

# Purchasing property: *Tax considerations*

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## Introduction

Under South African law, immovable property can be owned individually, jointly in undivided shares, or by an entity such as a company, close corporation, trust, or a similar entity registered outside the country. Importantly, purchasing property in one's personal capacity or through an entity has various tax-related advantages and disadvantages.

## Primary tax factors to consider

### Transfer duty

Transfer duty is paid by a purchaser on the acquisition of immovable property. It is payable to the South African Revenue Service ('SARS') on all transactions that are not subject to value-added tax ('VAT'). The rate is calculated on a sliding scale and is the same for natural persons, companies, close corporations, and trusts that purchase property.

Transfer duty may also be payable on the acquisition of shares in a company, a member's interest in a close corporation, or a beneficial interest in a trust where the entity constitutes a 'residential property company' or 'residential property trust', per the Transfer Duty Act.

### Value-added tax

No transfer duty is payable if the transaction attracts VAT. VAT is payable where a seller is a VAT vendor and sells property that forms part of their VAT enterprise. If VAT is payable, the seller is liable to pay it to SARS. It is imperative that the sale agreement clearly indicates whether the purchase price includes VAT, excludes VAT, or is zero-rated for VAT.

If the property is being sold as part of a going concern and both parties are registered VAT vendors, the transaction may qualify to be zero-rated for VAT, provided the requirements of the Value-Added Tax Act are met. The sale agreement must stipulate that the property is being sold as part of a going concern.

Whether VAT or transfer duty is payable, it is important to ensure that the parties are up to date with the filing of their tax returns with SARS, otherwise delays may ensue. Generally, SARS will not issue the necessary transfer duty receipt or VAT documentation until the parties are tax compliant.



## Capital gains tax

The first R3 million of any capital gain made on the sale of a property by an individual is disregarded for capital gains tax ('CGT') purposes, provided the property in question is the individual's primary residence. This exemption generally only applies to South African tax residents and where the property is owned by the individual in their personal capacity.

| <i>Individual or entity</i>      | <i>Effective CGT rate</i> |
|----------------------------------|---------------------------|
| Individuals and special trusts   | 18%                       |
| Companies and close corporations | 21.6%                     |
| Other trusts                     | 36%                       |

## Estate duty

Upon their death, an individual's estate (including immovable property held in their personal capacity), less allowable deductions, is subject to estate duty. A rebate of R3.5 million is allowed. Thereafter, estate duty is payable at a rate of 20% on the dutiable value of an estate up to R30 million and 25% on the value exceeding R30 million.

## Purchasing property in a personal capacity

### Advantages

- Lower effective CGT rate.
- The first R3 million of the capital gain may qualify for the primary residence exclusion.
- No auditors' or accounting officers' fees.

### Disadvantages

- The primary residence exclusion generally does not apply to non-residents.
- The primary residence exclusion does not apply to investment properties or second homes.
- Estate duty may be payable on death in respect of the assets in one's estate.
- Property owned in one's personal capacity may be attached by personal creditors in the event of insolvency or sequestration.



## Purchasing property in a company

### Advantages

- Purchasing in a company may offer protection from business creditors. If a purchaser intends to trade or run a business on the property, it may be to their advantage to purchase the property in an entity to ensure that business creditors will generally only have recourse against business assets. Property owned in a private capacity is typically protected from attachment.
- At the time of acquisition of the immovable property, the sale agreement may be signed on behalf of a company 'to be formed' and ratified by the company after its formation in accordance with the Companies Act. A purchaser must therefore have a clear idea of the entity they intend to use to acquire ownership at the time of contracting.
- Alternatively, the provisions of the Companies Act may be invoked so that a promoter signs on behalf of a company to be formed. Specific requirements apply and one should consult a conveyancer for expert advice.
- In certain circumstances, a company may provide financial assistance in connection with the acquisition of its shares, provided the requirements of the Companies Act are met.

### Disadvantages

- Companies are subject to a higher effective CGT rate than individuals.
- Annual financial statements and annual returns must be maintained and filed where applicable.
- Where the property being sold constitutes all or the greater part of the company's assets or undertaking, a special resolution of shareholders may be required in terms of the Companies Act.
- In order for a shareholder to access profits retained by the company, dividends may be declared, which could attract dividends tax.
- The value of the shares in a company forms part of a shareholder's estate for estate duty purposes and may be attached by creditors in the event of sequestration.

## Purchasing property in a close corporation

### Advantages

- A close corporation ('CC') is a separate juristic person and may offer protection from business creditors. Where a property is acquired for business purposes, creditors will generally only have recourse against the assets of the CC, subject to applicable law.
- Existing close corporations continue to exist as separate juristic persons and may continue to acquire, own, and dispose of immovable property.
- Members may manage the affairs of the CC directly without the formal governance requirements that apply to companies.

### Disadvantages

- Since the commencement of the Companies Act, no new CCs may be registered, save in very limited circumstances. Purchasers wishing to acquire property through a CC may generally only do so by using an existing close corporation.
- Close corporations are subject to the same effective CGT rate as companies.
- Annual returns must be submitted to the Companies and Intellectual Property Commission ('CIPC'), and proper accounting records must be maintained.
- The value of a member's interest forms part of that member's estate for estate duty purposes and may be attached by creditors in the event of sequestration.
- If profits are distributed to members, careful tax planning should be undertaken to determine the most tax-efficient method of distribution.



## Purchasing property in a trust

### Advantages

- Trusts are effective estate planning tools.
- Assets properly owned by a trust generally do not form part of the founder's or beneficiaries' deceased estates, provided the trust has been validly established and properly administered.
- A trust may eliminate potential complications where there are multiple heirs, since it remains the owner of the property despite the death of a founder or beneficiary.
- Trust assets generally cannot be attached by the personal creditors of beneficiaries.

### Disadvantages

- Trusts attract the highest effective CGT rate if capital gains are taxed in the hands of the trust. Capital gains may, however, in appropriate circumstances, be vested in beneficiaries and taxed at their applicable rates.
- Income retained by a trust is generally taxed at a flat rate of 45%, although income vested in beneficiaries may be taxed in their hands, depending on the circumstances.

## Conclusion

In deciding on the appropriate entity in which to acquire immovable property, it is recommended that potential purchasers consult an experienced conveyancer and, where appropriate, a tax adviser prior to signing a sale agreement to obtain expert advice based on their specific circumstances.

For legal guidance, contact our team at [info@stbb.co.za](mailto:info@stbb.co.za).

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