SOUTH AFRICAN REVENUE SERVICE

GUIDE TO THE DISPOSAL OF A RESIDENCE FROM A COMPANY OR TRUST

(1 OCTOBER 2010 TO 31 DECEMBER 2012)

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Guide to the disposal of a residence from a company or trust

Foreword

This guide deals with the window of opportunity covering the period 1 October 2010 to 31 December 2012 for the disposal of a residence from a company or trust into the hands of individuals free of transfer duty, capital gains tax, secondary tax on companies, and the dividends tax to be implemented on 1 April 2012.

The relief measures are applicable to a wide variety of situations, and it is not the purpose of this guide to deal with all of them.

It is not a binding general ruling issued under s 76P of the Income Tax Act 58 of 1962.

This guide reflects the law as amended by the Taxation Laws Amendment Act 7 of 2010, which was promulgated on 2 November 2010.

Should you require additional information concerning any aspect of taxation you may

- visit the SARS website at www.sars.gov.za;
- visit your nearest SARS branch;
- contact your own tax advisor / tax practitioner;
- if calling locally, contact the SARS Contact Centre on 0800 00 7277; or
- if calling from abroad, contact the *SARS* Contact Centre on +27 11 602 2093.

Comments on this guide may be sent to **policycomments@sars.gov.za**.

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Glossary

In this guide

- **“CGT”** means capital gains tax, namely, the normal tax attributable to the inclusion of a taxable capital gain in taxable income under s 26A of the Act;
- **“company”** includes a close corporation unless otherwise indicated;
- **“IFRIC”** means the International Financial Reporting Interpretations Committee;
- **“para”** means paragraph;
- **“s”** means section;
- **“ss”** means sections;
- **“STC”** means secondary tax on companies;
- **“the Act”** means the Income Tax Act 58 of 1962;
- **“the Transfer Duty Act”** means the Transfer Duty Act 40 of 1949
- **“the VAT Act”** means the Value-Added Tax Act 89 of 1991;
- references to paragraphs are to paragraphs of the Eighth Schedule to the Act;
- references to sections are to sections of the Act unless otherwise indicated; and
- unless the context otherwise indicates, any word or expression in this guide bears the meaning ascribed to it in the Act.

1. Purpose

This guide deals with CGT, dividends tax, STC and transfer duty relief measures that apply to the acquisition by a natural person of a residence from a company or trust between 1 October 2010 and 31 December 2012.

2. Background

Paragraph 45 provides that only a natural person (individual) or special trust is entitled to disregard the whole or a portion of the capital gain or loss on disposal of that person's primary residence. Subject to certain exceptions

- as a general rule, the first R1,5 million of capital gain or capital loss must be disregarded, and
- if the proceeds are R2 million or less, the full amount of any capital gain must be disregarded.

This exclusion does not apply when the residence is owned by a company, close corporation or trust (whether discretionary or vesting).

Historically many individuals purchased their residences in companies or trusts for a variety of reasons, including protection from creditors, avoidance of transfer duty and estate duty and circumvention of the Group Areas Act 36 of 1966 (repealed). A window of opportunity was granted in 2002 which enabled these persons to transfer their residences out of their companies or trusts into their own names without suffering any adverse CGT, STC or transfer duty consequences [see Appendix A of the *Comprehensive Guide to CGT* (Issue 3)].

Following the amendment of the Transfer Duty Act in 2002, it is no longer possible to avoid transfer duty by disposing of the shares or member's interest in a company holding residential property, or by substituting beneficiaries holding contingent interests in residential property of a discretionary trust.

Before the amendments effected by the Revenue Laws Amendment Act 74 of 2002 the distribution of capital profits in anticipation of liquidation or deregistration or during the course of winding up of a company was exempt from STC. However, since the amendments, any capital profit derived by a company on or after 1 October 2001 is subject to STC, even if distributed in anticipation of liquidation or deregistration or during winding up. Furthermore, with effect from 1 January 2011 all capital profits, regardless of whether derived before 1 October 2001, will be subject to STC.

The last two factors have made it costly from a tax point of view for a company or trust to dispose of a residence. Not only will the company or trust not qualify for the primary residence exclusion but the company will potentially be liable for CGT at 14% and STC at 10%. The CGT consequences of an interest in a residence held by a trust will be borne either by the trust (which pays CGT at the rate of 20%) or by a resident beneficiary if the trust's capital gain is attributed to that beneficiary under para 80. A natural person acquiring the residence will be subject to transfer duty on a sliding scale at a rate varying between 0 and 8%.[1]

[1] New transfer duty rates apply to properties acquired under purchase agreements concluded on or after 23 February 2011. These sliding scale rates will also apply to legal persons (close corporations, companies and trusts). For details see the SARS website under Tax Types/Transfer Duty.

It has emerged that many individuals did not avail themselves of the 2002 opportunity, with the result that they now face the adverse tax consequences described above when disposing of a residential property from a company or trust.

