THE TRANSFER OF PRIMARY RESIDENCE AND TAX IMPLICATIONS INVOLVED

BY

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Submitted in part fulfillment of the requirements for the Degree of Masters of Commerce (M Com Taxation) at the University of KwaZulu Natal. Student number 9700918.

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Date Submitted : 26 May 2005
DECLARATION

I declare that:

The transfer of primary residence and tax implications involved is my own work and all sources that I have used or quoted have been indicated and acknowledged by means of complete references.

Mkhize M I

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In the name of almighty God, the most beneficient, the most merciful. At the outset I am thankful to all mighty God for granting me good health, insight, ability and for instilling in me the inspiration, perseverance and motivation necessary to complete this study.

I also wish to express my sincere appreciation and gratitude to the following persons for their assistance and support in the completion of this study:

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ABSTRACT

Chapter 1 Introduction

In his budget speech of 23 February 2000 the minister of finance Mr Trevor Manuel announced the introduction of Capital Gains Tax (CGT) in South Africa. Internationally, the idea of such tax is uncommon, with many of our trading partners having implemented CGT decades ago.

In order to give effect on the proposal relating to CGT, an Eighth Schedule has been added to the Income Tax Act 58 of 1962. The Eighth Schedule determines a taxable gain or loss and a new section 26A of the principal Act provides that the taxable gain is included in taxable income. The date from which capital gains tax started was 1 October 2001.

Chapter 2 The transfer of primary residence from private individuals

The Department of Inland Revenue makes a distinction between what it calls Property Investors and Property Traders.

This is a very important distinction; A Property Investor will be liable to pay Income Tax on rental income and Capital Gains Tax (CGT) on profits made when selling the property in the normal way, however, a Property Dealer (also known as a trader) will find that all his or her profits made on the sale of a property are taxed as Income Tax and not taxed as Capital Gains. So, the key to deciding your tax minimising strategy is figure out whether you will be treated as a dealer or an investor.
The Eighth Schedule to the Income Tax Act 58 of 1962 provides that only natural persons (individuals) are entitled to exclude the first R1 million of gains on disposal of their primary residences.

**Chapter 3 & 4** The transfer of primary residence from Trusts, Companies and Close Corporations

Many individuals have historically purchased their residence in companies for a variety of reasons, including protection from creditors, avoidance of transfer duty and estate duty and circumvention of the repealed Group Areas Act. These persons now face a potential Capital Gains Tax (CGT) liability when their company, close corporation or trust disposes of the residence.

The Eighth Schedule to the Income Tax Act 2004 provides that only natural persons (individuals) and special trusts are entitled to exclude the first R1 million of gains on disposal of their primary residence. This exclusion does not apply where a company, close corporation or trust owns the residence.

**Chapter 5** Transfer Duty

A system whereby conveyancers will be able to lodge transfer duty declarations and make payments electronically via the internet will become operational during April 2005. Conveyancers will be able to lodge the declarations by transferors (sellers) and transferees (purchasers) to SARS branches electronically and simultaneously make payments to designated SARS bank accounts. SARS will verify the duty calculations and authorizes the issue of a transfer duty receipt. Conveyancers wishing to make use of e-
filing should register as e-filers by visiting the e-Commerce section of the SARS website.

**Chapter 6** Conclusion and Recommendations

Comments and suggestions are provided on how should SARS treat the transfer of primary residence in most efficient, cost effective manner and improve taxpayer service by implementing the electronic data filing system to be used for transfer duty purposes.

**Chapter 7** Bibliography

All sources that have been used or quoted are indicated and acknowledged by means of complete references.
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CHAPTER 1
GENERAL INTRODUCTION

1.1 Introduction

In his budget speech of 23 February 2000 the minister of finance Mr Trevor Manuel announced the introduction of Capital Gains Tax (CGT) in South Africa. Internationally, the idea of such tax is uncommon, with many of our trading partners having implemented CGT decades ago.

Before the implementation of CGT, taxpayers were taxed on the ordinary income earned from owning assets, but were not generally taxed on profits arising from the disposal of those assets. The effect of CGT is that all capital gains and losses made on the disposal of assets will be subject to CGT unless excluded by specific provisions.

In order to give effect on the proposal relating to CGT, an Eighth Schedule has been added to the Income Tax Act 58 of 1962. The Eighth Schedule determines a taxable gain or loss and a new section 26A of the principal Act provides that the taxable gain is included in taxable income. The date from which capital gains tax started was 1 October 2001.

CGT will only be triggered on the disposal of an asset. The taxable gain will then form part of taxable income and must be included in Income Tax Return for the year of assessment in which the disposal occurred. If taxpayers are not registered for Income
Tax, (SITE only taxpayer), an abridged return will be available for completion and subsequent submission.

1.2 Some important definitions

1.2.1 What is meant by a disposal?

A wide meaning has been given to the concept of disposal. The Eighth Schedule of the Income Tax Act 58 of 1962 deals with the disposal and deemed disposals. 'Disposal' is defined in paragraph 1 of the Eighth Schedule as,

- Any event, act, forbearance or operation of law as envisaged in paragraph 11 of the Eighth Schedule, and
- An event, act, forbearance, or operation of law which the Eighth Schedule treats as the disposal of an asset.

Paragraph 11 of the Eighth Schedule is very broad in its ambit. It states that a disposal includes the following:

- Any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset including;
- A sale of an asset;
- Donation of an asset;
- The expropriation, or conversion, grant, cession, exchange of an asset;
- Any alienation or transfer of ownership of an asset;
- The forfeiture of an asset;
- The termination of an asset;
• The redemption, cancellation, surrender, discharge, relinquishment, release, waiver, renunciation, expiry or abandonment of an asset;

• The scrapping, loss or destruction of an asset;

• The vesting of an interest in an asset of a trust in a beneficiary (this is a disposal by a trust);

• The distribution of an asset by a company to a shareholder (this is a disposal by a company);

• The granting of an option;

• The exercise of an option;

• The renewal or extension of an option;

• The decrease in the value of a person’s interest in a company, trust or partnership as a result of a value shifting arrangement.

1.2.2 Exclusions

Huxham & Haupt (2005:694) asserted that “Certain assets are excluded from CGT. Some of the important exclusions to note are

• A primary residence (R1 million gain or loss).

• Most personal belongings and effects such as motor vehicles, furniture, etc.

• Proceeds from an endowment policy or life insurance policy (unless is a second hand policy).

• Compensation for personal injury or illness.

• Prices or winnings from a South African competition e.g. National Lottery.
The research will be based on the disposal of primary residence from Private individuals, Trusts, Companies and Close Corporations and the Transfer Duty implications”.

1.2.3 Capital gains or losses
A person’s capital gain in respect of an asset disposed of is the amount by which the proceeds exceed the base cost of that asset. A capital loss is equal to the amount by which the base cost exceeds the proceeds.

1.2.4 Base cost
Huxham & Haupt (2005:674) cited that “The base cost of an asset is generally the expenditure actually incurred in acquiring an asset together with expenditure directly related to the acquisition or disposal of an asset or to improve the asset. The base cost does not include any amount otherwise allowed as a deduction for income tax purposes. Some of the main costs that may form part of the base cost of an asset are:

- Expenditure to acquire the asset.
- Transfer cost, stamp duty.
- Advertising cost to find the seller or a buyer.
- Costs of improvements to an asset.
- Cost of the valuation of an asset for the purpose of calculating a capital gain or loss in respect of the asset.
- Costs directly related to the acquisition, creation or disposal of that asset e.g. fees paid to the surveyor, auctioneer, accountant or legal advisor for services rendered.
• VAT paid and not claimed or refunded on asset.
• Cost of establishing, maintaining or defending a legal title or right in that asset.
• Cost of moving the asset from one location to another (on Acquisition).
• Cost of installation of that asset, including the cost foundation and supporting structures”.

1.2.5 The base cost of an asset held before 1 October 2001

SARS website contended that “In order to exclude the portion of the gain relating to the period before 1 October 2001 any one of the following options may be used.

- 20% of the proceeds upon realization can be deemed to be the base cost (no records kept); or
- Market value of the asset, as at 1 October 2001, which is called the valuation date (The valuation must be done before 30 September 2003 and the revised deadline is now 30 September 2004; or
- Time apportionment method.

The calculation must be done as follows:

Original cost + gain = \frac{\text{period before valuation date}}{\text{Period held before and after valuation}}

Note: Where there is a loss, the formula will reduce the original cost by the portion of the loss relating to the period before the valuation date.

Where no records have been kept, first or second method must be used”.
1.2.6 What is a “primary residence”?  

Mitchell, Stein & Silke (2004:211) highlighted that there are two basic requirements, which must be met before a home may be considered a primary residence:

- It must be owned by a natural person (not a trust, company or close corporation); and
- The owner or spouse of the owner must ordinarily reside in the home and must also use the home for domestic or private residential purposes.

When will the sale of a primary residence be subject to CGT?

- If the capital gain or loss on the sale of the residence exceeds R1 million, the portion that exceeds a million will be subject to CGT.
- Where the property is larger than 2 hectares, the area that exceeds 2 hectares will be subject to CGT.
- No exclusion from CGT will be allowed, in respect of the period on or after valuation date (1 October 2001), when the person was not ordinarily resident in the primary residence.
- The exclusion will not be allowed in respect of that part of a primary residence, which has been used for the carrying on of a trade, after the valuation date (1 October 2001).

Will the sale of any private residence be subject to capital gains tax?

The primary residence exclusion means that the most capital gains of the home will not be subject to CGT.
1.2.7 Annual exclusions

SARS confirmed that “The annual exclusion of a natural person in respect of a year of assessment is R10 000. Where a person dies during the year of assessment, that person’s annual exclusion for that year is increased to R50 000”.

1.2.8 Taxable capital gain

Huxham & Haupt (2005:694) asserted that “A person’s taxable capital gain for the year of assessment is:

(a) In the case of individual, 25% of the net capital gain for that year of assessment.

(b) Companies and trusts will be taxed on 50% of the net capital gain for that year of assessment”.

1.3 Valuation of assets

(Eighth Schedule to the Income Tax Act 58 of 1962)

According to SARS web site it is contended that:

"Taxpayers will need to determine the base cost of their assets in order to determine the gain or loss on disposal of the assets. One of the following methods may be used:

(a) 20% of the proceeds, reduced by any post-valuation date expenditure, upon realization of the asset can be deemed to be the base cost.

(b) Market Value of the asset (this topic is expanded upon below).

(c) Time apportionment basis.

In addition, it will be necessary to determine the market value of assets under a variety of other circumstances, which include death, donation, immigration, emigration and connected person transactions".

1.3.1 Market value on valuation date (1 October 2001)

The transitional measures which deal with the requirements regarding the valuation of assets on valuation date are contained in paragraph 29 of the Eighth Schedule to the Income Tax Act 58 of 1962.

The following requirements apply when determining the market value of an asset on 1 October 2001:
• **Time limit for performing valuations**

All valuations were to be carried out by 30 September 2003. Failure to do so would mean that this method cannot be used. It is emphasized that, whenever the valuation is carried out prior to 30 September 2003, the asset must be valued according to its condition, prevailing economic conditions, etc. pertaining as at 1 October 2001.

• **Who may perform valuations?**

The Income Tax Act does not prescribe who may perform valuations. This is the responsibility of the taxpayer and the onus of substantiating a valuation rests with the taxpayer. The taxpayer may, however appoint a professional person to assist with the valuation.

• **The onus is on the taxpayer to substantiate a valuation**

The fact that the valuation was done by a qualified valuer will not prevent the Commissioner from auditing such a valuation. Where the Commissioner is not satisfied with a valuation, he may:

- Request further information or documents relating to the valuation; or
- Adjust the valuation.

His right to adjust the valuation is subject to objection and appeal.

SARS presented that these are the examples of the details which the Commissioner may require:
Residential property

Valuer’s valuation, including basis of valuation and calculations;

Physical address;

Size of property;

Details of improvement to property;

Plans of the property as at 1 October 2001;

Details of recent property sales in the same area;

Current municipal valuation of the property;

Any other information which may be relevant.

Farming property

If the Land’s Bank valuation is not used, it would do taxpayer well to note the detail requested in the Land Bank questionnaire used for valuing immovable property on which *bona fide* farming operations are carried on (for Estate Duty purposes).

1.4 CONCLUSION

Capital Gains Tax (CGT) will only be triggered on the disposal of an asset. The taxable gain will then form part of taxable income and must be included in Income Tax Return for the year of assessment in which the disposal occurred. If the taxpayer is not registered for Income Tax, (SITE only taxpayer), an abridged return will be available for completion and subsequent submission. The next chapter is dealing with the transfer of primary residence from private individuals and the tax implications that are involved.
CHAPTER 2

THE TRANSFER OF PRIMARY RESIDENCE FROM PRIVATE INDIVIDUALS

2.1 INTRODUCTION

The Department of Inland Revenue makes a distinction between - what it calls Property Investors and Property Traders.

This is a very important distinction so if you do nothing else please take note; A Property Investor will be liable to pay Income Tax on rental income and Capital Gains Tax (CGT) on profits made when selling the property in the normal way, however,

A Property Dealer (also known as a trader) will find that all his or her profits made on the sale of a property are taxed as Income Tax - and not taxed as Capital Gains.

So, the key to deciding your tax minimising strategy is figure out whether you will be treated as a dealer or an investor.

2.2 General principles and definitions (paragraphs 44-46)

According to Brettenny (2004:22) “A natural person or a special trust (as defined in paragraph 1) must, in determining an aggregate capital gain or loss, disregard to much of the gain or loss in respect of the disposal of the primary residence of that natural person or special trust as does not exceed R1 million”.

