring company becomes a shareholder in the South African company and has an interest in the assets of the South African company in proportion to the number of shares held in the company. As the foreign acquiring company contributed either money or assets to acquire its shares in the South African company, upon liquidation the foreign acquiring company has a claim against the company's liquidated estate for the money or assets contributed to acquiring the shares in the company.

If the foreign acquiring company is, for example, the majority shareholder and it decides to liquidate the South African company, what possible consequences are there for the patent registered in the South African company? It is important to establish whether the patent application was filed in the company's name or in the name of the inventor – who may be an employee of the company – to determine who holds the patent at the date of liquidation. If the patent holder is the South African company, the foreign acquiring company may be the patent holder if, upon acquiring the majority shareholding, the patent rights were transferred to the foreign acquiring company subject to the necessary approval as discussed above. However, if the patent rights are not transferred to the foreign acquiring company, the inventor may still be the patent holder.

Where the foreign acquiring company becomes the patent holder, it may decide what happens to the patent upon liquidation of the company. It can either retain ownership of the patent or sell the patent for an appropriate value.

3.11 Conclusion

From our discussion, it is clear that there is no automatic transfer of the ownership of a patent. The patent holder must transfer or assign the patent rights to another

¹⁴¹ *ibid.*

¹⁴² *ibid.*

company. In the case of a foreign takeover, the South African company requires the approval of the Authorised Dealers to transfer the patent rights abroad. The patent holder must file an international patent application in the foreign countries in which it seeks protection otherwise the patent enjoys protection only in South Africa.

If the assignment or transfer of the patent rights is denied, the South African company (the patent holder) may take the decision on review in terms of the PAJA since the Authorised Dealers are an organ of state. However, if the review application is unsuccessful, the patent rights may not be transferred or assigned, and the foreign company may not use the patent.

The next chapter deals with the Value- Added Tax implications of the transfer of the patent rights as a result of a foreign takeover or merger.

CHAPTER FOUR: THE VALUE-ADDED TAX (“VAT”) IMPLICATIONS OF A MERGER OR TAKEOVER

4.1 Introduction

The purpose of this chapter is to establish the VAT consequences where patent rights are transferred as a result of a merger or takeover. The focus of the chapter is on establishing whether the transfer of patent rights satisfy the definition of a supply in order to trigger the levying of VAT on the transaction.

4.2. Charging provision in terms of the VAT Act

In terms of section 7(1) of the Value-Added Tax Act (the “VAT Act”), VAT is levied on:

- (a) “the supply by any vendor of goods or services supplied by him on or after the commencement date in the furtherance of any enterprise carried on by him”;
- (b) “on the importation of any goods into the Republic by any person on or after the commencement date”; and
- (c) “on the supply of any imported services by any person on or after the commencement date”.¹⁴³

In South Africa, a registered VAT vendor is required to levy VAT at fifteen per cent on the supply of its goods or services or on the importation of goods and services into the Republic.¹⁴⁴ VAT is levied at each stage in the manufacture and supply chains.¹⁴⁵ If a foreign company carries on an enterprise in South Africa and meets the requirements set out in section 23 of the VAT Act, the company is required to register for VAT in South Africa.¹⁴⁶

Section 7(1) of the VAT Act can be divided into five key elements:

- 1.) A supply;
- 2.) of goods and services;
- 3.) by a vendor;
- 4.) in the course and furtherance of an enterprise; and
- 5.) in the Republic.

¹⁴³ Section 7(1) of the Value-Added Tax Act 89 of 1991.

¹⁴⁴ *ibid.*

¹⁴⁵ Silver *VAT Handbook* 4.

¹⁴⁶ Shepstone & Wylie ‘Expatriate employees’ (accessed: 28 June 2023).

Each of these elements is now discussed with specific reference to the transfer of patent rights as a result of a foreign takeover or merger.

4.3 Supply

The VAT Act defines supply as:

“performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and any derivative of 'supply' shall be construed accordingly.”¹⁴⁷

In *Commissioner for SARS v De Beers*¹⁴⁸ the court described taxable supplies as any supply which is taxable, including taxation at a zero-rate, under section 7(1)(a) or section 11 of the VAT Act. Supplies can be either the supply of goods or services. Supplies can be divided into three categories: standard-rated; zero-rated; and exempt supplies. Only standard-rated and zero-rated supplies qualify as taxable supplies as a zero or fifteen per cent tax is levied.¹⁴⁹

The transfer of patent rights resulting from a merger or takeover, qualifies as a supply because the respective entities conclude an agreement to merge or to take control of the other entity. The transfer of the patent rights satisfies the requirement of supply, as the transfer of the patent rights is the performance in terms of a merger or takeover agreement.

Supplies that fall under the category of exempt supplies, are not subject to VAT and no VAT may be claimed on the acquisition of stock to manufacture exempt supplies.¹⁵⁰ Section 12 of the VAT Act sets out the list of supplies that qualify as an exempt supply, for example, financial services, services by a school or university, transport services, and others.¹⁵¹

¹⁴⁷ Section 1 of the Value-Added Tax Act 89 of 1991.

¹⁴⁸ (503/ 2011) [2012] ZASCA 103 (1 June 2012) para 21.

¹⁴⁹ Sonnenbergs 'VALUE-ADDEDD TAX 2119. Basic concepts' (accessed: 28 August 2023).

¹⁵⁰ Botes *An Introduction to VAT* 146.

¹⁵¹ Section 12 of the Value-Added Tax Act 89 of 1991.

4.3.1. Intra-group and deemed supplies

Intra-group transactions include transactions between the different companies within, a single group, for example a transaction between a holding and a subsidiary company. The intra-group supplies between the companies have different VAT treatment and some of the supplies can be exclusive of VAT.

