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Accounting Matters

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## TIME IS RUNNING OUT IF YOUR RESIDENCE IS IN A TRUST, A COMPANY OR A CLOSE CORPORATION (CC)

Did you purchase your residence in one of the above entities? Now do you find yourself wondering how you can extricate yourself from this without incurring transfer duty, capital gains tax (CGT), and dividends tax (DT)?

The government has given you an opportunity to unwind this situation by transferring the residence into your name (or the name of a beneficiary or shareholder) without paying transfer duty, DT and CGT. ***But you must act before 31 December 2012***.

Why has SARS given you this tax break? Part of the condition of this opportunity is that SARS requires that (subject to some recent concessions noted below) you liquidate or deregister the trust, company or CC once the transaction has been completed. This will considerably reduce the number of trusts, companies and CCs in existence and will make SARS' tasks of administration and enforcing taxpayer compliance easier.

Of course, if your residence is in another entity as part of a long term strategy it may not be in your interest to take this opportunity. **A very important factor is to take expert advice to ensure no tax is paid if you do decide to transfer your residence**.

### *Does it make economic sense to have my residence in an individual's name?*

One day you will dispose of your residence (unless as noted above your residence is part of a long term strategy such as preserving your assets in a family trust).

The CGT is significantly lower if the property is in your name. CGT is 13.3% in your name (assuming you pay the maximum marginal rate of income tax at 40%), 18.6% in a company and CC and 26.6% in a trust. In addition, there is a R2,000,000 "primary residence exclusion" for individuals plus a R30,000 "annual exclusion". You also do not have to worry about other taxes like DT.

The table below compares the different entities.

*N.B: The figures shown below should not be taken at face value; they are only a rough guide to illustrate the potential tax savings. Take proper advice on your particular circumstances!*

| DISPOSAL OF A RESIDENCE: ILLUSTRATIVE CGT COMPARISON | | | |
|---|---|---|---|
| | CGT Payable By Seller | | |
| CAPITAL GAIN | Individual | Company / CC | Trust |
| R2,000,000 | R0 | R372,960 | R532,800 |
| R3,000,000 | R129,204 | R559,440 | R799,200 |
| R4,000,000 | R262,404 | R745,920 | R1,065,600 |

### NOTES

- Dividend tax of 15% applies when companies and CCs distribute the profits. So if you want to take your profit out of the corporate, **you will pay another 15% dividend tax over and above the CGT**.
- A "special trust" (i.e. a trust created solely for the benefit of a person who suffers from a mental illness or a person who suffers from any serious physical disability) is treated as an individual in this instance.
- Holiday homes - although the "primary exclusion" of R2,000,000 applies only to a "primary residence" and not to a secondary residence such as a holiday home, the tax savings will still be significant.
- On death, the "annual exclusion" increases to R300,000 for the year of death.
- All exclusions are shown at the new, increased rates likely to come into effect shortly.
- CGT for individuals is shown at the maximum marginal rate so it will be a lot less for anyone with a low marginal rate.
- With a trust, you may be able to reduce the CGT substantially by having the profits taxed in the hands of a beneficiary with a low tax burden.

The benefits are self-evident from the table – where there is a R2,000,000 capital gain, it is R372,960 more favourable than a company or CC and R532,800 more beneficial than a trust.