Brettenny (2004:22) confirmed that “The definition of a primary residence means a residence:
• In which a natural person or special trust holds an interest (including the right of use or occupation),

• In which he or a beneficiary of the special trust or his spouse or the spouse of a beneficiary ordinarily resides or resided as his main residence, or who uses or used it mainly for domestic purposes.

(Residence means any structure which is used as a place of residence of a natural person and specifically includes a boat, caravan or mobile home).

The following are important issues:

• Only one residence can be a primary residence;

• The R1 million exclusion limitation operates per primary residence (not each person holding an interest in the residence). The apportionment of the exclusion may apply where more than one person holds an interest in the primary residence;

• The primary residence exclusion is only available to the extent that the land upon which the residence is situated does not exceed two hectares. Should the size of the land exceed two hectares apportionment is required;

• The land must be used mainly for private or domestic purposes together with the residence. Any portion of the land not used for private or domestic purposes will not qualify for the exclusion. Once again apportionment is required; and

• The land must be disposed of at the same time as the residence to the same person who has acquired the residence”.

The same information is also presented by Huxham & Haupt (2003:663), Geach

Huxham & Haupt (2004: 669-670) presented that:

"A residence is defined as one which is mainly used for domestic purposes paragraph (44). Where it is or was used (wholly or partly) for carrying on trade for any portion of the period (after 1 October 2001).

The portion of the capital gain or loss to be disregarded in terms of paragraph 45 must be determined with reference to the period (from, 1 October 2001) during which that person used that part of residence for domestic purposes as well as to the part of the residence used by that person mainly for purposes other than the carrying on of trade.

Again the wording is vague and ambiguous. What this means is that if the person used, say 30% of the residence for carrying on a trade, or used the whole residence 30% of the time for carrying on a trade, then only 30% of the gain is subject to 70% of the gain is subject to R1 million exclusion. This is on of those provisions where the draftsman leaves it to the court to interpret in the case of a dispute between taxpayer and the Revenue Services. It is a general principle of law that legislation must be interpreted in such a way that it makes sense (without doing violence to the language used).

It is submitted, however, that the provision is open to another interpretation. Under this interpretation, if 30% of the residence is used carrying on trade, then the maximum exclusion the person is entitled to on the sale of the residence is R700 000 of the gain (R1
million less 30% of the R1 million. In other words 30% of the R1 million is what must be disregarded so this is what must be adjusted by the 30% business use”.

Mitchell, Stein & Silke (2004:212) highlighted that:

“Paragraph 45(2) of the Income Tax Act provides that where more than one natural person or special trust holds an interest in a primary residence at the same time the amount to be disregarded in terms of paragraph 45(1) must be apportioned in relation to each interest held.

Paragraph 46 provides parameters in respect of the size of the property qualifying for exclusion in terms of the primary residence provisions. It provides that a primary residence includes the land upon which it is actually situated and may also include other unconsolidated adjacent land, which is used mainly for domestic purposes together with the residence. In terms of paragraph 46(a) the total of all the land may, however, not exceed two hectares. The land includes unconsolidated adjacent land, provided that on the disposal of the primary residence, the unconsolidated adjacent land is disposed of at the same time and to the same person.

When the size of the property qualifying for exclusion as a primary residence exceeds two hectares a reasonable apportionment is required as any gain of loss attribute to the property in excess of two hectares is subject to CGT”. 
The following example presented in the Explanatory Memorandum 2001, illustrates the application of paragraph 46 of the Eight Schedule to the Income Tax Act.

Example 2.1

On 1 November 2001 Rick purchased a smallholding, three hectares in size, for R2 450 000 (the cost of the land was R1 750 000 and the cost of the residential building was R700 000). Rick occupied it throughout the period of his ownership until he sold it four years later. Over his period of ownership improvements amounting to R150 000 (R120 000 to the land and R30 000 to the residential building) were effected to the property and repairs amounting to R18 000 (to the residential building) were also carried out. The smallholding was sold for R6 000 000 (the land for R500 000 and the residential building for R1 000 000). An agent's commission of R480 000 was paid by Rick. The total property was used mainly for domestic purposes in association with the primary residence.

As the maximum size of the land qualifying for the primary residence exclusion is two hectares, an apportionment needs to be done.

The following example is presented by Mitchell, Stein & Silke (2004:216):

"The following calculation apportions the capital gain realized between the primary residence and the remaining land."
<table>
<thead>
<tr>
<th></th>
<th>Land</th>
<th>Primary</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds</td>
<td>R 5000 000</td>
<td>R 1 000 000</td>
<td>R 6 000 000</td>
</tr>
<tr>
<td>Less base cost</td>
<td>R 2 270 000</td>
<td>R 810 000</td>
<td>R 3 080 000</td>
</tr>
<tr>
<td>Acquisition cost</td>
<td>R 1 750 000</td>
<td>R 700 000</td>
<td>R 2 450 000</td>
</tr>
<tr>
<td>Cost of improvements</td>
<td>R 120 000</td>
<td>R 30 000</td>
<td>R 150 000</td>
</tr>
<tr>
<td>Repairs (not part of base cost)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agent’s commission of sale (apportionment on the basis of the proceeds)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>basis of the proceeds)</td>
<td>R 400 000</td>
<td>R 80 000</td>
<td>R 480 000</td>
</tr>
<tr>
<td>Capital gain</td>
<td>R 2 730 000</td>
<td>R 190 000</td>
<td>R 2 920 000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Primary</th>
<th>Remaining</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Residence</td>
<td>land</td>
<td></td>
</tr>
<tr>
<td>(2/3)</td>
<td>(1/3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital gain on Land (see above)</td>
<td>R 2 730 000</td>
<td>R 1 820 000</td>
<td>R 910 000</td>
</tr>
<tr>
<td>Capital gain on primary residence (See above)</td>
<td>R 1 90 000</td>
<td>R 190 000</td>
<td></td>
</tr>
<tr>
<td>Capital gain</td>
<td>R 2 920 000</td>
<td>R 2 010 000</td>
<td>R 910 000</td>
</tr>
<tr>
<td>Less primary</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Residence exclusion R 1 000 000  
Subject to CGT R 1 920 000  

Alternative bases of reasonable apportionment will be acceptable".

2.3 Domestic-purposes limitation

Paragraph 46 (b) of the Income Tax Act requires that the land must be used mainly for domestic purposes in association with the primary residence. Any portion of the land not used mainly for domestic purposes in association with the primary residence will not qualify for the exclusion.

For instance, if one-and-half hectares of a two-hectare plot, which has a residence qualifying as a primary residence thereon, is used to grow vegetables for sale to a local market then this is not used mainly for domestic purposes and only half a hectare will qualify for exclusion as a primary residence.

Brettenny (2004:18) presented the following example:

Example 2.2

Jill owns a primary residence as defined situated on 3 hectares of the land. The base cost of the residence is R200 000 and the land R400 000 (R600 000 in total).

Jill disposes of the residence including the land for R1 800 000 of which R1 200 000 is attributable to the land.
## Solution

<table>
<thead>
<tr>
<th></th>
<th>Land not Qualifying</th>
<th>Residence and Land qualifying For exclusion</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Proceeds from disposal</strong></td>
<td>R400 000</td>
<td>R1 400 000</td>
<td>R1 800 000</td>
</tr>
<tr>
<td><strong>Base cost (R400 000 * 1/3)</strong></td>
<td>R133 000</td>
<td>R 466 667</td>
<td>R 600 000</td>
</tr>
<tr>
<td><strong>Gain</strong></td>
<td>R266 667</td>
<td>R 933 333</td>
<td>R 1 200 000</td>
</tr>
<tr>
<td><strong>Primary residence exclusion</strong></td>
<td>-</td>
<td>R 933 333</td>
<td>R 933 333</td>
</tr>
<tr>
<td><strong>Capital gain</strong></td>
<td>R266 667</td>
<td>-</td>
<td>R 266 667</td>
</tr>
</tbody>
</table>

### 2.4 Ordinary residence - apportionment of periods (paragraph 47 – 50)

Mitchell, Stein & Silke (2004:216-218) presented that:

“In terms of paragraph 47, where a natural person or special trust disposes of an interest in a residence which is or was a primary residence, and the person, or a beneficiary of the trust, or his spouse of his or the spouse of the beneficiary, was not ordinarily resident in the residence throughout the period on or after the valuation date during which the person or trust held the interest, then the portion of the capital gain or capital loss to be disregarded in terms of paragraph 45 (see above) must be determined with reference to the portion of the period during which the person, beneficiary or spouse was ordinarily resident.

This means that where a residence is used as a primary residence on or after 1 October 2001, a qualifying person will be required to apportion any capital gain or capital loss to be disregarded, as a result of not being resident in the residence, with reference to the
period that he was ordinarily resident in the primary residence. This paragraph is subject to the provisions of paragraph 48 in terms of which certain periods are deemed to be periods of ordinarily residence in the residence.

The following examples are adapted from the Explanatory Memorandum 2001 illustrates the application of paragraph 47 of the Income Tax Act.

**Example 2.3**

Thomas's employer transfers him from East London to Durban. He has owned a house in East London for twenty years. He decides not to sell it but rather to allow his son, a part-time student, to live in it for no consideration. He and his wife move to Durban where they lease a residence because Thomas has only two years to serve until he retires. They spend their holidays in East London and stay in their house. Upon retirement Thomas and his wife intend returning to East London when he retires.

The question arises to whether Thomas may consider the residence in East London to have been his primary residence for the full period of ownership. The crux of the matter revolves around paragraph 47 of the Income Tax Act, which requires apportionment where Thomas was not considered ordinarily resident in the East London house.

Paragraph 47(1) (b) of the Eight Schedule to the Income Tax Act 58 of 1962 does not require physical occupation but hinges on concept of ordinary residence. In Thomas's situation, as his intention was to return to the East London house (which he in fact did) it
would therefore seem that he is ordinarily resident there after valuation date. No apportionment of any capital gain realized is therefore necessary.

It should be noted, however, that the facts of each situation will have to be carefully considered in determining ordinary residence in respect of primary residence. Should Thomas have been absent from his East London house for, say, fifteen years, it will be more difficult for him to argue that he was ordinarily resident in that house.

**Example 2.4**

Ursula owns a property in Johannesburg in which she and her husband, Victor, spend most of any given year. Ursula and Victor are employed in Johannesburg. They are married out of community of property. Victor owns a residence in Plettenberg Bay in which he lived for three years before he and Ursula were married and before he moved to Johannesburg. He had lived in Johannesburg for two years at the time CGT is implemented. The house in Plettenberg is now used as a holiday home by Ursula and Victor, who spend most of their annual leave there. It stands vacant for the rest of the year. Upon moving to Johannesburg, Victor employed an armed response service in Plettenberg Bay to attend to the security of his house. His intention is to claim this house as a primary residence and hence not to pay CGT upon its eventual disposal. Five years after valuation day, Victor sells his house in Plettenberg Bay.

From the above information Victor is not ordinarily resident in Plettenberg Bay. Victor resides in a house belonging to his wife where he is permanently located. He is
employed in Johannesburg and returned to Plettenberg Bay only for holidays. Any capital gain made upon the disposal of his house in Plettenberg Bay will be subjected to CGT in full.

It is further confirmed by Brettenny (2004:19) that: “Where a residence is used as a primary residence on or after 1 October 2001 but the qualifying person was not ordinarily resident in the residence for the full period up to disposal, apportionment of the capital gain or loss to be disregarded is required.

However in terms of paragraph 48 of the Income Tax Act 58 of 1962 certain periods of absence are deemed to be periods of ordinarily residence in the residence. This would be when:

- The primary residence of a person is offered for sale and is vacated due to the acquisition or proposed acquisition of a new primary residence.

Or

- The residence is in the process of erection,

Or

- The residence is accidentally rendered uninhabitable (for example due to a fire),

Or

- The death of the person.

This residence deeming rule is for a continuous period not exceeding two years. The first part of the deeming rule can thus override the general principle that only one residence
can be a primary residence. For example, a person may transfer from one city to another for employment reasons and have difficulty in disposing of his or her current residence. In the meantime that person may acquire a new residence in his or her new employment city. The original primary residence would qualify as such for a period of two years.

Paragraph 49 of the Income Tax Act 58 of 1962 caters for two situations relating to non-residential use. The first is where the primary residence is used partly for purposes of carrying on a trade therein.

The second is where the property is not used as a primary residence for the entire period of ownership after 1 October 2001”.

The same information regarding this topic is further presented by K Huxham & P Haupt, (2003: 665).

2.5 Apportionment: when land is greater than two hectares

Geach (2001:111-112) confirmed that “When a primary residence is disposed of together with land on which it is situated the first R1 million applies provided

- The land does not exceed two hectares;
- The land is situated for domestic purposes and
- The land is disposed of at the same time and to the same person as the residence.

Where the size of the property qualifying for exclusion as a primary residence exceeds two hectares then SARS has indicated that a reasonable apportionment can be made. Any gain attributable to the property in excess of two hectares would be subject to CGT. SARS has indicated that there are a number of different methods of performing the
apportionment. Any method would be acceptable, provided that such methods are acceptable.

Example 2.5

Mr X has a small estate on 3 hectares which constitutes his primary place of residence. The property cost R2 450 000. He lived on the property until it was sold for R6 million. Agents commission amounted to R480 000. Over the period of township improvements amounting to R160 000 were affected to the property and repairs amounting to R18 000 were also carried out. The total property was used mainly for domestic purposes in association with the primary residence.