As opposed to the above, section 8 of the VAT Act makes provision for deemed supplies. Deemed supplies include, *inter alia*, the following:

- 1.) a supply will be considered as a deemed supply where a payment is made in circumstances that are not generally considered to be a supply; or
- 2.) when there was not a supply by a VAT vendor in carrying out his or her enterprise, but the supply could qualify as a taxable supply.¹⁵²

Examples of deemed supplies, as set out in section 8 of the VAT Act, include a sale in execution, cession of an enterprise, the sale of an enterprise as a going concern, and transactions between branches and the key business.¹⁵³

As the study focuses on mergers and takeovers, it is necessary to consider under what circumstances a merger and takeover constitutes an intra-group supply that is exempt from VAT or considered a deemed supply.

Section 50(1) and (2) of the VAT Act¹⁵⁴ provides that where a vendor has more than one enterprise or the enterprise consists of several branches, the vendor is permitted to register each branch or enterprise separately on condition that the enterprise or branch is separately identifiable and maintains its own accounting records. To effect the separate registration of each enterprise or branch, the vendor should submit a VAT102 form to SARS for each enterprise or branch that is required to be registered separately.¹⁵⁵

¹⁵² Botes *An Introduction to VAT* 80.

¹⁵³ *ibid* 80 – 88.

¹⁵⁴ 89 of 1991.

¹⁵⁵ Silver *VAT Handbook* 161.

Any vendor which is liable for VAT registration must complete a VAT 201 registration form. The VAT registration form (Form VAT 201) must be submitted physically by the owner or the representative vendor of the enterprise to the SARS branch closest to where the enterprise trades.¹⁵⁶

In contrast, each subsidiary to a main company needs to register for VAT independently as a group of companies are not permitted to register as a single entity.¹⁵⁷ The transactions between the subsidiaries constitute a supply between different vendors. But transactions between the respective branches in the same vendor do not constitute a supply between separate vendors and do not attract VAT.¹⁵⁸

To eliminate confusion, it is important to differentiate between a subsidiary of a main company and a branch of a main company. On the one hand, a subsidiary company is a separately registered company in South Africa, and a local or foreign company holds a percentage of shares in this separately registered company.¹⁵⁹ On the other hand, a branch is not a separately registered company and merely operates as one of the offices within a single company.¹⁶⁰

Where the main business is in the Republic, and a branch is located outside the Republic, the goods and services supplied by the foreign branch do not form part of the supplies made by the main business in the Republic.¹⁶¹ If the main business is not located in the Republic – therefore is a foreign vendor – and it has a branch in South Africa, the foreign vendor will be excluded from the definition of an enterprise on condition that the foreign business has an independent accounting system and the company is identifiable separately.¹⁶² If these two requirements are met, the foreign company will not be subject to VAT and the South African branch will carry the VAT burden on the supplies made in carrying on its enterprise in South Africa.

¹⁵⁶ Botes *An Introduction to VAT* 40.

¹⁵⁷ Stiglingh *Silke* 1098.

¹⁵⁸ *ibid.*

¹⁵⁹ Lumsden 'Branch vs Subsidiary' (accessed: 10 September 2023).

¹⁶⁰ *ibid.*

¹⁶¹ Stiglingh *Silke* 1100.

¹⁶² *ibid* 1101.

Section 8(9) of the VAT Act contains a deeming provision for transactions with a foreign branch or foreign key business. When the South African vendor performs its duties in the exercise of its enterprise to its foreign key business or branch, the supplies will be deemed taxable supplies if the foreign branch or foreign key business is separately identifiable and is situated outside South Africa.¹⁶³ The delivery of the goods or services to the foreign company is deemed a taxable supply and, therefore, attracts VAT.¹⁶⁴ The South African vendor is liable to account for the output tax on the transaction.¹⁶⁵

In short, a foreign entity is compelled to register for VAT if it has a South African subsidiary or holding company and the foreign entity is making supplies for the subsidiary entities in South Africa.¹⁶⁶ If the main business or a branch of the foreign company is not located in South Africa, the foreign company will not have VAT consequences on its supplies made outside South Africa provided that the main business or branch maintains an independent accounting system and can be able to be identified on its own.¹⁶⁷

4.3.2 Supplies between companies in a foreign takeover

If the foreign vendor has a subsidiary in South Africa, and it makes supplies to the South African vendor, both entities (the foreign and the South African vendors) are liable to account for VAT on the transactions between them. It may be assumed that both vendors are registered for VAT as the South African subsidiary company qualifies as the foreign company's establishment in South Africa.

4.3.3 Supplies between companies to a merger

As discussed in Chapter 2, upon the merging of two companies the assets of the respective companies are joined into one company or are joined to form a new company.¹⁶⁸

¹⁶³ Botes *An Introduction to VAT* 88.

¹⁶⁴ *ibid.*

¹⁶⁵ *ibid.*

¹⁶⁶ South African Institute of Chartered Accountants, 'A foreign entity's liability to register' (Date accessed: 26 September 2021).

¹⁶⁷ *ibid.*

¹⁶⁸ Nicol (2013) 25 *South African Mercantile Law Journal* 30.

If the two merging companies had transacted with each other before the merger, the VAT principles would have been applied as set out above regarding transactions between a foreign holding company and a South African subsidiary company. The same VAT principles are applicable as the companies would have had their own separate legal personalities.

Upon the merging of the two companies to form the merged company, the location from where the merging company will operate is the determining factor for whether or not the South African VAT system applies. If the merging company is to be operated in South Africa, the registration requirements in section 23(1) of the VAT Act must be met. If the merging company is to be operated outside the Republic, the merging company will only be liable for VAT registration if it conducts an enterprise in South Africa.

4.4 Goods and services

The second element requires the supply to be a supply of goods and services. Goods are defined in the VAT Act as:

“corporeal movable things, fixed property and any real right in any such thing or fixed property, but excluding-

- (a) money;
- (b) any right under a mortgage bond or pledge of any such thing or fixed property; and
- (c) any stamp, form or card which has a money value and has been sold or issued by the State for the payment of any tax or duty levied under any Act of Parliament, except when subsequent to its original sale or issue it is disposed of or imported as a collector’s piece or investment article.”¹⁶⁹

Services are defined in the Act as something done or still to be done by a party and specifically excludes the supply of goods or money.¹⁷⁰ Services further include the conceding, assignment, or cession of a right.¹⁷¹

The International Accounting Standard Number 38 (“IAS” 38) sets out the principles involved in identifying an intangible asset. IAS 38 identifies an intangible asset as an asset without a physical form.¹⁷² Intellectual property qualifies as an intangible asset

¹⁶⁹ Section 1 of the Value-Added Tax Act 89 of 1991.