### *Other Considerations*

- Do I qualify? Not everyone will qualify, but take professional advice. If your property is mainly used for residential domestic purposes, you are off to a good start.
- Does my holiday house or secondary residence qualify? Yes, the benefit has been extended to houses other than your primary residence, subject to restrictions relating to domestic, rather than business, usage. Remember that the "primary exclusion" of R2,000,000 won't apply here
- What about my company/trust structure? If you have a "multi-tier" structure (e.g. your company owns the house, and your trust or another company owns the shares in the company) the benefit has also been extended to you (again, subject to restrictions and requirements, so taking advice is essential). .
- Even if I qualify, will I benefit? Take full advice on this – depending on your particular circumstances, there may be good reason to leave the property where it is. Consult a professional on considerations such as estate planning, asset protection, conduiting a trust's distributions to a beneficiary with a low tax burden etc.
- Are there any risks? The disposal must be carefully structured by a professional to avoid any triggering of donations tax, dividends tax, adverse tax effects of any loan accounts etc. If the property is bonded, remember to give the bank timeous notice of cancellation and also check that the transferee will qualify for a new bond (and if so, at what interest rate).
- To whom should I transfer the property, how should I dispose of it, and at what price? Once again, take advice here - everyone's circumstances will be different, and there are many considerations.
- When must I dispose of it?
  By 31 December 2012.
- What will it cost me? The good news is that there is no transfer duty payable, and CGT is "rolled over" i.e. not payable now. Provide for conveyancer's fees, bond cancellation and registration fees, the cost to deregister or liquidate entities etc.
- Once I have moved my residence into my name, how long do I have before deregistering or liquidating the entity that owned the residence? SARS gives you six months to begin these proceedings and will give an extension if you ask. If there are other assets in these entities, SARS have made concessions which may help you – speak to a professional.

Depending on your circumstances, there are significant potential benefits to you. **Act now** as the deadline is 31 December 2012, after which this opportunity disappears.

## AS SARS ENFORCES COMPLIANCE WITH NEW POWERS, WHERE DOES THAT LEAVE YOU, THE TAXPAYER?

SARS is aggressively pursuing improved revenue collections from taxpayers. Key to this is a campaign to get taxpayers to comply with all tax laws. SARS has expanded its powers considerably and a High Court judge has called some of these powers "draconian".

The main provisions of the new Tax Administration Act (TAA) are effective from 1 October 2012. They give SARS officials increased powers like search and seizure powers (without a search warrant) - SARS officials can arrive unannounced at your premises to ascertain the business being carried out, demand the identities of people working there and check whether the business is registered for tax.

### *What do the Courts say?*

A recent High Court judgment, dealing with the pre-TAA powers of SARS, found that when SARS uses the powers given to it "checks and balances may be necessary to safeguard the rights of taxpayers". In this case, SARS had asked the taxpayer to complete a lifestyle audit and, based on the information received from the taxpayer, R1.3 million in additional tax was levied. In terms of provisions of the Income Tax Act (which still apply until 1 October), Revenue may make an *estimate* of the tax owing if SARS is not satisfied with the information given by the taxpayer. Despite the fact that the taxpayer objected to the additional assessment, SARS obtained a judgment for the tax owed from a court. This it is able to do in terms of the Income Tax Act, which allows SARS to obtain a civil judgment against a taxpayer where monies are overdue. In obtaining this judgment, SARS, who are not (until 1 October) obliged to inform the taxpayer of this process, did not do so.

These events happened in 2005. In 2007, the taxpayer's objection to the 2005 additional assessment was upheld as a SARS official had erroneously calculated the 2005 extra taxes. In 2010, the taxpayer applied for and was refused a bond by a bank, as the SARS judgment obtained in 2005 had not been rescinded. On application by the taxpayer, the South Gauteng High Court rescinded the judgment.

The judge used harsh language in his decision: the additional assessment from the lifestyle audit was performed in a manner which "suggests that suitably qualified or experienced persons were not engaged to perform the forensic analysis or accounting calculations. In the result their estimates were fundamentally flawed". The fact that no SARS official pursued the taxpayer's objection was "self-evidently incompetent".

### *Has this judgment affected the TAA?*

Several of the issues raised by the Court have been addressed in the TAA. SARS still has the right to issue additional assessments, but the taxpayer must be given a "statement of the grounds for the assessment". Taxpayers are still required to pay tax even if there is an objection or appeal pending but the taxpayer may request that payment be suspended. A Senior SARS official may allow the suspension of the payment based on specified criteria. Finally, SARS may obtain a civil judgment against a taxpayer but must give the taxpayer ten business days' notice of intention to apply for the judgment (except when satisfied that giving such notice "would prejudice the collection of the tax").

SARS hasn't diluted any of its powers but there is more even-handedness shown to taxpayers. SARS is obliged to apply its mind when making estimates, a taxpayer has a chance of getting payment suspended until after the objection and appeal is finalised and SARS must (except as noted above) give the taxpayer notice when applying for a civil judgment.



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