As the maximum size of the land qualifying for the primary residence exclusion is two hectares, an apportionment needs to be done. The following calculation apportions the capital gain realised to the primary residence and remaining land on the basis of the total size of the property.

<table>
<thead>
<tr>
<th></th>
<th>Land</th>
<th>Residential</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Building</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds</td>
<td>R5 000 000</td>
<td>R1 000 000</td>
<td>R6 000 000</td>
</tr>
<tr>
<td>Acquisition cost</td>
<td>R1 750 000</td>
<td>R 700 000</td>
<td>R2 450 000</td>
</tr>
<tr>
<td>Cost of improvement</td>
<td>R 120 000</td>
<td>R 30 000</td>
<td>R 150 000</td>
</tr>
<tr>
<td>Repairs (not part of the base cost)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Agents commission on sale</td>
<td>R 400 000</td>
<td>R 80 000</td>
<td>R 480 000</td>
</tr>
<tr>
<td>Capital gain</td>
<td>R2 730 000</td>
<td>R 190 000</td>
<td>R2 920 000</td>
</tr>
</tbody>
</table>
Primary Remaining Total
Residence Land

<table>
<thead>
<tr>
<th></th>
<th>Primary</th>
<th>Remaining</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>R1 820 000</td>
<td>R910 000</td>
<td>R2 730 000</td>
</tr>
<tr>
<td>Residential buildings</td>
<td>R 190 000</td>
<td>-</td>
<td>R 190 000</td>
</tr>
<tr>
<td>Capital Gain</td>
<td>R2 010 000</td>
<td>R910 000</td>
<td>R2 920 000</td>
</tr>
<tr>
<td>Primary residence exclusion</td>
<td>R1 000 000</td>
<td>-</td>
<td>R1 000 000</td>
</tr>
<tr>
<td>Balance subject to CGT</td>
<td>R1 010 000</td>
<td>R910 000</td>
<td>R1 920 000</td>
</tr>
</tbody>
</table>

Alternative bases of apportionment would also be acceptable, provided that such basis are reasonable”.

### 2.6 Non-Residential usage

Mitchell, Stein & Silke (2004:220-221) shows that:

“The purpose of paragraph 49 of the Income Tax Act is to reduce the capital gain or loss disregarded in terms of the primary residence exclusion where a part of the primary residence was used for the purpose of carrying on a trade in relation to that part. It also caters for the situation where the property was at some stage used as a primary residence but not for the entire period of ownership after the valuation date”.

The provisions of paragraph 49 are illustrated in the following example which has been adopted from the Explanatory Memorandum 2001.
Example 2.6

Yolandi acquires a residence on valuation date for R350 000 and resided therein for ten years. During this time she operated her media relations consulting business from the residence. Approximately 35% of the floor space was used for business purposes. Yoland also claimed 35% of her maintenance cost of the residence as a business expense for normal tax purposes. As an opportunity arose for her to expand her business ten years after she had acquired the property, she purchased another residence in which to live and converted her old residence into business premises. Fifteen years after converting the property she sold it for R2 650 000. Improvements over the years and all the other costs associated with the acquisition and disposal of the property amounted to R250 000.

<table>
<thead>
<tr>
<th>Proceeds upon disposal</th>
<th>R2 650 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less base cost (R350 000 + R250 000)</td>
<td>R 600 000</td>
</tr>
<tr>
<td>Capital gain</td>
<td>R2 050 000</td>
</tr>
<tr>
<td>Less period not ordinary resident</td>
<td></td>
</tr>
<tr>
<td>(R2 050 000 * 15/25 years) – (in terms of para 47)</td>
<td>R1 230 000</td>
</tr>
<tr>
<td></td>
<td>R820 000</td>
</tr>
<tr>
<td>Less part partially used for trade purposes</td>
<td></td>
</tr>
<tr>
<td>(R820 000 * 35% - (in terms of para 49)</td>
<td>R 287 000</td>
</tr>
<tr>
<td>Capital gain attributable to being a primary resident</td>
<td>R533 000</td>
</tr>
</tbody>
</table>

Yolandi will be able to exclude R533 000 of the total capital gain realised on terms of the primary residence exclusion (subject to its maximum limit of R1 000 000). The balance
of R1 517 000 (R2 050 000 - R533 000) will be subject to CGT and will be aggregated with any other capital gains or capital losses arising in the year of disposal before the R10 000 annual exclusion is applied.

2.7 Rental Periods

Paragraph 50 of the Eight Schedule to the Income Tax Act 58 of 1962 treats a residence as being used for domestic purposes during a continuous period of absence there from while the residence is being let in certain circumstances.

The purpose of paragraph 50 is twofold:

- First, to allow the qualifying person to let out his primary residence without the rental activity disqualifying the period of ownership s non-residential usage (in terms of para 49 of the Income Tax Act).
- Secondly, to provide a ‘safe harbour’ for a qualifying person to be temporary absent from primary residence without affecting his ‘ordinary residence’ status in relation to his primary residence.

To qualify all the following conditions must be met:

- The residence must not be let for more than five years.
- The qualifying person residing in the residence as a primary residence for a continuous period of at least one year prior to and after the period that the residence was let.
- No other residence has been treated as the primary residence of the qualifying person during the period that the residence is let.
• The qualifying person has been temporarily absent from the Republic or employed or engaged in carrying on business in the Republic at a location further than 250 kilometres from the residence.

The following example which has been extracted from the Explanatory Memorandum 2001 illustrates the possible applications of paragraph 50.

Example 2.7

Adam and Eve recently married. They each owned a residence in Pretoria and have lived in their respective residences for more than one year prior to their marriage. Both residences have been acquired after the valuation date. Upon marriage, Adam moved into Eve’s residence and let his residence for a period of five years. They intended moving into Adam’s residence after five years. Eve will then lease her residence. Adam and Eve are both employed within twenty kilometres of their respective residences.

Paragraph 50 is not applicable as both spouses are employed within 250 kilometres from their respective residences. They will, however be able to apportion, in terms of para 47, any gains that might arise upon the disposal of their respective residences in relation to the period that each residence qualified as a primary residence”.

Brettenny (2004:19), also submitted that:

“Once again apportionment is required. This can be illustrated by the following example:
Example 2.8

John acquired a residence on 1 October 2001 for R450 000 and resided there for a period of five years. During this period 15% of the floor space of the residence was used for his trade as a draughtsman. For normal tax purposes 15% of the qualifying expenses in respect of the residence had been claimed and allowed as a deduction.

Five years after the acquisition of the property John converted this property into exclusive trade use and acquired a new residential property. Ten years after converting the property is sold for R2 250 000. Improvement and all other costs associated with the acquisition and disposal of the property amounted to R350 000.

Solution

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from disposal</td>
<td>R2 250 000</td>
</tr>
<tr>
<td>Less base cost (450 000 + 350 000)</td>
<td>R 800 000</td>
</tr>
<tr>
<td>Capital gain</td>
<td>R1 450 000</td>
</tr>
<tr>
<td>Less: Period not ordinarily resident (10/15 * 1 450 000)</td>
<td>R 966 667</td>
</tr>
<tr>
<td></td>
<td>R 483 333</td>
</tr>
<tr>
<td>Less: Part partially used for trade purposes (15% * 483 333)</td>
<td>R 72 500</td>
</tr>
<tr>
<td>Capital gain attributable to being a primary residence</td>
<td>R 410 000</td>
</tr>
</tbody>
</table>

John is able to exclude R410 833 of the total capital gain of R1 450 000 in terms of the
primary residence exclusion.

Note that the exclusion is limited to R1 million. The balance of the capital gain of R1 039 167 will be aggregated with other capital gains and losses arising in the year of assessment of disposal before the R10 000 annual exclusion is applied”.

2.8 Disposal and acquisition

Mitchell, Stein & Silke (2004:218-219) asserted that:

“In terms of paragraph 48 of the Income Tax Act a natural person or a beneficiary of a special trust must, for purpose of paragraph 47, be treated as having been ordinarily resident in a residence for a continuous period (not exceeding two years), if he did not reside in the residence during the period for any of the following reasons:

- At the time the residence was the person’s primary residence it had been offered for sale and vacated due to the acquisition or intended acquisition or intended acquisition of a new primary residence.
- The residence was being erected on land acquired for that purpose in order to be used as the person’s primary residence.
- The residence had been accidentally rendered uninhabitable.
- The death of the person.

Paragraph 48 enables a natural person or a beneficiary of a special trust to be treated as having been ordinarily resident in a residence where the person was absent there from for
a continuous period not exceeding two years, in the four specific instances as detailed above.

The first specific instance deals with the situation of an overlapping period of ownership. It overrides the general rule contained in paragraph 45 (3) (see above). This instance which appears in the legislation as paragraph 48 (a) of the Income Tax Act illustrated in the following example which has been adapted from the Explanatory Memorandum 2001.

Example 2.9

Xolani is transferred from Knysna to Cape Town. She struggled to sell her house in Knysna. In the interim, she purchases a house in Cape Town. She sells her Knysna house eighteen months later. The overlapping period of ownership may be included as periods that both houses were considered to be ordinary residences and hence no apportionment is required.

The second specific instance caters for the situation where land has been purchased with the intention of erecting a primary residence on it. Land on its own will not be a primary residence as the definition of ‘residence’ means ‘any structure’ by Huxham and Haupt (2005:693). Where there is no structure there can be no primary residence. For the duration of the time taken to erect a structure, (for example a house) the period qualifies as the owner’s ordinary residence in terms of the overriding provision.

The third specific instance caters for the situation where a primary residence is rendered
accidentally uninhabitable. The forth and final specific instance, caters for the death of the person with an interest in the primary residence. For a two year period (being the maximum time limit of these paragraph 48 ‘concessions’) after death or for the period from death until the residence is disposed of by the executor of the estate, which ever is the shorter period, as diseased will be treated as having been ordinarily resident in the residence

The legislation does not specifically cater for improvements or renovations to a primary residence as the owner affecting them is still considered to be ordinary resident in the primary residence. A residence as defined exists and, therefore, it still qualifies as a primary residence.

2.9 Temporary letting

Arendse, Coetzee, Jordaan, Stein & Stglinghe (2004:594) asserted that: “A person will be treated as having used the residence for domestic purposes for the purpose of paragraph 49, even though he is absent from it for a continuous period of up to five years while it is being let. This mans that the adjustment usually required in terms of para 49 when there has been trade use need not be made. This concession applies if

- The person concerned resided in the residence as a primary residence for a continuous period of at least one year prior to and after the period of letting;
- No other residence was treated as his primary residence during the period of letting; and
• He was neither temporary absent from the Republic during the period of letting or was employed or engaged on carrying on the business in the Republic at a location further than 250 kilometers from the residence during the relevant period”.

Paragraph 50 deals with the situation where a residence is let for domestic purposes and allows a qualifying person to let out his primary residence without affecting his ordinary residence status. The following criteria must be met:

• The residence must not be let for more than five years.
• The residence must have been resided in by the qualifying person for at least one year before and one year after the letting activity.
• The residence is the only primary residence of the qualifying person during the letting period.
• The qualifying person is employed or engaged in carrying on business in the republic at a location further than 250 kilometres from the residence or is temporarily absent from the Republic.

2.10 Transitional rules on transfers from a company or trust
(paragraph 51 of the Eighth Schedule to the Income Tax Act)
A number of fiscal provisions were introduced to facilitate the transfer of an interest in a residence from a company or trust to a natural person without the payment of a transfer duty, stamp duty, secondary tax on companies STC or capital gains tax CGT.
The criterion for the fiscal advantage was:

- The transfer must have taken place between 20 June 2001 and 30 September 2002.
- The natural person alone or together with his or her spouse must have held all the share capital or members’ interest of the company (from 5 April 2001 to date of registration of transfer in the deeds registry) or the natural person or his or her spouse must have disposed of the residence to the trust by way of donation, settlement or other disposition or have made funds available to the trust to acquire and to improve the residence.
- The natural person alone or together with his or her spouse must have personally resided in the residence and used the residence mainly for domestic purposes as his or her or their ordinarily residence from 5 April 2001 to the date of registration of transfer in the deed registry.
- Registration of transfer in the deeds registry must have taken place not later than 31 March 2003.

This concession only applied in respect of that portion of the property contemplated by paragraph 46 (land not exceeding 2 hectares used mainly for domestic or private purposes together with the residence and disposed of at the same time and to the same person who acquired the residence).

2.11 Apportionment: Part-residential and part-business

Geach (2001:110) confirmed that:

"An apportionment is possible in situations where the property is partly used for
residential purposes and partly for business purposes. Many taxpayers (such as the accountants, architects, doctors, shopkeepers) use a property for both residential and business purposes. 'Partial' residential use could be based either on 'time' or on 'portion of building'.

The following requirements must be present before an apportionment will be possible:

- The property must be a 'primary residence'; and
- It must be used for some time after 1 October 2001 as a primary residence; or
- Part of the building must have been used for residential purposes

In these circumstances there is an apportionment of the gain. Apportionment can be based on either

- Time used after 1 October 2001 for residential purposes; or
- Portion of residence used for residential purposes”.

2.12 Multiple primary residences

Geach (2001:109) contended that “In terms of the CGT legislation a taxpayer cannot have more than one primary residence. A person can however establish a property as his or her prime place of residence and after the disposal of that residence establish another property as his or her prime place of residence. Whether or not a property constitutes a prime place of residence is a question of fact, and is not a question of law. It must also be remembered that the onus is on the taxpayer to prove that a capital gain must be excluded (disregarded) for the purposes of CGT. This onus is clearly established in terms of section 82 of the Income Tax Act. This means that the Commissioner can refuse to accept
a property as a primary place of residence and the taxpayer is then obliged, on a balance of probabilities, to prove otherwise.