¹⁷⁰ *ibid.*

¹⁷¹ *ibid.*

¹⁷² IAS, ‘38 ‘Intangible Assets’ (accessed: 22 November 2023).

as it has no physical form. A patent is, therefore, classified as an intangible asset that forms part of the of a company.

The transfer of intellectual property does not qualify as a supply of goods as it does not fall within the definition of ‘goods’ under the VAT Act. Therefore, the transfer of intellectual property is classified as the supply of a service for the purposes of charging VAT.¹⁷³ This study is restricted to the transfer of patent rights and, as such, the transfer of any tangible patented goods (as part of the assets being transferred) as a result of a merger or takeover falls outside the scope of the study.

4.5 By a vendor

The third element is that the supply must be by a vendor. A person is a vendor if he or she has registered him- or herself as a vendor or is required in terms of the VAT Act to register as a vendor.¹⁷⁴ The VAT Act distinguishes between compulsory and voluntary VAT registration. In terms of compulsory registration, a person is compelled to register for VAT if the total value of his or her taxable supplies exceeds one million Rand in the furtherance of an enterprise in a twelve month period.¹⁷⁵ If this requirement is met, the person must register for VAT at the end of the month ending the twelve month period.¹⁷⁶ A person is further compelled to register for VAT if a written contractual agreement is concluded where the taxable supplies’ value will exceed one million Rand in the next twelve months, for example, a commercial lease agreement.¹⁷⁷

When a person is not compelled to register for VAT in terms of the VAT Act, he or she is still entitled to register for VAT on a voluntary basis. Section 23(3)(a) and (b) of the VAT Act allows the following persons to register for VAT voluntarily:

- (a) “A municipality or a welfare organisation/ share block company/ foreign donor-funded project deemed to carry on an enterprise; and
- (b) A person’s taxable supplies exceeded or is expected to exceed R50 000 (fifty thousand rand) in the furtherance of an enterprise.”¹⁷⁸

¹⁷³ Fairpo ‘VAT and intangibles’ (accessed: 22 November 2023).

¹⁷⁴ Botes *An Introduction to VAT* 20.

¹⁷⁵ *ibid* 30.

¹⁷⁶ *ibid*.

¹⁷⁷ *ibid*.

¹⁷⁸ *ibid* 33.

An entity is permitted to cancel its VAT registration on written request to the Commissioner, in the following instances:

1. the entity no longer meets the requirement of carrying on an enterprise and it will not commence trading within the next year;
2. the entity never started trading and will not start trading within the next year;
3. the entity no longer meets the requirements for VAT registration, either compulsory or voluntary registration; or
4. the entity has failed to submit a return and more.¹⁷⁹

If the foreign takeover company continues the enterprise in the Republic, it is a vendor and ought to register as such. Where the foreign takeover company decides to cease its operations in the Republic, it will no longer be a VAT vendor on the premise that the requirements for the cancellation of VAT registration have been met and it may be required to deregister.

Where the foreign takeover company ceases operations in the Republic, section 8(2) of the VAT Act is triggered. Section 8(2) of the VAT Act reads:

“...where a person ceases to be a vendor, any goods or right capable of assignment, cession or surrender which in either case then forms part of the assets of his enterprise, shall be deemed to be supplied by him in the course of his enterprise immediately before he ceased to be a vendor, unless the enterprise is carried on by another person”¹⁸⁰

The vendor is regarded as having ‘supplied’ all its assets to itself on the day it ceased to be a vendor. The ‘supply’ is regarded as a deemed supply in terms of the Act, and therefore, a deemed output VAT liability is created. The foreign takeover company is required to account for output tax on the assets or a right capable of cession, despite the absence of the sale of the assets or the right.

4.6 Conducting an enterprise in the Republic

The fourth element is that the supply must be made by the vendor during the furtherance of its enterprise. The VAT Act defines enterprise as:

¹⁷⁹ SARS ‘Cancellation of VAT registration’ (Deregistration)’ (accessed: 27 October 2024).

¹⁸⁰ Section 8(2) of the Value-Added Tax Act 89 of 1991.

“any enterprise or activity which is carried on continuously or regularly by any person in the Republic, or partly in the Republic, and in the course of furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club”.¹⁸¹

There must be ongoing activity to qualify as conducting an enterprise.¹⁸² A once-off transaction does not satisfy the requirements for conducting an enterprise.

An important case on the definition of an enterprise is *Commissioner: South African Revenue Service v De Beers Consolidated Mines Limited* (“the *De Beers* case”). In this case the appellant was of the view that the definition of enterprise, as set out in paragraph (a) of the definition, has two categories.¹⁸³ The first category concludes with the word “profit” and the second category starts with the word “including”.¹⁸⁴ The Supreme Court of Appeal held that the appellant’s interpretation was incorrect and confirmed that there cannot be two categories envisaged in the term enterprise.¹⁸⁵ The court held further that there must be a specific activity which complies with the all the requirements in the definition of an enterprise.¹⁸⁶

The phrase “enterprise or activity” used in the definition of an enterprise, makes the meaning of the word very extensive so that almost all forms of activity constitute an “enterprise”.¹⁸⁷

The definition of an enterprise is directly linked to the day-to-day operations of the vendor. The enterprise must be operated in the Republic of South Africa. Once the definition of an enterprise has been met, it is important to establish the location from where the vendor’s enterprise is conducted as the South African VAT system is not

¹⁸¹ Ibid s 1.

¹⁸² Silver *VAT Handbook* 25.

¹⁸³ *Commissioner: South African Revenue Service v De Beers Consolidated Mines Limited* (503/11) 2012 ZASCA para 36.

¹⁸⁴ SARS Interpretation Note 70 (Issue 2) of 2021 n15.

