

OWNERSHIP OF IMMOVABLE PROPERTY

2011



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INTRODUCTION

Various entities can hold ownership of immovable property. Transfer can be effected to a purchaser in his personal capacity (a natural person) or to a legal entity (a trust, a company or close corporation*) and the choice depends on the specific circumstances of the purchaser.

(* The new Companies Act 71, 2008 that is set to come into operation later on in 2010, provides that from the date that it is operative, no new close corporations can be incorporated. Close corporations that are already in existence at the time may continue to exist and may sell and purchase property as before.)

FACTORS

■ TRANSFER DUTY


Transfer Duty is paid by a purchaser on the acquisition of immovable property. It is payable to the receiver of revenue on all transactions which are not subject to VAT. The rate is based on the same sliding scale for natural persons, companies and trusts.

Transfer duty is also payable on the transfer of a member's interest in a close corporation owning residential property, on the transfer of shares in a

property owning company and on the transfer of the beneficial interest in a Trust holding property. (The 2009 Taxation Laws Amendment Act introduced a window period during which entities owning residential properties can, in certain circumstances, transfer the property free of transfer duty to the members, shareholders or beneficiaries of the entity. This window period will remain open until 31 December 2012 only.)

- Note that if a purchaser signs an agreement of sale personally whilst reserving the right to nominate another person or entity as purchaser (usually within a stipulated period) then the nominee must be appointed on the same date. If the nominee is appointed later, SARS will construe it as a subsequent sale transaction and double transfer duty will be payable. A purchaser must therefore have a clear idea of the entity in which he intends acquiring ownership at the time of contracting, since a nomination (and acceptance thereof by the nominee) offers too little time to make an informed decision.

If a purchaser chooses to buy property in an entity that is not formed yet, the agreement of sale must be signed



by the purchaser "on behalf of the company/close corporation* to be formed." Once the company/ close corporation* is formed, it must ratify the decision to purchase the immovable property. Note that the Trust Property Control Act does not provide for the acquisition of immovable property on behalf of a Trust that is not yet in existence and it is therefore not possible to do so.

■ **VAT**

Purchasers must keep in mind that no transfer duty is payable if the transaction attracts VAT. If VAT is payable, the seller is liable to pay it over to SARS. It is imperative that the Deed of Sale clearly indicates whether the purchase price includes or excludes VAT. If the property is being sold as part of a going concern and both the seller and purchaser are VAT registered, then the transaction will be "zero-rated" for VAT. The Deed of Sale must then stipulate that the property is being sold as part of a going concern. When VAT is payable it is important to ensure that the parties are up to date with the filing of their VAT returns with SARS, otherwise delays will ensue since SARS will not issue a receipt until the parties are compliant.

- **PROTECTION FROM CREDITORS**

If a purchaser intends to trade or run a business on the property, it may be to his advantage to purchase the property in his personal capacity in order to ensure that his business creditors will only be able to lay claim to business assets, whilst the property owned in his private capacity remains protected from claims.

- **CAPITAL GAINS TAX AND ESTATE DUTY**

The first R1.5 million of any profit made on the sale of a property by an individual is exempt from CGT, provided the property in question constitutes the individual's primary residence. This applies to South African residents only. Twenty five percent of the net profit remaining (after the R1.5 million exemption, if applicable) is then added to the individual's income for the year, and taxed at the purchaser's marginal rate of income tax, resulting in a maximum net CGT cost of 10%. This is the lowest rate of CGT possible.



■ ESTATE DUTY

On death of the individual, his/her estate (including the immovable property) with certain deductions, will be subject to estate duty. An abatement of R3.5 million is granted, but the remaining value is taxed at 20%.

A company however pays CGT at a flat rate of 28% on half of all profit earned from the sale of the property, resulting in an effective tax rate of 14% of the capital gain.

Trusts attract the highest rate of capital gains tax: 50% (inclusion rate) of all profits gained on sale of trust assets are included in the trust's taxable income and taxed at the rate of 40% (statutory rate), resulting in a net capital gains tax cost of 20% (effective rate) of the capital gain.

THE FOR AND AGAINST OF OWNING AS A NATURAL PERSON

FOR:

- Lower rate of CGT.
- First R1.5 million of profit is exempt from CGT if it is a primary residence.
- No auditors or accounting officer's fees.

AGAINST:

- R1.5 million exemption does not apply to non-residents.
- R1.5 million exemption does not apply to second or further properties.
- Estate duty payable on death.



THE FOR AND AGAINST OF OWNING IN AN ENTITY


■ Purchasing As a Private Company

FOR:

- At the time of acquisition of the immovable property, the agreement of sale can be signed on behalf of a company “to be formed” and the contract ratified by the company after its formation – thereby effectively allowing nominations at the time of signature without the entity being in existence or named at the time of signature.
- In the past a company was prohibited from providing financial assistance to a purchaser for the purpose of or in connection with the acquisition of shares in that company. Accordingly a bond could not be registered over the company’s property to finance the acquisition of shares. With effect from December 2007 such financial assistance is possible albeit in limited instances only. This may assist with the acquisition of property given the stringent lending requirements of banks.

AGAINST:

- Higher rate of CGT than payable by individuals:
 - Should the company or close corporation dispose of the property, then CGT is levied at an effective rate of 14% on the profit earned (i.e. 50% of the profits are taxed at the flat rate of 28%).
- Only in limited instances may bonds be registered over company property to pay for the acquisition of shares therein.
- Annual financial statements must be submitted.
- Where the property being sold is the only asset/ greater of assets of the company, a special resolution must be filed with the Registrar of Companies within one month of the sale. Failure to do so renders the transaction voidable.
- In order for the shareholder to access the profit made by the company or close corporation the company will have to declare a dividend which will attract secondary tax (STC).
- If you are the shareholder of a company or member of a close corporation, then the net value of the




shares or membership interest will form part of your estate when determining any liability for estate duty tax.

- Shares in the company or the membership in a close corporation are assets in an estate and can be attached by creditors in the event of sequestration.

■ **Purchasing as a Trust**


FOR

- An effective estate planning tool.
 - The assets held in a trust are not subject to estate duty.
 - Assets are protected from attachment.
 - Eliminates the complications arising when there are multiple heirs in your estate since the trust remains the owner even after your death.
 - The trust is a separate legal entity and the trust assets cannot be attached by the creditors of the beneficiaries.
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- The trust does not need to be audited and is therefore a more cost effective option than a company.

AGAINST

- Highest rate of CGT if profits on the sale of the property are taxed in the hands of the Trust: 50% of the gains are included in the trust's taxable income and taxed at 40% thereby giving an effective rate of 20%. Note that profits can also be distributed to the beneficiaries and taxed at their applicable marginal rate of income tax resulting in a maximum net capital gains tax cost of 10% ($25\% \times 40\% = 10\%$). The same principle can be applied to income generated by the trust. It can either be taxed in the hands of the trust or it can be distributed to the beneficiaries to be included in their gross income.
- The Trust must be in existence at the time of signing the agreement of sale.

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- Income tax is levied at a flat rate of 40% which is more than you would pay as an individual or if the property was held in another entity.
 - The trust must pay transfer duty at 8% of the purchase price, which is a higher rate than for individuals.
 - Unlike companies and close corporations, the trust must be in existence at the date of signature of the agreement to purchase.

CONCLUSION

The decision on the appropriate entity for the acquisition of immovable property is not to be taken lightly. The information included here is not meant to be exhaustive and it is therefore recommended that the purchaser consults an attorney prior to signing an agreement of sale in order to obtain expert advice having regard to the purchaser's personal circumstances.

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