**Example 2.10**

Mr X lives in a house in Johannesburg. He has a holiday cottage on the South Coast of KwaZulu Natal. He resides in 2002 and he disposes of his property in Johannesburg. Any gain on the disposal of the property in Johannesburg will be free of CGT up to R1 million.

If he now retires to his holiday cottage in KwaZulu Natal he will be able to establish that property as his primary place of residence, if his intention is in fact, to live there permanently”.

**2.13 Principle personal residence (PPR)**

Yardeystar website contended that:

“Individuals do not have to pay CGT on the disposal of their main home if the following conditions are met:

- Throughout the period the property was owned, it was your only home;
- The property was actually used as your home at the time you owned it;
- Throughout the period owned, the property was only used as your home, your family home with only one lodger at any one time; and
- The area of the house and the garden do not exceed 5 000 square meters.
Even if these conditions are not met, individuals may be entitled to PPR relief against all or part of any gain.

There is no rule about the length of occupation; rather consideration should be given to quality of occupation”.

The donation or financing requirement

- The individual must have either:
  - disposed of the residence to the trust by way of donation, settlement or other disposition; or
  - Financed all the expenditure actually incurred by the trust to acquire and to improve the residence.

2.14. The residence and use requirement

Price Waterhouse Coopers 2004 presented that:

- “Between 5 April 2001 and the date of registration the individual or his or her spouse must have:
  - Ordinarily resided in the residence; and
  - Used it mainly for domestic purposes as his or her or their ordinary residence.

- It follows that individuals acquiring their residences in a company or trust after 5 April 2001 will not qualify for the exemption”.
2.15 Transfer of land with a residence

The exemption applies in respect of the portion of the land on which the residence is situated and unconsolidated adjacent land that meets these requirements:

The use requirement

- Any land transferred must be used mainly for domestic purposes together with the residence from 5 April 2001 to the date of registration.
- The simultaneous transfer requirement
  - Any land transferred must be disposed of at the same time and to the same person as the residence.

2.16 The capital gains tax exemption

Price Waterhouse Coopers 2004 presented that: “The residence is treated as having been disposed of and acquired at market value on 1 October 2001, even though the actual date of disposal may be as late as 30 September 2002.

Since the market value of the property on 1 October 2001 will constitute its base cost, no capital gain or capital loss will arise in the hands of the company or trust.

Any growth or reduction in the value of the property after 1 October 2001 must be accounted for in the hands of the individual/s taking transfer should the primary residence become subject to CGT”.

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2.17 CGT – No plain sailing for trusts

Special trusts

The Eight Schedule of the Income Tax Act distinguishes between special and other trusts. A special trust is a trust that is created solely for a person who suffers from:

- A mental illness, as defined in the Mental Health Act of 1973; or
- Any serious physical disability.

Which incapacitates him or her from earning sufficient income for his or her maintenance. As the trust has to be created solely for this main purpose, few trusts will qualify as a special trust.

For CGT purposes special trusts will be treated similarly to its application to natural persons:

- Only 25% of the gain will be included in their taxable income and taxed at the marginal rates applicable to individuals. The result is that the maximum rate at which the gain will be taxed is 10.5%;
- These trusts will be entitled to the annual CGT gain/loss exemption of R10 000;
- Most exclusion for natural persons will also be applicable. For example, if a residence is registered in the name of trustees of a special trust and the beneficiary or his or her spouse ordinarily resides in it as his or her main residence, or the residence is used mainly for domestic or private purposes, it may qualify for the primary residence exclusion.
When a primary residence is owned by a company, close corporation or trust, a two-year grace period is provided to transfer it free of transfer or stamp duty, VAT or CGT to a natural person.

2.18 Transfer between spouses

Brettenny (2004:25) explained that:

"Where a person disposes of an asset to his spouse, any capital gain or loss is disregarded. The transferee spouse takes over all aspects relating to the asset. Thus the transfer is treated as having acquired the asset at the same time, for the same currency and to have used the asset in the same manner as the transferor during ownership by the transferor.

It should be noted that a spouse is deemed to have disposed of an asset to his or her spouse if the asset accrues to the surviving spouse upon that spouse's death. The same rule applies where an asset is transferred in respect of a divorce or other order for an agreement for the division of assets (permanent marital-like union).

The above mentioned rule does not apply in respect of the disposal of assets attributable to a permanent establishment in the Republic of that non resident.

Spouse is defined in section 1 of the Income tax Act to mean in relation to any person the partner of such person:

- In a marriage or customary union in terms of Republic law.
- In a union recognized as a marriage in terms of any religion (see note).
- In a same sex or heterosexual union which the commissioner is satisfied is
intended to be permanent (see note).

Note: In the absence of proof to the contrary the marriage or union is without community of property”.

Example 2.11

Geach (2001:108-109), outlined the following example:

Mr. and Mrs. X are married in community of property. They dispose of their primary place of residence for R2 800 000. the base cost of the residence is R1 300 000.

Their residence is a very large house, and this property falls within the community of property.

What are the CGT implications?

The proceeds are R2 800 000. The base cost of the asset is R1 300 000. A capital gain of R1.5 million is therefore realized from the disposal of the property.

<table>
<thead>
<tr>
<th></th>
<th>Mr X</th>
<th>Mrs X</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gain apportioned</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>In terms of paragraph 14</td>
<td>R1 500 000</td>
<td>R750 000</td>
</tr>
<tr>
<td>Disregard in terms of</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Paragraph 45(2)</td>
<td>R1 000 000</td>
<td>R500 000</td>
</tr>
<tr>
<td>Balance subject to CGT</td>
<td>R 500 000</td>
<td>R250 000</td>
</tr>
<tr>
<td>Annual exclusion</td>
<td>R10 000</td>
<td>R10 000</td>
</tr>
<tr>
<td>Aggregate capital gain</td>
<td>R240 000</td>
<td>R240 000</td>
</tr>
<tr>
<td>Taxable capital gain</td>
<td>R240 000</td>
<td>R240 000</td>
</tr>
</tbody>
</table>
2.19 Transfer of foreign currency asset between spouses

SARS contended that “Where a person disposes of a foreign currency asset to his or spouse, as contemplated in regulation 16(2) or regulation17 (1) (a), the person disposing of that foreign currency asset must be treated as having disposed of that foreign currency asset for proceeds equal to the foreign currency base cost thereof and the spouse acquiring the foreign currency asset must for purposes of regulation 9(3) (b) reflect that foreign currency base cost as the local currency value of that asset.

A person must be treated as having disposed of a currency asset or foreign currency contract to his or her spouse, if that asset is transferred to that spouse in consequence of a divorce order or, in the case of a union contemplated in paragraph (b) or (c) of the definition of “spouse” in section 1 of the Income Tax Act, 1962, an agreement of division of assets which has been made an order of court”

2.20 Conclusion

The Eighth Schedule to the Income Tax Act 2004 provides that only natural persons (individuals) and special trusts are entitled to exclude the first R1 million of gains on disposal of their primary residence. This exclusion does not apply where a company, close corporation or trust owns the residence.

The inclusion rate of the gain is 25%, and also enjoy the R10 000 exemption on the capital gains they generated. Primary residence does not only belong to private individuals and special trusts, trusts do have their primary residence. The treatment for CGT on the disposal of their residence is not similar with individuals.
CHAPTER 3

THE TRANSFER OF PRIMARY RESIDENCE FROM A TRUST

3.1 Introduction

The Eighth Schedule to the Income Tax Act 58 of 1962 provides that only natural persons (individuals) are entitled to exclude the first R1 million of gains on disposal of their primary residences. This exclusion does not apply where the residence is owned by a trust.

Many individuals have historically purchased their residences in trusts for a variety of reasons, including protection from creditors, avoidance of transfer duty and estate duty, etc. As a result, they now face a potential CGT liability when their trust disposes of the residence.

3.2 Trusts and trust beneficiaries

Mitchel, Stein and Silke (2004:211-215) stated that

"The disposal of an asset to or by a trust, for example by vesting it in a beneficiary of the trust, is as a general rule subject to the general principles governing disposals, base cost and proceeds as well as to the general ant-avoidance and loss limitation rules. The disposal of an asset to a beneficiary is for example, subject to the connected person rule in paragraph 38 while a disposal to a trust might be subject to the 'clogged loss' rule in para 39. A capital gain arising from the disposal of a trust asset will be taxable either in the hands of the trust or, where an attribution rule applies, in the hands of the beneficiary or a person who made a donation, settlement or other disposition to the trust".

3.3 Capital gain attributable to the beneficiary

Paragraph 80(1) of the Eighth Schedule to the Income Tax Act 58 of 1962 provides that "where a capital gain is determined in respect of the vesting by a trust of an asset in a trust beneficiary who is a resident that gain:

- Must be disregarded for the purpose of calculating the aggregate capital gain or aggregate capital loss of the trust, and
Must be taken into account for the purpose of calculating the aggregate capital gain or aggregate capital loss of the beneficiary to whom that asset was disposed of”.

Paragraph 80(2) of the Eighth Schedule provides that “where a capital gain arises in a trust in a year of assessment during which a trust beneficiary who is a resident has a vested interest (including an interest caused by the exercise of a discretion) in that capital gain but not in the asset, the disposal of which gave rise to the capital gain, the gain:

- must be disregarded for the purpose of calculating the aggregate capital gain or aggregate capital loss of the trust, and
- must be taken into account for the purpose of calculating the aggregate capital gain or aggregate capital loss of the beneficiary in whom the gain vests”.

The provisions of paragraph 80(1) and (2) of the Eighth Schedule are, however subject to the attribution rules embodied in:

- para 68, where that beneficiary is a spouse of the ‘donor’;
- para 69, where the beneficiary is the minor child of the ‘donor’;
- para 71, where the vesting of the asset or gain is revocable; or
- para 72, where the beneficiary is a person who is not a resident.

The taxable capital gain of a trust other than a special trust is taxed at an effective rate of 20% (previously between 16% and 21%). The attribution of a capital gain to a donor or beneficiary who is a natural person or a person other than a trust will therefore result in a lower effective tax rate in respect of the gain. Capital losses determined in respect of the disposal of the trust asset will, however be trapped in the trust.

When a capital gain is vested in a beneficiary who is not a resident, the gain will be subject to CGT in the trust. The reasons for this are as follows:

- The trust is a separate taxable entity;
- The gain on the disposal of the asset accrues to the trust;
- Where the trust vest that gain in the beneficiary it amounts to a disposal of income
after accrual;
• Unlike a resident beneficiary the Act does not make provision for a flow through of a capital gain to a non-resident beneficiary.

3.4 Vesting trusts
Where a right to claim a trust asset has been vested in a beneficiary, the asset is held by the trustee on behalf of that beneficiary. Actions by the trustee in respect of that asset are actions on behalf of that beneficiary.

3.5 Discretionary trust
The assets of a discretionary trust are treated as those of the trust until an unconditional right to those assets is vested in a beneficiary. Such vesting will be treated as a disposal by the trust at market value. The capital gain determined in respect of that disposal will in terms of paragraph 80 of the Eighth Schedule be taxed in the hands of the resident beneficiary in whom that right vests unless that gain is attributed to another person in terms of paragraph 68, 69, 71, or 72 of the Eighth Schedule. The same applies to the capital gain determined in respect of the disposal of trust assets to persons other than trust beneficiaries where that gain is vested in a trust beneficiary in the year in which it arises.

Any such capital gain that is not vested in any trust beneficiary in the year in which it arises. Any such capital gain that is not vested in any trust beneficiary in the year in which it arise will, therefore be taxed in the hands of the trust at the effective rates applying to trust unless the gain was derived by reason of a donation, settlement or other disposition and is subject to conditional vesting. In this case it might be taxed in terms of paragraph 70 in the hands of the resident who made the, settlement or other disposition.
Example 3.3
Discretionary trust - assets sold to the trust via interest free loan - trust and seller connected persons - transactions deemed to take place at MV losses clogged - assets subject to revocable vesting - attribution of income and capital gain into section 7(3) and paragraph 73 of the Eight Schedule - gain vested in non-resident beneficiary taxed in trust or attributable to resident donor in terms of paragraph 72.

Debora set up a trust in the Republic. The trustees of the trust are Deborah, Eileen (an accountant in Quemsey and Fish (a lawyer in Johannesburg). Debora sold the following assets to the trust at market value. Had the disposals not been at market value they would have been treated as having been made at market value.

<table>
<thead>
<tr>
<th>Asset</th>
<th>Market value</th>
<th>Base Cost</th>
<th>Capital Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares in Papa Ltd</td>
<td>R800 000</td>
<td>R200 000</td>
<td>R600 000</td>
</tr>
<tr>
<td>Shares in Oscar Ltd</td>
<td>R200 000</td>
<td>R250 000</td>
<td>R (50 000)</td>
</tr>
<tr>
<td>Undeveloped immovable property</td>
<td>R500 000</td>
<td>R100 000</td>
<td>R400 000</td>
</tr>
<tr>
<td>Rent producing shopping complex</td>
<td>R500 000</td>
<td>R200 000</td>
<td>R300 000</td>
</tr>
<tr>
<td>Deborah’s residence</td>
<td>R100 000</td>
<td>R 20 000</td>
<td>R 80 000</td>
</tr>
<tr>
<td></td>
<td>R2 100 000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The trust qualifies as a connected person in relation to Deborah as the trust beneficiaries include her spouse and children. The disposal by Debora to the trust are therefore governed by the connected persons rules governing the amount of the proceeds of such disposals (paragraph 38) and the clogging of capital losses determined in respect of such disposals (paragraph 39).