¹⁸⁵ *Commissioner: South African Revenue Service v De Beers Consolidated Mines Limited* (503/11) 2012 ZASCA para 36.

¹⁸⁶ ibid para 51.

¹⁸⁷ SARS Interpretation Note 70 (Issue 2) of 2021 8.

limited to South Africa. The VAT Act defines the Republic as the terrain of the Republic of South Africa, including the territorial waters and the adjoining zone.¹⁸⁸

The definition of an enterprise makes it clear that the enterprise must be conducted in the Republic, albeit only partially. Section 23(2)(ii) of the VAT Act does not require that the foreign company have a fixed establishment in South Africa, it merely requires that the foreign company has some sort of presence in South Africa either through an establishment or a representing vendor¹⁸⁹– for example, a subsidiary company acting in South Africa.

When an enterprise is conducted partly in South Africa, the supplies made in South Africa will be subject to VAT in South Africa and the vendor will have to account for VAT.¹⁹⁰ The location from where the supply is initiated is irrelevant for South African VAT purposes.

It is important to note that the disposal of an enterprise or a part thereof that is capable of operating independently as a going concern, is classified as a deemed supply by the enterprise in the furtherance of the enterprise.¹⁹¹ If the vendor has a patent registered in its name and the vendor earns royalties on the use of the patent, the patent rights constitute the vendor's enterprise. The transfer of the patent rights to third parties or to the merging company is deemed to be a disposal of a part of an enterprise. The transfer of the patent rights also qualifies as a supply in the furtherance of the enterprise.

Where the foreign entity ceases to operate in the Republic, a deemed supply is triggered, and the foreign entity must account for output VAT.

4.7 Preliminary conclusion

Where, on the basis of a takeover, patent rights are transferred to a new entity where the patent holder is a VAT vendor (or ought to be a VAT vendor), the transfer of the

¹⁸⁸ Section 1 of the Value-Added Tax Act 89 of 1991.

¹⁸⁹ van Zyl (2014) 47 *CILSA* at 161.

¹⁹⁰ Silver *VAT Handbook* 25.

¹⁹¹ Silver *VAT Handbook* 61.

patent rights constitutes a supply by a VAT vendor in the furtherance of the enterprise. However, it must now be determined whether the supply is either exempt (in terms of s 12 of the VAT Act) or zero-rated (in terms of s 11 of the VAT Act).

4.8 Exempt supply in terms of section 12 of the VAT Act

Section 12 of the VAT Act sets out the list of goods and services that are exempt from VAT for various reasons. The transfer of an equity security is important for purposes of this study. The transfer of an equity security entails a company's or an individual's share in the share capital of a company or the option of a share in the company.¹⁹²

However, it is only the transfer of the shares in a company that is exempt from VAT and not the transfer of the assets of the company. Therefore, the transfer of the patent rights is not exempt from VAT.

As section 12 of the VAT Act does not apply to the transfer of patent rights, the companies may consider whether the transfer of patent rights qualify as a zero-rated supply under section 11 of the VAT Act.

4.9 Zero-rated supply in terms of section 11 of the VAT Act

To establish whether the supply of patent rights is a zero-rated supply, sections 11(1)(e), 11(1)(p) and 11(2)(m) are considered in greater detail below. Another consideration for the levying of VAT at a zero rate, is whether the supply of patent rights can qualify as an exported service to a foreign VAT vendor.

4.9.1 Section 11(1)(e) of the VAT Act

In this case of a foreign takeover, the acquiring company will pay a consideration to obtain a part or the whole of a company. The acquiring company must obtain its own VAT registration number, as the acquiring company cannot operate an enterprise under the same VAT registration number as the seller of the company.¹⁹³

¹⁹² Silver *VAT Handbook* 112.

¹⁹³ Botes *An Introduction to VAT* 38.

The South African vendor can dispose of a part or the whole of his or her business to a foreign acquiring company through the sale of his or her assets in the business, the sale of the company as a going concern, or the sale of shares in the company.

I now consider the sale of the enterprise as a going concern. This method of disposal applies only where both the selling, and the acquiring company are registered VAT vendors in terms of the South African VAT system. In *Milner Street Properties (Pty) Ltd v Eckstein Properties (Pty) Ltd*¹⁹⁴ the Supreme Court of Appeal held that the disposal of an enterprise as a going concern attracts VAT at a rate of zero per cent if both parties are registered VAT vendors and the enterprise is an ‘income-earning’ activity at the date of disposal – ie, the enterprise can generate income for the vendor at the date of disposal.

Section 11(1)(e) of the VAT Act¹⁹⁵ provides that the supply of an enterprise or a part thereof as a going concern to a registered vendor will attract VAT at a zero per cent on condition that the parties have agreed in writing that:

1. at the time of disposal of the enterprise, the enterprise will engage in income-earning activity;
2. all the assets necessary for the effective operation of the enterprise are disposed of to the acquiring company; and
3. the supply of the enterprise includes tax at zero per cent.

The prerequisite for VAT at a zero rate, is a prior written agreement between the parties.¹⁹⁶ Providing the two respective registered vendors have a written agreement upon conclusion of the takeover, the sale of the enterprise will be subject to zero per cent VAT.

The sale of a part of the enterprise qualifies for zero-rating provided that the part of the enterprise can operate on its own and the rest of the requirements above have been met.¹⁹⁷ Therefore, the transfer of a stand-alone business sector or an outlet of a

¹⁹⁴ 2001 (4) SA 1315 (SCA) para 22.

¹⁹⁵ 89 of 1991.

¹⁹⁶ *Milner Street Properties (Pty) Ltd v Eckstein Properties (Pty) Ltd* 2001 (4) SA 1315 (SCA) para 9.

¹⁹⁷ SARS Interpretation Note 57 of 2010 para 4.11.

business can qualify for tax at a zero rate even if it operates from several geographical locations.¹⁹⁸ It is important that the business sector or outlet of the business is capable of independent operation.

