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MoneyTalk

Selling a Home owned by an Entity

RECENT AMENDMENTS AFFECTING HOME OWNERSHIPS

PRIOR to the introduction of capital gains tax, those who owned the homes in which they lived via a company, close corporation or trust were afforded an opportunity to transfer the properties from such entities to themselves without any adverse tax consequences.

The question that now arises from time to time is how the owner of a company owning an investment property can reduce the tax payable on the disposal of the property owned by the entity concerned.

Before the introduction of CGT it would have been possible for a company owning immovable property to dispose of it without being liable to income tax and to pass the proceeds out to the shareholders of a company or members of a close corporation without incurring secondary tax on companies (STC). This is in accordance with the provisions then contained in section 64B(5)(c) of the Act that excluded from STC those profits of a capital nature paid by a company to its shareholders upon liquidation or deregistration.

However, those provisions were amended such that capital gains declared as a dividend on or after 1 January 2003 became liable to STC to the extent that the gain arose after 1 October 2001.

Where a taxpayer owns the house in which he lives and disposes of it, he will qualify for the capital gains tax concession such that the first R1 million of gain realised on the disposal of his home is excluded from CGT. The taxpayer is required to comply with certain specific requirements in order to qualify for the R1 million concession and most importantly must own his home personally.

If the home is owned by any other entity, the R1 million exemption is not available.

It is appropriate to consider the CGT and STC that will become payable in the event that immovable property is disposed of by a company, close corporation or by a trust. The best way to deal with this is by way of examples.

Assume the following:	
Cost of property	R2 500 000
Selling price	R4 000 000

WHERE THE PROPERTY IS OWNED BY A COMPANY

Calculate CGT and STC payable if company wound up:

CGT	
Proceeds	R4 000 000
Less base cost	<u>R2 500 000</u>
	<u>R1 500 000 (A)</u>

CGT due @ 15%
(i.e. 50% x 30%) of (A) R 225 000

STC	
Capital gain after CGT	<u>R 1 275 000 (B)</u>
STC due (i.e. 12,5/112,5 of R1 275 000)	<u>R 141 666</u>

Total tax due R 366 666
Total tax as a % of profit **24,4%**

(B is arrived at as follows: R1 500 000 less CGT of R225 000)

DISPOSAL OF PROPERTY OWNED BY A NATURAL PERSON (A PRIMARY RESIDENCE)

CGT	
Proceeds	R4 000 000
Less base cost	R2 500 000
Less primary residence exemption	<u>R1 000 000</u>
Capital gain	<u>R 500 000 (B)</u>

CGT due @ 10% of (B) R 50 000

No STC is payable



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CGT as a % of profit of R1 500 000	3,33%
If an investment property (i.e. not primary residence) CGT amounts to	<u>R 150 000</u>
CGT as a % of profit of R1 500 000	10%

SALE OF PROPERTY OWNED BY A TRUST

CGT

Proceeds	R4000 000
Less base cost	<u>R2500 000</u>

Capital gain	<u>R1500 000</u> (C)
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CGT due @ 20% (i.e. 50% of 40%) of (C)	<u>R 300 000</u>
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No STC is payable

CGT as a % of profit **20%**

From the above it would appear that it is preferable that a natural person acquires immovable property directly as opposed to via a company, close corporation or trust in view of the CGT and STC that would otherwise become payable.

This remains the case even if the property is not a primary residence. The disadvantage is that the individual then exposes him or herself to creditors and will increase the value of his/her estate for estate duty purposes.

Furthermore, the ownership of immovable property directly by a trust would result in CGT of R300 000 as opposed to total tax due by a company of R366 666. On this basis it is preferable to own immovable property via a trust as opposed to a company or CC.

It must be noted that under the CGT rules applicable to trusts it may be possible to manage the CGT exposure by awarding the gain realised on the sale of the immovable property to a beneficiary of the trust, thereby reducing the CGT that would otherwise have been payable to a rate of 10 per cent.

A person owning shares in a company would prefer to dispose of the shares in the company to a purchaser instead of the property out of the company, thereby reducing the tax payable.

However, the purchaser will no doubt seek a reduction in the purchase consideration to take account of the STC liability that they will effectively take over in the event that they acquire the shares in the company.

With the recent changes introduced to the transfer duty provisions, that duty becomes payable whether a purchaser acquires residential property directly or acquires shares in a company owning residential property.

CONCLUSION

The extraction of a profit realised on the disposal of a residential property out of a company or CC has become far more costly as a result of the introduction of CGT and the imposition of STC on the capital profit realised after 1 October 2001.

It is, in my opinion, far preferable for an investor in immovable property to acquire the property directly, thereby ensuring that the rate of tax ultimately payable will be that much lower. Where immovable property is already owned by a company or trust it will result in tax becoming payable in the event that the property is transferred from the company or trust to an individual.

It is better to purchase a new property in one's own hands as opposed to a company or trust in order to reduce the exposure to CGT and STC. The tax consequences must, however, be weighed up against the commercial reasons for purchasing assets in a company, close corporation or trust.

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