The capital loss of R50 000 can, in terms of paragraph 39, be deducted only from capital gains determined in respect of the other disposals to the trust in the same or a subsequent tax year and not from gains from disposals to persons other than the trust. The capital gain of R80 000 in respect of the residence qualifies in Deborah’s hands for the primary residence exclusion as she ordinarily resided in this residence.
The sales took place on credit and Deborah’s loan of R2 100 000 to the trust bears no interest and is payable on demand. The beneficiaries of the trust are Deborah’s children Gail and Harold (a minor), Deborah’s spouse Ian and a list of charitable and educational institutions. The trustees have an unfettered discretion regarding the vesting, in a beneficiary, of any trust income or of any trust assets or of any gain from the disposal of any trust assets.

The following events occur in the first year of the trust’s existence:

• Gail emigrates;
• The trust earns rental income of R40 000 and dividend income of R12 500;
• The trustees exercise their discretionary powers at the end of that year by vesting the income of R52 000 in Harold.

<table>
<thead>
<tr>
<th>Market Value</th>
<th>Base Cost</th>
<th>Capital Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deborah’s residence is vested in Ian</td>
<td>R140 000</td>
<td>R100 000</td>
</tr>
<tr>
<td>Undeveloped property is sold to a third party but the proceeds are not vested in a beneficiary</td>
<td>R700 000</td>
<td>R500 000</td>
</tr>
<tr>
<td>Shares are vested in Gail</td>
<td>R610 000</td>
<td>R500 000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The interest-free loan of R2 100 000 qualifies as a donation, settlement or other disposition. The value of this benefit is equal to the amount of interest expense saved by the trust as a result of this loan. Assuming that the trust would have been able to obtain a loan from a bank or other institution at an interest rate of 12.5% p.a., the trust saves an amount, during the first year, equal to the amount of interest that would have been payable at this rate, namely R262 500. The trust would not have been able to distribute the full amount of any trust income and the full market value of any trust asset to the trust beneficiaries had it been obliged to pay R262 500 in interest.
The rental income of R40 000 and the dividends of R12 500 would have had to be applied to pay the interest charge and can therefore be treated as having arisen by reason of the donation made by Deborah. The income that was vested in Deborah’s minor child can therefore be taxed in her hands in terms of section 7(3) of the Income Tax Act.

The amount of the income so deemed to be that of Deborah must in terms of paragraph 73 of the Eighth Schedule be deducted from the total amount of the interest saved by the trust as a result of the interest-free loan extended by Deborah. The remaining amount, namely R210 000 represents the maximum amount of the capital gain that may be attributed to Deborah. It represents the portion of the gains that would have had to be applied by the trust to pay interest at a market-related value.

The trust cannot claim the primary residence exclusion in respect of the capital gain from the disposal of the residence to Ian as a trust is not a natural person or a special trust as required by the definition of ‘primary residence’ in paragraph 44. The gain of R40 000 must be taken into account in Ian’ hands in terms of paragraph 80(1) unless Deborah made the donation, settlement or other disposition mainly for purposes of tax avoidance (paragraph 68). If this were the case, the gain would have been taken into account in Deborah’ hands.

The vesting in a trust beneficiary of a trust asset or of the capital gain determined in respect of the disposal of a trust asset is, in terms of the trust deed, clearly subject to a contingent event, namely the exercise of the discretionary powers of the trustees. The capital gain of R200 000 in respect of the undeveloped property that was not vested in any beneficiary if the trust in the tax year in which it arose will therefore be subject to paragraph 70 with the result of that gain will be taken into account in Deborah’s hands.

Finally, the gain of R110 000 in respect of the shares vested in Gail will not be attributable to her in terms of paragraph 80 as she is not a resident. The gain will be taxed in the hands of the trust in terms of paragraph 72 of the Eighth Schedule.
The above example may be summarized as follows:

Rent R40 000
Interest R12 000
Total income R52 500
Distributed to Harold (minor) R52 500

Deemed back to Deborah – s 7(3) R52 000
Interest free loan
R2 100 000 * 12.5% = 262 500

Therefore interest available for deeming of capital gains back to Deborah (paragraph 73):
= R262 500 – 52 500 = 210 000

<table>
<thead>
<tr>
<th>Capital gain</th>
<th>Deborah</th>
<th>Ian</th>
<th>Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residence vested in Ian</td>
<td>R40 000</td>
<td>-</td>
<td>R40 000</td>
</tr>
<tr>
<td>Undeveloped property not vested</td>
<td>R200 000</td>
<td>R200 000</td>
<td>-</td>
</tr>
<tr>
<td>Shares vested in Gail (non-resident)</td>
<td>R110 000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total gains realised</td>
<td>R350 000</td>
<td>R200 000</td>
<td>R40 000</td>
</tr>
</tbody>
</table>

3.6 Non-resident trusts

Paragraph 80 of the Eighth Schedule deals with the persons who have an interest in the trust that is not a resident. Where a resident acquires a vested interest to an amount representing the capital of a non-resident trust and if the capital arose from:

- Capital gain of the trust in any previous year of assessment during which the resident had a contingent right to the capital; or

- Any amount which would have constituted a capital gain if the trust was a resident; and

- The capital gain has not been subject to tax in the Republic, the amount must be taken into account for the purpose of determining the aggregate capital gain or aggregate capital loss of the resident.

The provision does not have retrospective effect as ‘capital gain’ is defined in the Act and
refers only to capital gains arising on or after the valuation date.

3.7 Base cost of interest in a discretionary trust
A beneficiary’s interest in a discretionary trust is treated as having a base cost of nil if no trust assets have been vested in that beneficiary. The provision overrides paragraph 38(1) (b) which provides that an asset acquired from a connected person must have a base cost equal to market value. The full proceeds from the disposal of that interest will therefore be treated as a capital gain.

The above provisions does not affect the ‘connected person rule’ in terms of paragraph 38(1) (b) as regards the vesting of a right to an asset in a trust beneficiary. Once vesting takes place the beneficiary will acquire the asset at a base cost equal to its market value at the date of vesting. In other words there are two assets:

- The vesting right to or in the asset – dealt with in respect of paragraph 38(1) (b).
- The discretionary interest in the trust – dealt with in terms of paragraph 81 of the Eighth Schedule.

Example 3.4
Sale of discretionary interest in a trust
Johanna, Kim and Marius are the beneficiaries of a discretionary trust the only asset which is a holiday home. The trustees of the trust vested a portion of the house in Marius. The market value of that portion at the time it was vested in Marius amounted to R300 000. No rights to the hose have, however been vested in any of the other beneficiaries. Johanna and Marius sell their interest in the trust for R150 000 and R350 000 respectively.

The base cost of Johanna’s interest in the trust is nil while that of Marius is R350 000. Johanna’s capital gain in respect of her disposal of her interest will therefore amount to R150 000 while that of Marius will amount to R50 000.
3.8 Death of a beneficiary of a special trust

3.8.1 Special trust

A special trust is defined in section 1 of the Principal Act 1962 as a trust created –

- Solely for the benefit of a person who suffers from a mental illness as defined in the Mental Health Act, 1973, or as a serious physical disability. The mental illness or disability must incapacitate the person from –
  - Earning sufficient income to maintain himself or herself, or
  - Managing his or her own financial affairs.

- By or in terms of a will of a deceased person solely for the benefit of beneficiaries who are the relatives of the deceased and who are alive on the date of death of the deceased (including beneficiaries who have been conceived but not yet born on that date of death) where the youngest of those beneficiaries is on the last day of the year of assessment of that trust under the age of 21.

The tax rate applicable to special trust differs from those of other trusts.

It has been proposed in the Revenue Laws Amendment Bill, 2002 that:

- The provisions of the Eighth Schedule only apply to the first category of special trust (mental illness, serious physical disability).
- All special trusts, including testamentary trusts in the second category, have an inclusion rate of 25%.

A special trust is in effect treated as a natural person for purposes of the Eighth Schedule. The following provisions of the Eighth Schedule which apply equally to a special trust.
### Table 3.8.1.1 Provisions affecting special trusts

<table>
<thead>
<tr>
<th>Paragraphs of the Income Tax Act</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>5(1)</td>
<td>Annual exclusion</td>
</tr>
<tr>
<td>10</td>
<td>Inclusion rate</td>
</tr>
<tr>
<td>45(1)</td>
<td>Primary residence exclusion</td>
</tr>
<tr>
<td>53(1)</td>
<td>Personal-use assets</td>
</tr>
<tr>
<td>59</td>
<td>Compensation for personal injury, illness or defamation</td>
</tr>
</tbody>
</table>

Adapted from Mitchel, Stein and Silke (2004:265).

In terms of the definition of a ‘special trust’ a trust loses its status as a special trust for years of assessment ending on or after the death of the beneficiary of that trust. The rates of tax to be applied to the taxable capital gain of the special trust after the death of the beneficiary will be the higher normal rates for trusts. Paragraph 82 is aimed at preserving, for purposes of the Eighth Schedule, the status of a trust as special trust in spite of the death of the beneficiary. The trust will continue to be treated as a special trust, except for the tax rate, until the earlier of the disposal of all assets held by the trust or two years after the beneficiary’s death.

A trust, other than a special trust, will have 50 % of its gain included in its taxable income and taxed at the applicable income tax rates. The result is that the effective CGT rate will either be 16 % or 21 %. In addition, most of the exclusions provided for in the Income Tax Act will not be applicable to the trusts.

#### 3.8.2 Disposals

Specifically included in the definition of ‘disposal’ is the vesting of a trust asset in a beneficiary, in the other words the distribution of a capital asset to a beneficiary. The vesting may result from the exercise of the trustees’ discretion or it may happen automatically, e.g. upon the beneficiary attaining the age of 25 years.
3.8.3 The disposal of a trust asset (those vests to a third party)

If the capital gain realised by the trust on the disposal of the asset to the third party should vest in a beneficiary of the trust in the same year that it arises, the capital gain must be ignored in the trust's hands and be treated as the beneficiary's gain. The beneficiary may therefore have a CGT liability without actually having received the amount of the capital gain, from which the CGT should be paid.

3.8.4 The disposal of a trust asset (those vest by the trustee to a third party)

A capital gain or loss will be realised by the beneficiary and the beneficiary will have to account for any CGT on any capital gain. The beneficiary may not necessarily have the cash to pay the CGT liability if the trustee did not distribute the proceeds of the disposal to the beneficiary. A capital loss realised by the beneficiary may be utilised to reduce the beneficiary's capital gains for that or future year of assessment.

It must be noted that it could be beneficial (from a CGT point of view) rather to vest assets in beneficiaries than to keep them vested in the trust because of the lower effective CGT rate of a beneficiary who is a natural person. A natural person or a special trust would also be able to make use of the annual exclusion of R10 000. However caution should be exercised in this regard, as the vesting of the asset would again include the asset into the beneficiary's personal estate and may have negative estate duty implications upon the beneficiary's death.

3.8.5 The vesting of a trust asset in a beneficiary

The Eighth Schedule to the Income Tax Act 58 of 1962 includes the vesting of a trust asset in a beneficiary in the definition of 'disposal'. A 'disposal' for CGT purposes will therefore take place when a trustee allocates a trust asset to a specific beneficiary. Recognition is therefore given to the fact that, when an asset vests in a beneficiary, it effectively becomes the beneficiary's asset and a transfer of ownership of the asset takes place from the trustee to the beneficiary. The trustee now proceeds to hold the asset only in a representative capacity that are, on 'behalf of' of the beneficiary.
The Eight Schedule also determines that a capital gain that arises by virtue of the vesting of a trust asset in a resident beneficiary must be ignored in the trust's hands and be treated as the beneficiary's gain. In other words, the beneficiary must pay the CGT on any capital gain, even though he may neither have possession of the asset nor sufficient cash to pay the CGT.

It is also important to keep in mind that a trust and its beneficiaries are considered to be connected parties in terms of the Income Tax Act. All disposals between a trust and a beneficiary will therefore be deemed to have taken place at market value.

3.8.6 The distribution of asset to the beneficiary to whom it vests.

The distribution of a trust asset to a beneficiary with a vested right in that particular asset is specifically excluded from the definition of a disposal in the Eighth Schedule. Therefore, when the trustee distributes such an asset to the beneficiary with a vested right in the asset, no CGT liability will occur.

3.9 Acquisition of property from a trust: Donation or financing requirement

Section 9(17) (b) of the Transfer Duty Act 1962 confirms that

"The requirements in this regard are –

- The trust must have acquired the property from the individual taking transfer of the property by way of donation, settlement or other disposition; or
- The individual taking transfer of the property must have provided the monies to finance all the expenditure incurred by the trust in acquiring and maintaining the property.

It is accepted that the above requirement has been met where a bond was utilized by a trust to acquire the property and the individual seeking the exemption has financed the installments in full.
The exemption does not apply in the following circumstances:

- The individual taking transfer of a property only partly financed the expenditure, for example, someone else paid for the addition of a room, etc.
- Cases where the beneficiaries acquired the interest in the property holding trust. The individual to whom the property needs to be transferred did not finance all the expenditure incurred by the trust in acquiring and improving the property”.

3.10 Donation to a trust

A trust is usually established when a ‘donor’ donates cash or asset to the trust, which should then be administered by the trustees in terms of the trust deed for the benefit of the beneficiaries of the trust.

A donation of a capital asset (other than currency) is a ‘disposal’ for purposes of CGT and will therefore trigger the payment of CGT. When a donation takes place, the effect thereof will be that the donor will be deemed to have disposal of the asset for proceeds equal to the market value thereof and will therefore realise a capital gain or loss (depending on the base cost of the asset). The donation will therefore have both a donations tax and CGT implications for the donor.