Therefore, the transfer of the patent rights from the South African company to the foreign acquiring company can attract VAT at a zero rate provided that the South African company and the foreign acquiring company have concluded a prior agreement setting out that at the time of the disposal of the enterprise:

1. the South African company and the foreign acquiring company are or will be registered VAT vendors;
2. the patent registered in the South African company, will be generating income in the form of royalties;
3. all the relevant patent rights for the use and enjoyment thereof have been disposed to the foreign acquiring company; and
4. the supply of the patent rights will be inclusive of VAT at a zero per cent.¹⁹⁹

The South African and the foreign acquiring company may only enjoy the tax relief if both the companies are registered for VAT in South Africa.

It is important to emphasise that the foreign acquiring entity must be a registered VAT vendor and it must continue with the activities of the former entity making taxable supplies in South Africa. Where the new or acquiring entity ceases operations in South Africa, a deemed supply is triggered as discussed in 4.5 of this study.

Further, section 11(1)(e) only applies if the South African Exchange Control Authorities (“the Authorities”) have approved the assignment of the patent rights to the foreign acquiring company. If the patent is the principal business activity of the enterprise and the Authorities deny the assignment of the patent rights, the transfer of the patent rights cannot be zero rated under section 11(1)(e).

¹⁹⁸ *ibid.*

¹⁹⁹ *ibid* para 4.1.

4.9.2 Section 11(1)(p) of the VAT Act

In terms of section 11(1)(p) of the VAT Act, the supply is chargeable at a zero rate, if:

- “11(1)(p)(i) the supply of an enterprise or part of an enterprise as a going concern, by a vendor to that vendor's branch or division, which branch or division is separately registered in terms of section 50(2): Provided that that enterprise or part, as the case may be, shall not be disposed of as a going concern unless-
- (aa) that enterprise or part is capable of separate operation; and
 - (bb) will be an income -earning activity on the date of transfer thereof; and
 - (cc) a tax invoice issued in accordance with section 20 in relation to that supply is inclusive of tax at the rate of zero per cent; or
- 11(1)(p)(ii) the supply of an enterprise, branch or division, as contemplated in section 50(2), as a going concern to a separately registered enterprise of that vendor: Provided that that enterprise or part, as the case may be, shall not be disposed of as a going concern unless-
- (aa) that enterprise or part is capable of separate operation; and
 - (bb) will be an income -earning activity on the date of transfer thereof; and
 - (cc) a tax invoice issued in accordance with section 20 in relation to that supply is inclusive of tax at the rate of zero per cent”.²⁰⁰

As the transfer of patent rights is classified as the supply, the supply is considered taxable at a zero rate provided that the supply of the patent rights is a supply as a going concern, and it is to a branch of the vendor. The branch must be separately registered in terms of section 50(2) of the VAT Act.

The enterprise or a part thereof, may not be disposed of as a going concern if it cannot be separately operated and if it does not qualify as an incoming-earning activity. The requirements in this section are very similar to the provisions of section 11(1)(e), save that in section 11(1)(p) the supply must be to a branch of the vendor.

Section 11(1)(p) is, therefore, not applicable to a takeover between a South African company and a foreign acquiring company, as the foreign acquiring company only acquires a percentage of shares in the South African company, and it is not classified as a branch to the South African company.

²⁰⁰ Section 11(1)(p) of the Value-Added Tax Act 89 of 1991.

4.9.3 Section 11(2)(k) of the VAT Act

A supply of services would be chargeable at a zero rate where: “the services are physically rendered elsewhere than in the Republic or to a registered vendor in a customs-controlled area”.²⁰¹

An important case on the interpretation of section 11(2)(k) is *Metropolitan Life Limited vs Commissioner for the South African Revenue Service*.²⁰² The case is concerned with the interpretation of section 7(1), section 11(2)(k) and section 14(5)(b) of the VAT Act. The appellant received services from a supplier, that operates a business outside the Republic, and did not consume the aforesaid services received from the supplier for purposes of making taxable supplies.²⁰³ The appellant’s argument was that the supply of the service (‘imported service’) fell within section 11(2)(k), and should VAT be levied at a zero per cent.²⁰⁴

The Court held that the imported services rendered to the appellant were evaluated accurately and that VAT was correctly levied in terms of section 7(1)(c) of the VAT Act.²⁰⁵ The Court further held that zero-rating in terms of section 11(2)(k) is not applicable to the service received by the appellant.²⁰⁶

It is important to note that this section applies only to a service rendered outside the Republic. Thus, where the patent rights vest in South Africa but are transferred to a foreign entity, this section does not apply to the transfer of the patent rights.

However, where in transferring the patent or after transfer of the patent, the South African entity renders a service to that foreign entity in respect of the now foreign patent, the service falls under section 11(2)(k) if it is rendered outside the Republic. An example is the foreign registration of the patent. The service rendered outside the Republic is then chargeable at a zero rate.

²⁰¹ *ibid* s 11(2)(k).

²⁰² 70 SATC 162 (16 May 2008).

²⁰³ *Metropolitan Life Limited vs Commissioner for the South African Revenue Service* 70 SATC 162 (16 May 2008) para 11.

²⁰⁴ *ibid* para 13.

²⁰⁵ *ibid* para 33.

²⁰⁶ *ibid*.

4.9.4 Section 11(2)(l) of the VAT Act

A supply of services is chargeable at a zero rate, where:

“[T]he services are supplied to a person who is not a resident of the Republic, not being services which are supplied directly-

(i) in connection with land or any improvements thereto situated inside the Republic;

or

(ii) in connection with movable property (excluding debt securities, equity securities or participatory securities) situated inside the Republic at the time the services are rendered, except movable property which-

(aa) is exported to the said person subsequent to the supply of such services; or

(bb) forms part of a supply by the said person to a registered vendor and such services are supplied to the said person for purposes of such supply to the registered vendor; or

(iii) to the said person or any other person, other than in circumstances contemplated in subparagraph (ii) (bb), if the said person or such other person is in the Republic at the time the services are rendered, and not being services which are the acceptance by any person of an obligation to refrain from carrying on any enterprise, to the extent that the carrying on of that enterprise would have occurred within the Republic”.²⁰⁷

