

This e-mail flyer is produced by the Corporate & Commercial Department of Shepstone & Wylie and includes commentary on aspects of immovable property in the Finance Minister's budget speech yesterday.

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IMMOVABLE PROPERTY AND THE BUDGET

17 FEBRUARY 2010

Against a backdrop of a major slowdown in household consumption expenditure, declining imports and exports and falling unemployment, which has led to a significant reduction in tax revenue, role players in the property industry, still operating in tough economic conditions, have received little further direct tax relief following the Budget delivered yesterday.

Although very little was announced to directly stimulate the property market, the R6.5 billion in tax relief for individuals would no doubt assist the ailing market. Substantial proposed spending in areas of infrastructure and rural development will be a key feature of the economic stimulus and investment by state-owned entities, and it was announced that targeted lending by development finance institutions will be increased as critical components of the economic recovery.

A summary of some taxation issues affecting immovable property, including those dealt with in the budget yesterday, some proposals in the pipeline as well as some feedback on issues raised in the 2008 and 2009 budget years, are detailed below:

Transfer duty

For the fourth year in a row, no changes to the rate of transfer duty were proposed by Finance Minister Pravin Gordhan delivering his first budget, the last substantial relief being granted in the 2006 fiscal year.

After the substantial reductions announced in the 2006 budget, transfer duty brackets are to remain the same for the 2010/11 financial year with the exempt threshold for transfer duty at R500 000. The upper threshold remains at R1 million.

For property values above R500 000, the rate of transfer duty remains at 5% up to R1 million, and for properties costing more than R1 million the rate is R25 000 plus 8% on the value above R1 million. Transfer duty on acquisitions of properties by persons other than natural persons also remains at 8% of the value.

Estate duty

The increase in the estate duty threshold to R3.5 million in 2007 remains unchanged, as does the rate of estate duty, at 20%. However this budget records that both estate duty and capital gains tax which are payable upon death, are perceived as giving rise to double taxation, that estate duty is acknowledged to raise limited revenue, that it is cumbersome to administer and that its efficacy is questionable as many wealthy individuals escape estate duty liability through trusts and other means. Consequently it is proposed that taxes upon death will be reviewed.

Donations tax

The threshold below which no donations tax is payable, remains at R100 000, with the rate unchanged at 20%.

Value added tax

No change is proposed to the value added tax rate of 14%. Taxpayers should note however, that VAT registrations are being monitored very carefully, including those taxpayers registering as such to own immovable properties. SARS offices are very carefully scrutinising immovable property transactions which are structured on the basis of being zero rated and which generally involve the sales of going concerns or letting enterprises.

TAX PROPOSALS 2010

The proposals that are under consideration and which involve immovable property, announced in the Budget, include the following:

Improvements on leased land

Depreciation allowances, including the accelerated depreciation relief for urban development zones, are available if the underlying land is owned by the party undertaking the improvement. This requirement creates practical problems for development partnerships undertaken by government and the private sector. As Government entities often provide long-term use of land in exchange for private development, an enhanced allowance will be considered for private developers who improve another party's land, subject to anti-avoidance mechanisms.

VAT and residential property developers

The sale of residential property by developers is subject to VAT at the standard rate, while the leasing of residential accommodation is VAT exempt. VAT input credits are allowed for standard-rated sales of property, but disallowed for exempted rentals. The temporary leasing of residential units requires a full claw-back of the VAT input credits for leased units.

As the current value of the adjustment is disproportionate to the exempt temporary rental income, the budget records that options will be investigated to determine an equitable value and rate of claw-back for developers.

Commercial accommodation (VAT)

The supply of commercial accommodation is taxable at the rate of 14 %, while the supply of residential accommodation is exempt. The supply of commercial accommodation (such as a motel or a hotel) usually consists of lodging together with domestic goods and services. It has come to light that certain entities that supply exempt residential accommodation have (as a result of definitional technicalities) crossed over into supplying commercial accommodation. An example of this crossover is the supply of student accommodation with furniture and other fittings, without any services. This supply marginally pushes this accommodation into the ambit of commercial accommodation, on which VAT must be charged. It is stated in the budget that the VAT treatment of commercial and residential accommodation will be reviewed and that legislation may be introduced to address these shortcomings during 2011.

Guaranteed R1 billion housing fund?

The President in his State of the Nation Address delivered on 11 February mentioned that a key new initiative will be to accommodate people whose salaries are too high to get government subsidies, but who earn too little to qualify for a normal bank mortgage. It is proposed that Government will set up a guarantee fund of R1 billion to incentivise the private banking and housing sector to develop new products to meet the housing demand.

The Minister of Finance in address yesterday referred to this aspect and stated that Government and the banks will work together to find appropriate financing support measures so that more people can access home loans. No further detail has been provided.

Recapitalisation of development finance institutions

The Government has taken steps to recapitalise its development finance institutions to allow them to step up their lending to municipalities, land reform programmes and businesses in distress due to the economic crisis. Including provisions in this budget, allowance has been made for the recapitalisation of the Land Bank to the value R2.5 billion. A guarantee of R15.2 billion has been approved for the Development Bank of Southern Africa, enabling it to extend capital to poorer municipalities for infrastructure projects. The Industrial Development Corporation is well capitalised and will continue to play a key role in implementing government's Industrial Policy.