The trust on the other hand, will be deemed to have acquired the asset at a cost equal to its market value.

Section 9(17) (b) provides that if “that person disposed of that residence to that trust by way of donation, settlement or other similar disposition or financed all the expenditure actually incurred by the trust to acquire and to improve the residence then the primary residence may be acquired in the name of that person or jointly in the names of that person and that person’s spouse [Section 9(17) (c)]”.

The legislation does not state that the natural person alone or together with that person’s spouse must have disposed of the residence to the trust by way of donation, settlement or disposition or financed all the expenditure. The reference is only to that natural person. It is therefore not a requirement that a spouse has to finance any portion of the expenditure
to qualify for the exemption if the residence is registered jointly in the spouse’s name that did not finance the expenditure the exemption does not apply. It must be registered in the name of the person who made the donation, settlement or other similar disposition, or financed all the expenditure, or in the name of that person together with that person’s spouse, in order to qualify for the transfer duty exemption.

Assuming that there are two spouses. A and B who are married out of community of property, the table below shows into whose name the residence may be transferred:

| Spouses who donated the Residence or Residence may be transferred into the Residence may be transferred into the name of Financed all the expenditure name of Financed all the expenditure |
|-----------------------------------------------|-----------------------------------------------|
| A only                                        | A, or A and B jointly                          |
| A and B jointly                               | A and B jointly                               |

3.11 Ensure transfer is free from CGT

It was contended by Geach (2001:114-115) that:

"The capital gains tax legislation provides (paragraph 51) that were an interest in a residence has been transferred from a company or trust to a natural person then

a) The company or trust must be treated as having disposed of that residence at market value on valuation date (i.e. there is no gain); and
b) That natural person must be treated as having acquired that residence at market value on the valuation date.

Since the market value of the property on 1 October 2001 will constitute its base cost, no capital gain or capital loss will arise in the hands of the company or trust.

The above will only apply if:

1. The natural person acquires that residence from that company or trust on or after the promulgation of the Tax Laws Amendment Act, 2001, but not latter than 30 September 2002;
2. That natural person or together with his or her spouse directly held all the equity share capital in that company from 5 April 2001 to the date of registration in the deeds registry of the residence in the name of that natural person or his or her spouse or in their names jointly, or

3. That natural person disposed of that residence to the trust by way of donation, settlement or other disposition or made funds available that enabled that trust to acquire that residence,

4. That natural person alone or together with his or her spouse or their ordinary residence from 5 April 2001 to the date of the registration, and

5. The registration of the residence in the name of the natural person or his or her spouse or jointly, takes place not later than 31 March 2003.

The paragraph 51 of the Eighth Schedule will only apply in respect of that portion of the land on which the residence is situated and adjacent land to the following extent:

1. To the extent that the land does not exceed 2 hectares;

2. To the extent that the land is used mainly for domestic or private purposes in association with that residence; and

3. Provided that the land is disposed of at the same time and to the same person as the residence.

Taxpayers may take advantage of the above concessions with effect from the date of promulgation of the Act”.

Arendse, Cetzee, Jordan Stein and Stiglingh (2004:594) also confirmed this information.

3.12 Loan account with trusts

Mitchel, Stein and Silke (2004:243) asserted that “It is an established estate-planning tool for a person (the lender) to sell an asset to a trust on loan account and thereafter to reduce the loan account (or waive a portion of the loan) annually by an amount of R30 000 without any donations tax implications.
As Ben Strauss correctly pointed out in 2002 April, a waiver or reduction of a loan is also treated as a disposal for CGT purposes. The annual waiver or reduction of a loan to a trust by an amount of R30 000 would therefore result in a capital gains of R30 000 in the hands of the trust which is being partially released from the debt.

The lender (who waived or reduced a portion of the loan account) would then normally realise a capital loss in the same amount (e.g., R30 000). However, if the lender should also be a beneficiary (or a relative of the beneficiary) of the trust, the capital loss realised by the lender on the partial reduction or waiver of the loan will be ring-fenced. This means that the lender will be able to utilise only the capital loss against capital gains realised from the disposals by the lender to the same trust.

It has been suggested that one should rather annually cede R30 000 of the loan to the trust, thereby effectively extinguishing a loan to that extent and avoiding the negative CGT consequences of a waiver or reduction of the loan. One should however, be careful that the transaction could not perhaps be seen as ‘abnormal’, thereby satisfying one of the requirements of the ant-avoidance provisions in the Income Tax Act”.

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3.13 Conclusion

The CGT consequences of trusts can be rather confusing for the uninitiated because of the number of permutations. In an effort to clear up this confusion the position is summarized below.

The trustee can –

- Vest an unconditional right to the asset
- Sell the asset
- Distribute the asset
- Distribute the gain
  - in the current year
  - in a future year

The beneficiary can –

- sell his or her vested or contingent right in the trust
- acquire a vested or contingent right in the trust
- acquire the asset from the trust

Non-resident beneficiaries are treated differently to resident beneficiaries.

The attribution rule will deem back a capital gain to the donor but the amount that can be deemed back will be restricted depending on the circumstances. Where the asset has been financed by a low or interest free loan from the donor the amount that can be deemed back is limited to –

- the interest saving enjoyed by the trust

Finally, there are special rules dealing with resident beneficiaries of non-resident trusts (paragraph 80(3) and the death of a beneficiary of a special trust (paragraph 82 of the Eighth Schedule).
CHAPTER 4

TRANSFERING PRIMARY RESIDENCE FROM A COMPANY

4.1 Introduction

Many individuals have historically purchased their residence in companies for a variety of reasons, including protection from creditors, avoidance of transfer duty and estate duty and circumvention of the repealed Group Areas Act. These persons now face a potential Capital Gains Tax (CGT) liability when their company, close corporation or trust disposes of the residence.

Following representations, legislation was introduced to allow individuals a window period of opportunity to transfer their residence out of their companies into their own names without incurring any adverse tax consequences. Set out below are the conditions that need to be satisfied to secure tax free transfer, and information regarding the person(s) into whose name the primary residence may be transferred.

This tax free transfer is only for a limited period. The transfer must take place on or after 20 June 2001, but no later than 30 September 2002, and the final date for registration of the transfer in the deeds office is 31 March 2003.

4.2 Primary residence

The term "primary residence" is defined in paragraph 44 of the Eighth Schedule as follows:
"Means a residence –

(a) in which a natural person or a special trust holds an interest, and

(b) which that person or a beneficiary of that trust or a spouse of that person or beneficiary –

(i) Ordinarily resided or resided in as his or her main residence, and

(ii) Uses or used mainly for domestic or private purposes,"

The law and application: In the notes that follow the word “company” also includes close corporation.

The relevant provisions offer exemption from:

- Transfer duty on the acquisition of the residence which will constitute that person’s primary residence (section 9 of the Transfer Duty Act, No 40 of 1949).

- Stamp duty on the registration of a mortgage bond and transfer of shares in a share block company (item 7 of Schedule 1 to the Stamp Duties Act, No 77 of 1968).

- Secondary tax on companies in respect of any dividend arising in consequence of the transfer (section 64B (5) (k) of the Income Tax Act ("The Act")).

- Secondary tax on any gain realized by the company or trust as a result of the disposal (paragraph 51 of the Eighth Schedule).
4.3 Donations Tax

The legislation does not provide for specific exemption from donations tax. In terms of section 58 of the Income Tax Act the disposal of property for a consideration which is less than adequate consideration, i.e. a sale of property at a considerations less than its fair market value, is deemed to be a donation.

The section however provides that the Commissioner must determine that the consideration is adequate. In this case where the following conditions are complied with it has been decided that the Commissioner will not seek to adjust the consideration:

(a) The transfer must be exempt in terms of either section 9(16) or 9(17)of the Transfer Duty Act

(b) The transaction is not entered into for the purpose of tax avoidance, other than that specifically provided for.

4.4 Conditions that need to be satisfied to secure tax free transfer

Paragraph 51(1) of the Eighth Schedule stipulates that where an interest in a residence has been transferred from a company or trust to a natural person, that company or trust must be treated as having disposed of that residence at market value on the valuation date, i.e. 1 October 2001 and that natural person must be treated as having acquired that primary residence at market value on the valuation date. The effect therefore is that the value for CGT purposes to be determined on 1 October 2001 is transferred from the entity to the individual. The growth in the value of the residence from 1 October 2001 to

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Mitchel Stein and Silke (2003:222) highlight that "Paragraph 51(1) applies only where

- The natural person acquires the residence from the company on or after the promulgation of the Taxation Laws Amendment Act, 2001 but not latter than 30 September 2002;

- The natural person alone or together with his spouse directly held all the equity share capital in the company from 5 April 2001 to the date of registration in the deeds registry of the residence in the name of the natural person or his spouse or in their names jointly or the natural person disposed of the residence to the trust by way of donation, settlement or other similar disposition or made funds available that enabled the trust to acquire and to improve the residence;

- The natural person alone or together with his spouse personally and ordinarily resided in the residence and used it mainly for domestic purposes as his or her ordinary residence from 5 April 2001 to the date of the registration; and

- The registration of the residence in the name of the natural person or his spouse or in their names jointly takes place not latter than 31 March 2003.

This paragraph applies only in respect of the portion of the property contemplated in paragraph 46 that is the land on which the residence is and adjacent land as:
• Does not exceed two hectares;
• Is used mainly for domestic purposes together with the residence; and
• Is disposed of at the same time and to the same person as the residence”.

The primary residence requirement after acquisition:
After acquisition, the residence must constitute the individuals “primary residence” as defined above.

4.5 The residence and use requirement
Section 9(16) (c) and 9(17) (c) of the Transfer Duty Act confirms that
“The person or persons to whom the residence is to be transferred must have-
• Ordinarily resided in the residence; and
• Used it mainly for domestic purposes as his or her or their ordinary residence as from 5 April 2001 to the date of transfer.

It should be noted that:
• Property acquired after 5 April 2001;
• Property used for mainly for purposes other than a private residence at any time after 5 April 2001 to the date of transfer; and
• Property which was not used by the individual concerned from 5 April 2001, but from a subsequent date, does not qualify for any of the exemptions”. 
4.6 Acquisition of the property from a company

Sections 9(16) (a) and 9(17) (a) of the Transfer Duty Act confirms that

“The acquisition must take place between 20 June 2001 (date of promulgation of the Taxation Laws Amendment Act, 2001) and 30 September 2002.

The disposal by the company to the individual prior to 20 June 2001 or after 30 September 2002 does not qualify for the exemption.

4.7 Acquisition from a company: 100% direct shareholding requirement

Section 9(16) (b) of the Income Tax Act presents that

“The individual alone or together with his or her spouse must directly hold all the share capital of the company or member’s interest in the close corporation, as from 5 April 2001 to the date of registration of the property in the deeds registry.

“All” means 100% of the share capital if for example, a minor child holds 1% of the share capital, and the exemption does not apply.

“Directly” means the shares or interest in the company must be registered in the names of the individuals concerned and be held for their own benefit.

The concession therefore, does not apply where –

• The residence is held by a subsidiary company;

• The shares in the company holding the residence are owned by a trust; or

• The shares are held by more than one person and those persons are not spouses”.
4.8 Transfer of land with a residence

Provisions to section 9(16) and 9(17) read with paragraph 46 of the Eighth Schedule

The exemption applies in respect of the primary residence and the land on which it is situated, including unconsolidated adjacent land. The total portion of the land may not exceed two hectares. The land on which the residence is situated as well as any unconsolidated adjacent land must also be used mainly for domestic or private purposes. Any land transferred must be disposed of at the same time and to the same person as the residence.

The position of the land that exceeds two hectares will not qualify for the exemption and therefore will be subject to transfer duty and CGT. The transfer duty will be calculated at the rates and value applicable on the date of acquisition. The gain or loss for capital gains tax purposes must also be determined on the date of acquisition, having regard to any increase or decline in the value of the land exceeding two hectares from 1 October 2001 to the date of disposal by the company or trust.

4.9 Into whose name may the primary residence be transferred?

4.9.1 From a company

Section 9(16) (b) of the Transfer Duty Act provides that if a "natural person alone or together with that person's spouse directly held all the share capital or member's interest, then the primary residence may be registered: in the name of that natural person or jointly in the name of that person or that person's spouse."
For spouses of the exemption the residence of which is held by the company, can not be transferred in the name of the spouse who holds no shares. For example, if the husband holds all the shares and the primary residence are transferred to his wife’s name, the exemption does not apply. If each spouse holds a percentage of the shares (quantity irrelevant) of which the sum constitute 100% shareholding, the transfer of the residence to the name of either of the spouse or to their names jointly will qualify for the exemption”.