The main issue in the case of *XO Africa Safaris v CSARS*²⁰⁸ is the applicability of section 11(2)(l) of the VAT Act to XO Africa Safaris services. The Supreme Court of Appeal had to decide whether the services rendered by XO Africa Safaris to foreign tour operators qualified as a standard rated or zero-rated supply. It was found that the services were delivered to individuals in the Republic and not the foreign tour operators directly.²⁰⁹ Consequently, the supply of services did not qualify as a zero-rated supply under section 11(2)(l) of the VAT Act.²¹⁰ The Supreme Court of Appeal held that the purpose of section 11(2)(l) of the VAT Act is to ensure that VAT is levied at a standard rate on services consumed within South Africa.²¹¹

The transfer of the patent rights to the foreign acquiring company will be chargeable at a zero rate in terms of this section as the supply of the patent rights is to an enterprise outside the Republic and it does not qualify as one of the exceptions listed in the section. However, the South African transferring company still requires the approval of the South African Exchange Control Authorities.

²⁰⁷ Ibid s 11(2)(l).

²⁰⁸ (395/2015) [2016] ZASCA 160 (3 October 2016).

²⁰⁹ *XO Africa Safaris v CSARS* (395/2015) [2016] ZASCA 160 (3 October 2016) para 29.

²¹⁰ Ibid para 29.

²¹¹ Ibid para 31.

4.9.5 Section 11(2)(m) of the VAT Act

A supply of services would be chargeable at a zero rate, where the services comprise of:

- “(i) the filing, prosecution, granting, maintenance, transfer, assignment, licensing or enforcement, including the incidental supply by the supplier of such services of any other services which are necessary for the supply of such services, of intellectual property rights, including patents, designs, trade marks, copyrights, know-how, confidential information, trade secrets or similar rights; or
- (ii) the acceptance by any person of an obligation to refrain from pursuing or exercising in whole or in part any such rights, where and to the extent that those rights are for use outside the Republic.”²¹²

Section 11(2)(m) provides for the transfer of patent rights at a zero rate. This section does not require that both companies to the takeover be registered as VAT vendors for the transfer of the patent rights to be zero rated, it only requires that the patent rights are used outside the Republic. Section 11(2)(m) is the more convenient section to choose when it comes to the transfer of patent rights as it does not set requirements to be satisfied before the transfer of patent rights may be effected at a zero rate, as is the case of section 11(1)(e) of the VAT Act. In terms of section 11(2)(m), the only requirements to meet are that the patent rights be used outside the Republic and the prior authorisation from the relevant authorities to transfer the patent rights.

If the takeover does not satisfy all the requirements for the disposal of an enterprise or a part thereof, as a going concern as set out in section 11(1)(e) of the VAT Act, the takeover will attract VAT at a standard rate of fifteen per cent. However, if the vendor’s enterprise consists of patents, the transfer of the patent rights to the foreign acquiring company is subject to VAT at zero per cent in terms of section 11(2)(m) of the VAT Act on condition that the patent rights are used outside the Republic.

Should the South African Exchange Control Authorities not grant the use of the patent rights to the foreign acquiring company, and the foreign acquiring company does not wish to use the patent rights in South Africa, it can be argued that the operations (exploitation of the patent rights) of the foreign acquiring company have ceased. If the foreign acquiring company is a registered VAT vendor and its operations cease, a

²¹² Section 11(2)(m) of the Value-Added Tax Act 89 of 1991.

deemed disposal is triggered in terms of the transfer of the patent rights. If the foreign acquiring company is not a registered VAT vendor, the transfer of the patent rights to it will be regarded as a taxable supply in the hands of the South African transferring company provided that it does not qualify as an export of the patent rights.

It is important to note that sections 11(2)(m), 11(2)(k) and 11(2)(l) only apply when the relevant authorisation from the South African Exchange Control Authorities has been obtained as patents cannot be used outside South Africa without the necessary approval. As previously indicated, patents are territorial in nature and enjoy protection in the country where the patent is registered.²¹³

4.10 Direct export of goods in terms of section 11(1)(a)(i)

Section 11(1)(a)(i) provides for the supply of goods at a zero rate if the goods are exported to a country outside the Republic.²¹⁴ The transfer of patent rights qualifies as a supply of a service, as discussed earlier in the chapter. The transfer of patent rights does not qualify as an export of goods and, therefore, section 11(1)(a)(i) is not applicable to the transfer of patent rights. That said, any patented goods that are transferred as a result of the take-over or merger, and which are exported to the foreign entity, qualify for a zero-rating in terms of this section. A complete discussion of the transfer of patented goods falls outside the scope of this study.

4.11 Conclusion

The supplies between the respective branches of a company are not subject to VAT as this may result in double taxation. However, the supplies between a subsidiary and a holding company attract VAT consequences. For purposes of the study in relation to a foreign takeover, the transfer of patent rights falls outside the scope of an intra-group supply.

Further, the actual transfer of the shares of a company to a foreign company in a takeover is exempt for VAT purposes as opposed to the transfer of patent rights which is not exempt. The transfer of patent rights does however qualify for the charging of

²¹³ Dean *Introduction to Intellectual Property Law* 239.

²¹⁴ Section 11(1)(1)(a)(i) of the Value-Added Tax Act 89 of 1991.

VAT at zero per cent. Zero-rating applies when the enterprise is disposed of as a going concern and both companies are registered VAT vendors. Zero rating also applies if an enterprise is disposed of to a branch of the main company as a going concern, and the branch is separately registered. The last resort for a zero rating is that the supply of patent rights may qualify for VAT at a zero rate in terms of sections 11(2)(k), 11(2)(l) and 11(2)(m) of the VAT Act.

The transfer of patent rights to a foreign company does not qualify as an export of goods and the transaction can therefore not be zero-rated. However, the transfer of patent rights qualifies for the charging of VAT at zero per cent on condition that the relevant Authorities' approval is obtained. Sections 11(2)(k), 11(2)(l) and 11(2)(m) of the VAT Act only apply if the relevant Authorities' approval has been obtained. If the relevant approval has not been obtained, the patent rights cannot be exploited outside South Africa and the transfer of the patent rights is not possible.