Liquidating residential property entities

Government has previously announced a window period expiring 31 December 2011 allowing residential corporate property entities to liquidate, without triggering additional tax with the properties being transferred to the individuals behind such entities. This is a similar provision which applied when CGT was introduced in 2001. The concession allowed the transfer of residential properties to natural persons free from various taxes including transfer duty. Many of these entities were initially established to eliminate transfer duty under prior law but have since become tax-inefficient. On further review, it has been determined that this window is insufficient and it is proposed that a new, more

flexible window period apply so that these residential property entities are to be liquidated or dissolved with limited compliance and enforcement effort.

Islamic-compliant finance

It is recognized that the tax system may act as a barrier to certain forms of Islamic-compliant finance, which prohibits payment or receipt of various types of interest. It is proposed that the tax treatment of financial instruments such as forward purchases, financial leasing and purchases of profit shares will be reviewed over the next two years, and tax treaties with relevant countries will be re-examined.

Transfer duty electronic returns and payments

As a strategic matter, SARS has prioritised the replacement of manual processes with electronic processes, including the phasing out of cash payments by taxpayers. To achieve this result in the administration of transfer duty, an amendment is proposed so that SARS will only process transfer duty returns and payments that are submitted electronically.

UPDATE ON MATTERS RAISED IN THE 2008 AND 2009 BUDGETS

Matters raised in the previous two years budgets which have a bearing on immovable property, and which do not appear to have been dealt with yet by the legislature include:

Transfer duty on leases?

The aspect of transfer duty and leases was raised in 2007 and the Minister announced that the total repeal of stamp duty could lead to the undermining of transfer duty, and it was contended that perhaps transfer duty should be applied to long term leases. Revenue appear to have held the view for some time now that the acquisition of a long term lease is akin to ownership of a property, and that accordingly a tenant should perhaps pay transfer duty on a similar basis as if he had taken ownership of the property.

As far back as the 2004 budget, the Minister expressed concern that long-term leases were being taxed at much lower rates than property transfers and that stamp duty on leases should be brought more in to line with transfer duty rates. The 2007 budget review provided that the relationship between the VAT Act, Transfer Duty Act and stamp duties on long-term leases would be examined. Nothing further appears to have yet been formally proposed, although the Stamp Duties Act was abolished on 1 April 2009.

Re-examination of taxation in the South African real estate sector

A study was commissioned some while back by The Tax Policy Unit, National Treasury and SARS to inform government policy on the economic, administrative and legislative implications resulting from the interaction between the VAT, Transfer Duty and Stamp Duty Acts and to explore possible alternatives to address the complications that arise from the interaction between these three Acts.

The terms of reference of this project included evaluating the economic impact, administrative and compliance implications of the various types of property taxes, focusing in particular on the nexus between the VAT Act, Transfer Duty Act and Stamp Duty Act, exploring the possibility of de-linking the previously mentioned Acts, and exploring the possibility of designing the Transfer Duty Act as a source of revenue for municipalities receiving revenue earmarked for that particular municipality.

Following the introduction of VAT long after transfer duty and stamp duties, provisions were created in the respective acts to impose only one of these taxes on a transaction, but there was a concern expressed by Revenue that in limiting the incidence of "double" taxation in some circumstances has led to eliminating the tax in total where previously transfer duty may have been payable. One of the suggestions was to impose both VAT and transfer duty on all fixed property transactions although it was acknowledged that this would necessitate a reduction in the current transfer duty rates. Formal proposals on a change to property taxes are still awaited.

Share block schemes

The Treasury reported in 2009 that shares in share block schemes represent a special form of interest in underlying real estate and under current law, the transfer of such shares can trigger transfer duty, VAT or neither. It was noted in the budget documentation that the law was to be clarified so at least one form of indirect tax applies, although nothing has been forthcoming yet.

Municipalities to get a share of transfer duties in their areas?

Following the abolition of the Regional Services Council (RSC) levy, which formed a significant source of municipal revenue, it was proposed that the replacement revenue source for municipalities should be a tax that enhances the fiscal autonomy and discretion of local governments, strengthens the accountability of local government regarding the administration and use of the proposed tax base, yields an adequate and buoyant revenue stream for municipalities in the face of cyclical instability, and maintains macroeconomic balance.

As part of a package of reforms, the VAT zero-rating of municipal property rates and other VAT reforms were introduced from 1 July 2006. Further reforms under consideration include the sharing of the general fuel levy and/or transfer duty in the medium term, a local business tax in the longer term, as well as grants as a guaranteed revenue source for municipalities or categories of municipalities. Similar ideas regarding transfer duties were raised by the Tax Policy Unit, National Treasury and SARS in a study commissioned by them referred to above.

DAVID WARMBACK
SHEPSTONE & WYLIE

031-3020409 (phone)

0865573431 (fax)

082-4437674 (cell)

e-mail : warmback@wylie.co.za