Assuming that there are two spouses, A and B who are married out of community of property, the table below shows into whose name the residence may be transferred:

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Residence may be transferred into the name of</th>
</tr>
</thead>
<tbody>
<tr>
<td>A owns 100%</td>
<td>A</td>
</tr>
<tr>
<td>A and B jointly own 100%</td>
<td>A, B or A and B jointly</td>
</tr>
</tbody>
</table>

4.10 THE CAPITAL GAINS TAX FOR COMPANIES

4.10.1 Overview of the core provisions of capital gains tax

The flowchart below figure 4.10.1.1 sets out the core steps in determining a taxable capital gain to be included in taxable income or an assessed capital loss to be carried forward to a subsequent year of assessment. It is adapted from SARS website
<table>
<thead>
<tr>
<th><strong>INCOME TAX ACT 58 of 1962</strong></th>
<th><strong>Eighth Schedule</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income</td>
<td>disposal (or deemed disposal) of asset</td>
</tr>
<tr>
<td>Exemptions</td>
<td>proceeds (or deemed proceeds)</td>
</tr>
<tr>
<td>Income</td>
<td>deduct base cost</td>
</tr>
<tr>
<td>Deductions</td>
<td><strong>Capital gain</strong>.bat</td>
</tr>
<tr>
<td></td>
<td>Exclusion?</td>
</tr>
<tr>
<td></td>
<td>Deferral of gain?</td>
</tr>
<tr>
<td>Taxable income</td>
<td>sum of all gains and losses</td>
</tr>
<tr>
<td>Rates of tax</td>
<td><strong>Aggtrate capital gain</strong></td>
</tr>
<tr>
<td>Income (normal) tax payable</td>
<td>deduct previous assessed capital loss (if applicable)</td>
</tr>
<tr>
<td></td>
<td>Net capital gain</td>
</tr>
<tr>
<td></td>
<td>Multiply by</td>
</tr>
<tr>
<td></td>
<td>inclusion rate</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Taxable</td>
</tr>
<tr>
<td></td>
<td>capital gain</td>
</tr>
</tbody>
</table>
4.10.2 Determining a capital gain or loss

The Eighth Schedule provides for four key definitions which form the basic building blocks in determining a person's capital gain or loss. These four definitions are:

"asset", "disposal", "proceeds" and "base cost".

A CGT event is triggered by the disposal of an asset. Unless such a disposal occurs, no gain or loss arises.

4.10.3 Direct costs of acquisition and disposal

Expenditure directly related to the cost of acquisition, creation or disposal of an asset:

- Cost of acquisition;
- Cost of creating an asset;
- Cost of obtaining a valuation for CGT purposes;
- Remuneration of a surveyor, valuer, auctioneer, accountant, broker, agent, consultant or legal advisor;
- Transfer costs;
- Stamp duty, transfer duty or similar duty;
- Advertising costs to find a seller or to find a buyer;
- Moving costs - but only in acquiring or disposing of an asset;
- Installation costs including foundations and supporting structures;
- Cost of an option to acquire or dispose of an asset; and
- VAT paid and not claimed or refunded in respect of an asset.
4.10.4 Costs of establishing, maintaining or defending a legal title or right in an asset

Cost of improvements or enhancements

The improvement or enhancement must, however, be reflected in the state or nature of the asset at the time of disposal.

Example

Determination of taxable capital gain

XYZ (Pty) Limited has sold the following assets during the tax year:

<table>
<thead>
<tr>
<th></th>
<th>Capital gain or loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vacant land</td>
<td>R50 000</td>
</tr>
<tr>
<td>Trade mark</td>
<td>5 000</td>
</tr>
<tr>
<td>Truck</td>
<td>(5 000)</td>
</tr>
<tr>
<td>Machine</td>
<td>(10 000)</td>
</tr>
<tr>
<td></td>
<td>R40 000</td>
</tr>
</tbody>
</table>

As this is the first year that CGT has been introduced, XYZ (Pty) Limited does not have an assessed capital loss from the previous year. Note that an assessed capital loss may only be deducted from capital gains and added to capital losses. It may not reduce ordinary income.
<table>
<thead>
<tr>
<th>Aggregate capital gain</th>
<th>40 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessed capital loss b/f</td>
<td>-</td>
</tr>
<tr>
<td>Net capital gain</td>
<td>40 000</td>
</tr>
<tr>
<td>Inclusion rate</td>
<td>50%</td>
</tr>
<tr>
<td>Taxable capital gain</td>
<td>20 000</td>
</tr>
</tbody>
</table>

\[(40 000 \times 50\%) \]

The taxable capital gain will be included in the company's taxable income and taxed at the rate of 30%, i.e. \(20 000 \times 30\% = 6 000\). The effective rate of tax on the sum of all the gains and losses is \(6 000/40 000 \times 100 = 15\%\).

4.11 Conclusion

A number of provisions have been introduced to permit natural persons to transfer an interest in a residence from a company to himself or herself without fiscal disadvantage.
CHAPTER 5
TRANSFER DUTY

5.1 Introduction

Transfer duty is payable when a party obtains the right to acquire fixed property, whether or not the transfer of the property is taken. Where a party enters into a transaction and disposes of that property before transfer takes place, he is liable for duty if any consideration accrues to the original purchaser, even if the original sale is cancelled. The Transfer Duty Act provides for the situations where a property is bought for a company still to be registered, as well as a property being acquired as agent for someone else.

5.2 Imposition of a transfer duty

The Transfer Duty Act 40 of 1949 confirmed that

"Subject to the provisions of section 9 of the Income Tax Act 58 of 1962, there shall be levied for the benefit of the National Revenue Fund a transfer duty on the value of any property (which value shall be determined in accordance with the provisions of section 5, 6, 7, and 8) acquired by any person on or after the date of this Act by way of a transaction or in any other manner, or on the amount by which the value of any property is enhanced by the renunciation, on or after the said date, of an interest in or restriction upon the use or disposal of that property, at the rate of

(a) 10% of the said value or the said amount, as the case may be if the person by whom the property is acquired or whose favour or whose benefit the said interest or restriction is renounced is a person other than a natural person; or

(b) Subject to the provisions of subsection (5):

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(i) 0 per cent of so much of the said value or the said amount, as the case may be, as does not exceed R150 000;

(ii) 5 per cent of so much of the said value or the said amount as the case may be, as does exceed R150 000 but does not exceed R320 000; and

(iii) 8 per cent of so much of the said value or said amount, as the case may be as exceeds R320 000

If the person who acquires the property or in whose favour or for whose benefit the said interest or restriction is renounced is a natural person.

This is also asserted by LexisNexis (2005:336).

SARS also confirmed that the purchase of fixed property is subject to transfer duty on a sliding scale (as tables below) when acquired by natural persons and at a fixed rate of 10 per cent for properties acquired by juristic persons.

Transfer Duty Rates – 2004/2005

<table>
<thead>
<tr>
<th>Property value</th>
<th>Rates of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>R0-R150 000</td>
<td>0%</td>
</tr>
<tr>
<td>R150 0001-R320 000</td>
<td>5% on the value above R150 000</td>
</tr>
<tr>
<td>R320 0001 and above R8 500 plus</td>
<td>8% on the value above R320 000</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Property value</th>
<th>Rates of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>R0-R190 000</td>
<td>0%</td>
</tr>
<tr>
<td>R190 0001-R330 000</td>
<td>5% on the value above R190 000</td>
</tr>
<tr>
<td>R330 0001 and above R7 000 plus</td>
<td>8% on the value above R330 000</td>
</tr>
</tbody>
</table>
5.3 By whom, when and to whom duty payable

LexisNexis (2005:337) asserted that "(1) The duty shall within six months of the date of acquisition be payable by the person who has acquired the property or in whose favour or for whose benefit any interest in or restriction upon the use or disposal of property has been renounced.

(1A) where a person who acquires any property fails to pay the duty within the period contemplated, the public officer as defined in section 101 of the Income Tax Act of 1962 (Act No. 58 of 1962), of that company and the person from whom the shares or member's interest are acquired shall be jointly and severally liable for such duty:

Provided that the public officer or person from the shares or members interest was acquired, may recover any amount of duty paid by him or her in terms of this subsection from-

(a) the person who so acquired that property; or

(b) in the case of a public officer, from that company.

(1B) Where a person who acquires any property fails to pay the duty within the period contemplated in subsection (1), the trust and the trustees of that trust shall be jointly and severally liable for such duty: Provided that the trust or trustee may recover any amount of the duty paid in terms of this section by the trust or trustees, as the case may be from –

(a) the person who so acquired that property; or

(b) in the case of the trustee from that trust.
(2) The determination of the amount of duty payable under this Act, a deposit on the account of the duty payable may be made to the office of the South African Revenue Services to whom the duty is payable.

(3) The duty and the penalty payable under section 4 and any transfer duty and interest payable under any law repealed by this Act shall be paid to the office of South African Revenue Service where payments are accepted, for the area in which the property in question is situated or, if the property in question is situated in the area of more than one office of the South African Revenue Service where payments are accepted, to any one of those offices, or in either case, to the office of South African Revenue Service or the area where the deeds registry in which the property is registered is situated.

(4) Where in addition to any amount of duty which is payable by any person in terms of this Act, an amount of penalty is payable by him in terms of the provisions of this Act, any payment made by that person or after 1 April 1994 in respect of such duty or penalty which is less than the total amount due by him in respect of such duty and penalty shall for the purpose of the Income Tax Act be deemed to be made—

(a) in respect of such penalty; and

(b) to the extent that such payment exceeds the amount of such penalty.

(5) Any agreement concluded prior to 1 April 1994 between the Commissioner and the person liable for the payment of any duty or penalty which provides for the allocation of any payment to be made on or after that date otherwise than in accordance with the
provisions of subsection (4) shall, in so far as it provides for such allocation cease to have effect”.

5.4 Residential Properties held in Discretionary Trusts

SARS asserted that “In December 2002 the Transfer Duty Act was amended to put a stop to avoidance schemes involving residential properties held in companies, close corporations and trusts. The Minister of Finance announced in his Budget Speech in February 2003 that further measures would be introduced to prevent the avoidance of transfer duty and to enable the Commissioner of the South African Revenue Service (SARS) to obtain civil judgments against persons who had failed to pay transfer duty.

Prior to the Act being amended in 2002, SARS commenced issuing assessments on transactions involving discretionary trusts as SARS holds the view that even before the amendment to the Act, transfer duty was payable because:

- in substance, fixed property transactions had occurred;
- fixed property transactions had occurred because, in light of the radical changes made to the trust deeds, the existing trusts had been replaced by new trusts; and/or
- fixed property transactions had occurred as new trusts; independent from the original trusts had been created.

While it had been hoped to have a test case in this regard, the parties who challenged SARS have withdrawn their cases and paid the assessments. SARS is now raising assessments against parties who were previously assessed but have not paid the duty and
penalties.

The assessments were issued on the basis that the 10% rate of duty (plus penalties) is payable. The 2002 amendments to the Transfer Duty Act, 1949, however, provide that in the abovementioned circumstances, transfer duty at the rate applicable to natural persons is payable. In light hereof, the desire has been expressed by many parties to settle their dispute with SARS at the rates applicable to natural persons. SARS is accordingly prepared to settle these cases on the basis set out in the annexure to this media release. These settlements will be in terms of the settlement provisions contained in section 88D of the Income Tax Act, 1962, which apply mutatis mutandis to the Transfer Duty Act, 1949”.

5.5 Outstanding taxes and tax returns

SARS website confirmed that “SARS will use property transfers to ensure that, where applicable, the parties concerned are on the income tax register and that their tax returns and taxes due are up to date. Where sellers owe taxes, conveyancers will be appointed as the agents of SARS to pay over monies held by them. SARS will notify conveyancers where there are problems relating to the tax affairs of buyers or sellers. The parties concerned will be given the opportunity to rectify matters, but should they fail to respond to the request, the issue of transfer duty receipts/exemptions will be delayed until SARS has issued garnishee orders or taken other steps to ensure compliance. These may include attaching properties or registering caveats against properties”.
5.6 Penalty on late payments of duty

LexisNexis (2005:338) confirmed that

(1) “If any duty remains unpaid after the date of the expiration of the period referred to in section 3, in addition to the unpaid duty, be payable a penalty, at the rate of 10 per cent on the amount of the unpaid duty, calculated in respect of each completed month in the period from that date to the date of payment, provided that if in any case the period referred to in section 3 ended before 1 July 1982 and the said penalty is chargeable or is in part chargeable in respect of any completed month commencing before July 1982 the penalty payable in respect of such completed month and any earlier completed month or months shall be the amount of penalty which would have been payable in terms of this subsection before its amendment by the Revenue Laws Ac, 1982, if the unpaid amount of such duty had been paid on the day after the end of the only or latest of such completed months.

(2) For the purpose of subsection (1) a deposit on account of duty shall be deemed to be a payment of duty.

(3) Whenever the Commissioner is satisfied that the delay in the determination of the value on which the duty is payable cannot be ascribed to the person liable to pay the duty, he may allow a reasonable extension of time within which the duty may be paid without penalty if, within six months of the date of acquisition of the property:
(a) a deposit on account of the duty payable is made to the Commissioner of the
amount equal to the duty calculated on the amount of the consideration paid or
payable on the declared value, as the case may be; and

(b) application is made in writing to the Commissioner for such extension of time”.

5.7 Exemptions from transfer duty

Section 9 of the Transfer Duty Act 40 of 1949 confirmed that

“No duty shall be payable in respect of the acquisition of property by –

(a) The government and provincial administration;

(b) Any rural council, municipal council, town council, village council, town board, local
board, village management board, health committee or any district council or the Far
West Rand Dolomitic Water Association formed on the 6 July 1964, or the Rand Water
Board, or the council established under section 2 of the Local Government Affairs
Council Act (House of Assembly), or the Local Authorities Loans Fund Board
established by section 4 of the Local Authorities Loans Fund Act, 1984 (Act No.67 of
1984), or any regional council established under section 3 of the Regional Services
Councils Act, 1985 (Act No.109 of 1985), or any joint services board established under

(c) Any irrigation board established under VI, any water board established under Chapter
VII or any body established under Chapter VIIA of the Water Act, 1956 (Act No.54 of
1956) and any regional water services corporation constituted under section 7 of the
water Services Ordinance, 1963 (Ordinance No.27 of 1963).

(d) A public benefit organization which is exempt from tax in terms of section 10(1) (cN) of the Income Tax Act, 1962 (Act No 58 of 1962), or any institution, board or body, which is exempt from tax in terms of section 10 (1) (cA) (i) of that Act, which has as its sole or principal object the carrying on of any public benefit activity contemplated in section 30 of that Act.