Where the foreign takeover entity ceases operations in South Africa or because of the operations ceasing in South Africa a deemed supply is triggered.

If the foreign entity is a VAT vendor (or ought to be a VAT vendor) and it ceases operations, the transfer of the patent rights from the South African entity to the foreign entity is a taxable supply. Where the South African entity ceases to exist and, because the approval from the South African Exchange Control Authorities to transfer the patent rights is not granted or the foreign entity decides to abandon the patent rights, the deeming provisions will kick in. The South African entity then needs to account for output tax liability on the assets still in its possession on the date of ceasing its operations.

CHAPTER FIVE: RECOMMENDATIONS AND CONCLUSIONS

5.1 Introduction

The study has investigated and provided an in-depth analysis of the transfer of patent rights through a merger and/or takeover. The study further investigated the VAT consequences of the transfer of the patent rights between the respective companies to a merger and/ or takeover. This final chapter offers a summary of the study and links the findings to the research questions posed at the outset.

5.2 Summary of the findings

Chapter two of the study involved an in-depth discussion on the meaning of the terms “merger” and “takeover” of companies. These two terms are regulated by the Companies Act read with the Income Tax Act. A merger and a takeover are possible between South African companies and foreign companies; however, the statutory merger provisions of the Companies Act only apply to a merger and takeover between South African companies.²¹⁵

The processes to implement and approve a merger are regulated by sections 113 to 116 of the Companies Act and the study briefly discussed the requirements for a statutory merger to lay a sound foundation of what the term entails and distinguish it from a takeover.

The term takeover is distinguished from merger. A takeover can take various forms, for example, a friendly or hostile takeover. The Companies Act and the Takeover Regulations control takeovers in South Africa of public, state-owned or private companies.²¹⁶ The Takeover Regulations establish the TR Panel and set out its responsibilities.

The main difference between a merger and a takeover is the ownership and division of the respective companies’ assets and liabilities and the conclusion of an agreement between parties to affect a takeover or merger.

²¹⁵ Cassim MF (2008) 20 *South African Mercantile Law Journal* 8.

²¹⁶ Cassim *Business Structures* 409.

As both merger and takeover involve the transfer of assets and liabilities, the study focused specifically on the transfer of a patent registered in one company to the merger or takeover. Chapter 3 provided an in-depth discussion of patents in general, including the requirements of a patent, its lifespan and the remuneration that a patentee is entitled to for his or her invention.

To register an invention as a patent, a patentee should file a patent application with the Patent Office.²¹⁷ Once a patent is registered, the patentee has the right to exclude others from the use of the patent.²¹⁸ Should the patentee assign the intellectual property to a foreign company, the assignment of the patent is subject to the approval of the South African Exchange Control Authorities.²¹⁹ Chapter 3 set out the criteria on which the Authorised Dealers base their decision to authorise the transfer of intellectual property to a foreign company.

If the Authorised Dealers decline the application to transfer the patent rights, the patentee is entitled to take their decision on review in terms of the PAJA as the Authorised Dealers are an organ of state and the PAJA regulates the administrative action of the Authorised Dealers.

The main concern regarding patents is that they only enjoy protection in the country of their registration.²²⁰ If the patentee requires protection for the patent outside South Africa, he or she must apply for the patent to be registered in that specific country.²²¹ Consequently, there is no automatic transfer or automatic access to patent rights.

South Africa is a signatory to the Paris Convention for the protection of Intellectual Property. What this entails for South Africa is that the patentee will enjoy protection for a patent in other countries that form part of the Union under the Paris Convention.²²² A patentee is entitled to lodge an international patent application for international protection of the patent.

²¹⁷ Companies & Intellectual Property Commission 'Register Patent' (accessed: 12 September 2023).

²¹⁸ Tong (2015) 36 *Industrial Law Journal* 870.

²¹⁹ Foster 'Intellectual Property Transactions' (accessed 13 September 2023).

²²⁰ Dean *Introduction to Intellectual Property Law* 239.

²²¹ *Ibid.*

²²² Doi 2002 *Fordham International Law Journal* 378.

South Africa is also a signatory to the Patent Cooperation Treaty which allows a signatory to submit an international patent application together with a national application.²²³

The study further dealt with the accessibility of a patent through a foreign takeover or merger and how the respective processes differ. In the case of a foreign merger, the companies have access to the respective companies' assets and liabilities. However, a patent is an exception to the automatic transfer of ownership of the assets between the companies. The owner of the patent must transfer, assign, or cede the patent rights to the other company to the merger.²²⁴ If the patent is to enjoy protection in a foreign country, the patent owner must file an international patent application in that country. The patent will only enjoy protection under the South African laws if no international patent application has been filed.

In a foreign takeover, the foreign company (acquiring company) only assumes control over a percentage of the company and not specific assets – save where there is a complete takeover. A patent will form part of the sale of the company in the case of a complete takeover. The principles regarding the assignment, cession, and transfer of the patent discussed above apply.

Lastly, Chapter 3 dealt with a patent in liquidation proceedings. A patent registered in a company forms part of the assets of that company and may be sold or transferred to third parties to collect funds for the liquidated estate.²²⁵ The patent holder may decide either to object to the sale of the patent or to retain ownership of the patent and exclude the patent from the assets of the insolvent estate.²²⁶ The patent holder may be required to provide proof that the patent is separate from the rest of the assets in the liquidated estate.²²⁷

²²³ Department of Trade and Industry 'The World of Intellectual Property' 10 (accessed: 15 November 2023).

²²⁴ Foster Intellectual Property Transactions' (accessed 13 September 2023).

²²⁵ Barter 'Insolvency and Intellectual Property Rights in South Africa' (accessed: 26 November 2023).

²²⁶ *ibid.*

²²⁷ *ibid.*

Chapter 4 involved an in-depth discussion of the VAT consequences where patent rights are transferred as a result of a merger or takeover. VAT is levied at fifteen per cent in South Africa on the supply of goods or on the importation of the goods and services.²²⁸

Section 7(1) of the VAT Act provides five key elements to be met before VAT will be levied. The study considers the transfer of patent rights against each of the five elements to establish whether VAT should be levied on the transfer of patent rights.