In respect of property acquired by such public benefit organization, institution, board or body, the whole, or substantially the whole, of which will be used for the purposes of one or more public benefit activity carried on by such public benefit organization, institution, board or body as the case may be”.

5.8 VAT

SARS confirmed that “Many VAT 249 (now TD5) declarations are received which indicate that the transaction is zero-rated because the fixed property is part of a going-concern which is being sold. On investigation, it is often found that the transaction is not the sale of a going concern. Vendors and conveyancers are again reminded that where the transaction does not comply with the requirements of section 11(1) (e) of the VAT Act, SARS will not hesitate to impose additional tax. Where appropriate, SARS will also seek convictions for tax evasion”.

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LexisNexis (2004:2) further presented that

"1. Since 30 September 1991 three forms of payment of Value Added Tax (VAT) on the sale of the property may be identified:
   (a) Payment of VAT on the purchase price where no transfer duty would be payable.
   (b) Payment of VAT on the commission for the estate agent.
   (c) Payment of VAT on the conveyancer's transfer fees and mortgage bond registration or cancellation fees.

2. VAT will only be payable if the seller, the estate agent and the attorney are vendors. The seller's status will however need to be determined in each case.

3. The exemption from transfer duty under section 9 (15) of the Transfer Duty Act, No 40 of 1949 will only be applicable if:
   (a) The seller is a registered vendor;
   (b) The immovable property is sold in the course of or in order to advance seller's enterprise;
   © The enterprise is continuously or regularly carried on by him.

4. There will be no transfer duty when any VAT is payable on the purchase price".
5.9 Penalties

Section 17 of the Transfer Duty Act 40 of 1949 confirmed that

(1) Any person who –

(a) Fails to comply with any requirement or demand under this Act;

(b) Knowingly submits or causes to be submitted to the Commissioner a declaration which fails to disclose any material fact relevant to the nature of the transaction by which property has been acquired or to the consideration payable in respect of any property or to the value on which duty is payable;

(c) Without good cause fails to –

(i) Comply with any requirement; or
(ii) Reply to or answer truly any question put to him by any person acting under section 11C, 11D, or 11E of the Transfer Duty Act 40 of 1949; or

(d) Obstruct or hinders any officer in the carrying out of his duties.

Shall be guilty of an offence and liable on conviction to a fine or imprisonment for a period not exceeding one year.

(2) A person who makes in any declaration knowing it to be false shall be guilty of an offence and liable on conviction to the penalties prescribed for the crime of perjury". 
5.10 Incomplete declarations

Many declarations are received by SARS which are incorrectly completed, or the signatures appear on the documents are clearly not those of the transferors and transferees. These practices are unacceptable and unprofessional, while the signing of a declaration by a person other than the declarant, is illegal. Various punitive provisions have recently been incorporated into the Transfer Duty Act and will be rigorously applied.

5.11 Additional duty in case of evasion

SARS presented that "It has also come to light that certain building contractors are involved in schemes whereby the land is sold separately from a building contract. Parties engaged in such schemes are warned that there are provisions contained in section 50A of the VAT Act to prevent the avoidance of VAT in these circumstances".

Section 17A of the Transfer Duty Act 40 of 1949 confirmed that

"(1) Where any person or person under the control or acting on behalf of that person fails to perform any duty imposed upon him or her by this Act or does or omits to do anything with intent:
(a) To evade the payment of any amount of duty payable by him or her; or
(b) To cause a refund to him or her by the Commissioner of any amount of duty which is:
(l) Excess of the amount properly refunded to him or her, that person will be chargeable with additional duty not exceeding an amount equal to double the amount of the duty."
(2) The amount of the additional duty shall be assessed by the Commissioner and shall be paid by the person within such period as the Commissioner may allow.

(3) The power conferred upon the Commissioner by this section shall be in addition to any right conferred upon him or her by this Act to institute or take other proceedings under this Act”.

5.12 Estate agents required to report certain transactions

SARS confirmed that “Most property transactions must be registered with the Registrar of Deeds and registration cannot take place without a transfer duty receipt/exemption certificate from SARS (for example where the transaction is subject to VAT). This does not happen where fixed property is registered in the name of a trust, company or close corporation and there is merely a change of beneficiaries, shareholders or members.

To ensure compliance, estate agents who are parties to transactions involving trusts owning residential property or residential property companies (including close corporations) are required to declare such transactions to SARS. A declaration (TD7) is now available on the SARS website for this purpose. Failure to declare such transactions constitutes an offence”.

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5.13 Transfer from a company, close corporation or trust:

Ensure the transfer is free from transfer duty

Geach (2001:114) contended that "No transfer duty will become payable on the transfer of property into the name of a natural person provided that the following requirements are met.

5.13.1 Transfer from a company or from close corporation

1. The acquire of the residence must be a natural person and that residence must constitute that person's primary residence for CGT purposes when acquired by that natural person;

2. The acquisition must take place on or after the promulgation of the Taxation Laws Amendment Act, 2001, but not latter than 30 September 2002;

3. The natural person alone or together with that person's spouse must hold all the share capital of the company or member's interest in the close corporation, as the case may be from 5 April 2001 to the date of registration in the deeds registry of the residence in the name of the natural person or jointly in the name of that person and that person's spouse;

4. That natural person or that person's spouse must have ordinarily resided in that residence and used it mainly for domestic purposes as his or her or their ordinary from 5 April 2001 to the date of that registration;

5. The registration of the residence must take place not later than 31 March 2003.
The paragraph will only apply in respect of that portion of the land on which the residence is situated and adjacent land to the following extent:

1. To the extent that the land does not exceed 2 hectares;

2. To the extent that the land is mainly for domestic or private purposes in association with that residence; and

3. Provided that the land is disposed of at the same time to the same person as the residence”.

5.13.2 Transfer from a trust

Geach (2001:116) cited that “It is important to note that not all property currently held by a trust will benefit from the exclusion from transfer duty. The requirements listed below must be met before a property, currently held by a trust, before an exemption from transfer duty will be allowed.

1. The person acquiring the residence must be a natural person and that residence must constitute that person’s primary residence for CGT purposes when acquired by that natural person;

2. The acquisition must take place on or after the promulgation of the Taxation Laws Amendment Act, 2001, but not later than 30 September 2002;

3. The person acquiring the residence must have disposed of that residence to the trust by way of donation, settlement or other disposition or must have financed all the expenditure actually incurred by the trust to acquire and to improve the
4. That person or his or her spouse must have ordinarily resided in that residence and used mainly for domestic purposes as his or her or their residence from 5 April 2001 to the date of registration in the deeds registry of the residence in the name of that person and that person's spouse; and

5. The registration of the residence must take place not later than 31 March 2003.

The paragraph will only apply in respect of that portion of the land on which the residence is situated and adjacent land to the following extent:

a) To the extent that the land does not exceed 2 hectares;

b) To the extent that the land is used mainly for domestic or private purposes in association with that residence; and provided that the land is disposed of at the same time and to the same person as the residence.

Taxpayers may take advantage of the above concessions with effect from the date of promulgation of the Act".

5.14 Ensure transfer is free from secondary tax on companies (STC)
Geach (2001:117) cited that “Section 64B of the Income Tax Act 58 of 1962, is amended to provide that secondary tax on companies (STC) will not apply where the interest in a residence is distributed as a dividend or is sold. Provided the requirements listed below are met, than any capital profit realized on distribution or on sale may be distributed free of CGT
The requirements that need to be met in order to qualify for this exemption are as follows:

1. The interest in the residence must have been distributed or disposed of;
2. The distribution of the capital profits must be completed;
3. All the shares in a company must have been owned by the natural person or his or her spouse between 5 April 2001 and the date of registration of the property in the deeds registry. This means that, for example, that the exemption is not available where a residence is held by a subsidiary company;
4. The person or his or her spouse must have been ordinarily resided in the residence and used it mainly for domestic purposes as his or her or their ordinary residence between 5 April 2001 and the date of registration;
5. After the distribution or disposal, the residence must meet the criteria of primary residence in the hands of the person taking transfer;
6. Where the land is situated on the land that exceeds 2 hectares, the portion of the dividend relating to the excess will not qualify for STC exemption;
7. The portion of the dividend that relates to land that is not used mainly for domestic or private purposes together with the residence will not qualify for SCT Exemption;
8. All the land must be transferred at the same time as the residence in order for the dividend to qualify for exemption.

Taxpayers must take advantage of the above with effect from the date of promulgation of the Act”.

Example (based on an example given by SARS)
X (Pty) Ltd owns a residential property in which the company’s sole shareholder resides. The house was acquired at market value of R250 000 on 1 March 1995. The market value of the property on 1 October 2001 is R500 000.

The balance sheet of X (Pty) is as follows:

| Share capital – 2 shares of R1 each | 2 |
| Non-distributable reserve | R250 000 |
Shareholder’s loan  
- R249 998
- R500 000

Property at market value  
- R500 000

The non-distributable reserve arose as a result of the revaluation of the property on 1 October 2001. The shareholder wishes to transfer the property out of the company into his own name.

The provisions of section 64B (5) (k) of the Income Tax Act 58 of 1962 should be read and dealt with in terms of the following:

1. Section 9 (16) or (17) of the Transfer Duty Act, 1949 which enables the primary residence to be transferred from a company or trust free of transfer duty.
2. Item 7(e) of the first Schedule to the Stamp Duties Act, 1968 which enables the stamp duty-free transfer of a mortgage bond.
3. Paragraph 51 of the Eighth Schedule which stipulates that the residence must be treated as if having disposed of at a market value on 1 October 2001. Since the market value of the property on 1 October 2001 will constitute its base cost, no capital gain or capital loss will arise in the hands of the company.
4. The provisions of the company’s memorandum and articles of association which will have to be examined to determine whether there are any restrictions on the distribution of capital surpluses.

It has been assumed that the size of the property does not exceed 2 hectares. Any capital profit attributable to the area exceeding 2 hectares would attract CGT if distributed in the normal course of business. Such a distribution may however be exempt in terms of section 64B (5) (c) if made in the anticipation of or during the course of winding-up or deregistration.
5.15 CONCLUSION

In light hereof, a system whereby conveyancers will be able to lodge transfer duty declarations and make payments electronically via the internet will become operational during April 2005. Conveyancers will be able to lodge the declarations by transferors (sellers) and transferees (purchasers) to SARS branches electronically and simultaneously make payments to designated SARS bank accounts. SARS will verify the duty calculations and authorizes the issue of a transfer duty receipt. Conveyancers wishing to make use of e-filing should register as e-filers by visiting the e-Commerce section of the SARS website.

Copies of the deeds of sale must be electronically scanned and submitted with the declarations. Due to the impracticality of obtaining the digital signatures of buyers and sellers, the conveyancers will be required to digitally countersign the declarations transmitted to SARS. The deeds of sale and original transfer duty declarations, with all the requisite signatures must be retained by the conveyancers for a period of 5 years from the date of submission thereof to SARS. Submission of Transfer Duty declarations should be made to the SARS branch where the property is situated.
CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

The South African Revenue Services makes a distinction between what it calls - property investors and property traders; this is a very important distinction.

A property investor will be liable to pay Income Tax on rental income and Capital Gains Tax (CGT) on profits made when selling the property in the normal way that would be expect.

A property dealer (also known as a trader) will find that all his or her profits made on the sale of a property are taxed as income tax, and not as Capital Gains.

The Eighth Schedule to the Income Tax Act 58 of 1962 provides that only natural persons (individuals) and special trusts are entitled to exclude the first R1 million of gains on disposal of their primary residence. This exclusion does not apply where a company, close corporation or trust owns the residence.

The inclusion rate of the gain is 25%, and also enjoy the R10 000 exemption on the capital gains they generated. For SARS to increase their revenue, they should reduce the exemption from R1 million to R500 000 per primary residence, and also increase the inclusion rate from 25% to 50% on capital gains derived from the disposal of primary residence, and lastly increase the exemption from R10 000 to R15 000 and the taxpayers can appreciate this.
Primary residence does not only belong to private individuals and special trusts, trusts and companies do have their primary residence. The treatment for CGT on the disposal of their residence is not similar with individuals. The Eighth Schedule to the Income Tax Act 58 of 1962 provides that only natural persons (individuals) are entitled to exclude the first R1 million of gains on disposal of their primary residences. This exclusion does not apply where the residence is owned by a company, close corporation or trust.

Many individuals have historically purchased their residences in companies or trusts for a variety of reasons, including protection from creditors, avoidance of transfer duty and estate duty etc. As a result, they faced potential CGT liability when their company, close corporation or trust disposed of the residence.

Legislation was introduced to allow individuals a window of opportunity to transfer their residence out of their companies into their own names without incurring any adverse tax consequences. There were conditions that need to be satisfied to secure tax free transfer, and information regarding the person(s) into whose name the primary residence may be transferred. This was highly appreciated, taxpayers benefited and it also created a friendly atmosphere between SARS and taxpayers.

This tax free transfer was only for a limited period, the transfer was to take place on or after 20 June 2001, but not latter than 30 September 2002, and the final date for registration of the transfer in the deeds office is 31 March 2003.

In Pretoria, 14 April 2005, the South African Revenue Service (SARS) has launched a
new transfer duty system that will enable conveyancers to access and submit declaration forms on the net electronically. The initiative is aimed at improving client service, modernise SARS processes and ensure easy compliance with all tax laws.

From then onwards, conveyancers were able to submit transfer duty declaration forms and effect transfer duty payments electronically once they have registered as e-filers on the SARS website.
CHAPTER 7

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