The first element is a supply, and it includes, *inter alia*, a performance in terms of an agreement.²²⁹ The transfer of patent rights as a result of a merger or takeover satisfies the requirement of a supply, as the transfer of the patent rights is a performance in terms of an agreement. The study focused on the difference between intra-group supplies and deemed supplies and further distinguished between a subsidiary and a branch of a main company to establish when the subsidiary/branch is required to register for VAT. The location of the branch/subsidiary also plays a role in determining whether to register for VAT. The study also distinguished between supplies between companies in a foreign takeover and between companies to a merger.

The second element is the supply of goods and services. The transfer of patent rights qualifies as the supply of a service in that a patent is an intangible asset without physical form.²³⁰

The third element is that the supply must be by a vendor. A person is a vendor if he or she has registered as a vendor or is required to do so in terms of the VAT Act.²³¹ A further distinction was made between voluntary and compulsory registration for VAT, and the instances in which an entity is permitted to cancel its VAT registration were considered.

²²⁸ Section 7(1) of the Value-Added Tax Act 89 of 1991.

²²⁹ *Ibid* s 1.

²³⁰ IAS, '38 'Intangible Assets' (accessed: 22 November 2023).

²³¹ Botes *An Introduction to VAT* 20.

The fourth element is that the supply must be made by the vendor in furtherance of its enterprise. The most important consideration here is that there must be an ongoing activity to qualify as the conducting of an enterprise.²³² Once the definition of an enterprise has been met, it is important to establish whether the enterprise is conducted within South Africa, even if only partially.

Of note is that the disposal of an enterprise or part thereof that is capable of operating independently as a going concern, is classified as a deemed supply by the enterprise in the furtherance of its enterprise.²³³ For purposes of the study, if the patent rights constitute the vendor's enterprise and the vendor disposes of those rights to a third party, the transfer of the patent rights is deemed to be a disposal of the enterprise. The transfer of the patent rights further qualifies as a supply in the furtherance of the enterprise.

As the transfer of the patent rights qualifies as a supply, the study focused on whether the supply qualifies as an exempt or zero-rated supply. The transfer of patent rights does not qualify as an exempt supply under section 12 of VAT Act. The examination then shifted to zero-rated supplies under section 11 of the VAT Act. The study focused on sections 11(1)(e), 11(1)(p), 11(2)(k), 11(2)(l), and 11(2)(m) of the VAT Act.

Section 11(1)(e) addresses the sale of an enterprise as a going concern at a zero rate on the condition that the requirements in section 11(1)(e) are met. The transfer of the patent rights from the South African company to the foreign company can attract VAT at a zero-rate providing the companies have concluded a prior written agreement that both are registered for VAT in South Africa, the patent generates an income, the use and enjoyment of the patent rights have been disposed of to the foreign company, and the supply of the patent rights will be inclusive of VAT at zero per cent.²³⁴ The transfer of the patent rights remains subject to the approval of the South African Exchange Control Authorities before the tax relief can be considered.

²³² Section 1 of the Value-Added Tax Act 89 of 1991.

²³³ Silver *VAT Handbook* 61.

²³⁴ SARS Interpretation Note 57 of 2010 para 4.1.

Section 11(1)(p) of the VAT Act governs the supply at a zero rate if it is a supply of an enterprise as a going concern to a branch or division that is separately registered in terms of section 50(2) of the VAT Act. Section 11(1)(p) does not apply to the transfer of patent rights in a takeover or merger as it is not a disposal to a separately registered branch or division.

Section 11(2)(k) of the VAT Act relates to the supply of a service outside the Republic. The section, too, does not apply to the transfer of patent rights from a South African company to a foreign company as the patent rights vest in the South African company. However, if the patent is registered outside the Republic, and services are rendered outside the Republic in terms of the patent, section 11(2)(k) will apply.

Section 11(2)(l) of the VAT Act governs the supply of a service at a zero rate where the service is supplied to a non-resident and does not fall under one of the exceptions listed in the section. The section applies to the transfer of patent rights from a South African company to a foreign company in that the patent rights are supplied to an enterprise outside the Republic, and it does not fall under one of the exceptions listed in the section. Further, the transfer of the patent rights remain subject to the approval of the South African Exchange Control Authorities before the tax relief can be considered.

Section 11(2)(m) of the VAT Act relates to the supply of intellectual property at a zero rate if it is used outside the Republic. This section is the more convenient section through which to claim tax relief as it does not require the fulfilment of requirements before the patent rights may be transferred at a zero rate, as in the case under section 11(1)(e) of the VAT Act. The only requirement is that the patent rights should be used outside the Republic. Further, the transfer of the patent rights remains subject to the approval of the South African Exchange Control Authorities before tax relief can be considered.

The VAT Act also provides for the direct export of goods at a zero rate under section 11(1)(a)(i) of the VAT Act. This section does not apply to the transfer of patent rights as the transfer of patent rights qualify as a service.

5.3 Recommendations

1. The most important consideration for the transfer of patent rights outside South Africa, is to obtain the approval of the South African Exchange Control Authorities. No approval results in no transfer of the patent rights.
2. A patent is territorial in nature; therefore, it is important that if one intends to sell or transfer the patent rights to a foreign company, the patent enjoys international protection. There is no automatic access to patent rights.
3. If the South African Exchange Control Authorities approve the transfer of the patent rights to a foreign company, it is important to consider the VAT consequences. The transfer of the patent rights can qualify as a supply at a zero rate under various sections of the VAT Act.
4. The most convenient section to use when claiming tax relief is section 11(2)(m) of the VAT Act, as the only requirement in terms of the section is that the patent rights are used outside the Republic. If the patent rights are transferred to a foreign company, the patent is used outside the Republic.
5. If the foreign takeover company ceases its operations in the Republic, section 8(2) of the VAT Act is triggered. The foreign takeover company must account for output tax on its assets, despite the absence of the sale of its assets.

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