Paragraph 51

A further window of opportunity in the form of para 51 of the Eighth Schedule, which operates on a roll-over basis, was introduced by the Taxation Laws Amendment Act 17 of 2009. Paragraph 51 applies to the disposal of a residence by a company or trust on or after 11 February 2009 but no later than on or before 30 September 2010. Thus para 51 will apply to residences acquired under contracts signed on or before 30 September 2010 which are not subject to any suspensive conditions at that date. There is no time limit on the registration of the property in the deeds registry. In other words a property acquired unconditionally on or before 30 September 2010 which is registered after that date must still be dealt with under para 51.

A disposal of a residence that is subject to suspensive conditions which are only fulfilled after 30 September 2010 must be addressed under para 51A.

For guidance on para 51, see Appendix B of the *Comprehensive Guide to CGT* (Issue 3).

Paragraph 51A

On 17 February 2010 it was announced in the 2010 Budget Tax Proposals that para 51 was inadequate and that a

> "new, more flexible window period is proposed so that these residential property entities are to be liquidated or dissolved with limited compliance and enforcement effort."

The Taxation Laws Amendment Act 7 of 2010, which was promulgated on 2 November 2010[2] inserts a new para 51A which widens the relief in a number of respects but also imposes new conditions. The new relief measure comes into operation on 1 October 2010 and applies to the acquisition of a residence from a company or trust on or after that date.

This guide deals with the relief measures in para 51A and related provisions.

3. Taxes qualifying for exemption

The relevant provisions offer exemption from

- transfer duty on the acquisition of an interest in a residence contemplated in paragraph 51A [s 9(20) of the Transfer Duty Act],
- STC on any dividend declared which constitutes the disposal of an interest in a residence contemplated in para 51A [s 64B(5)(*k*A)],
- dividends tax (which will replace STC on 1 April 2012)[3] on a dividend constituting the disposal of an interest in a residence contemplated in paragraph 51A [s 64F(*i*) and (*i*A)], and
- CGT on any capital gain realised by the company or trust on disposal of an interest in a residence [para 51A].

[2] *GG* 33726 of 2 November 2010.
[3] As announced by the Minister of Finance in his 2011 Budget Speech on 23 February 2011.

4. The transfer duty exemption

The transfer duty exemption requirements are contained in s 9(20) of the Transfer Duty Act.

> **9. Exemptions from duty.—**
>
> (20) No duty shall be payable in respect of any acquisition of any interest in a residence as contemplated in paragraph 51 or 51A of the Eighth Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962), where that acquisition takes place as a result of a transfer or disposal contemplated in either of those paragraphs.

Effective date

Under s 3(3) of the Taxation Laws Amendment Act 7 of 2010, s 9(20) comes into operation on 1 October 2010 and applies in respect of acquisitions taking place on or after that date and before 1 January 2013.

5. The STC exemption

The STC exemption is contained in s 64B(5)(*k*A).

> (5) There shall be exempt from the secondary tax on companies—
>
> (*k*A) any dividend declared by a company which constitutes a disposal of an interest in a residence as contemplated in paragraph 51A of the Eighth Schedule; and

Effective date

Section 64B(5)(*k*A) came into operation on 1 October 2010 and applies in respect of disposals made on or after that date and before 1 January 2013.

In order to qualify for an exemption from STC under s 64B(5)(*k*A)

- the residence must comply with para 51A, and
- the dividend declared must comprise the disposal of a residence.

The *Oxford English Dictionary* provides, amongst others, the following meaning of the term "disposal":[4]

> "**2.** The action of disposing of, putting away, getting rid of, settling, or definitely dealing with."

A distribution *in specie* of a qualifying residence thus constitutes the "disposal" of a residence in the ordinary sense of the term and will meet the requirements in the second bullet point above.

A sale of the residence to a shareholder at less than market value will give rise to a dividend as defined in s 1, to the extent that it comprises[5]

> "any amount transferred or applied by a company for the benefit of any shareholder in relation to that company by virtue of any share held by that shareholder in that company".

[4] [OED Online] **http://dictionary.oed.com/ff** Oxford University Press [Accessed 21 February 2011].
[5] Opening words of the definition of a "dividend" in s 1.

Example 1 – Sale of an interest in a residence to a shareholder at less than market value

Facts:

A company holds a residence with a book value of R1 million and a market value of R1,5 million, which it disposes of to its sole shareholder for R1 million, The shareholder has ordinarily resided in the residence from 11 February 2009 to the date of disposal.

Result:

The sale gives rise to a dividend as defined in s 1 of R1 500 000 less R1 000 000 = R500 000, being the benefit to the shareholder by virtue of that shareholder's shares in the company. The dividend of R500 000 is exempt from STC under s 64B(5)(*k*A) since it results directly from the disposal of the residence.

A sale by a company of a residence at less than market value to a connected person in relation to a shareholder will, to the extent of the benefit, comprise a deemed dividend under s 64C(2)(*a*), which reads as follows:

> (2) For the purposes of section 64B, an amount shall, subject to the provisions of subsection (4), be deemed to be a dividend declared by a company to a shareholder, where—
>
> (*a*) any cash or asset is distributed or transferred by that company to or for the benefit of that shareholder or any connected person in relation to that shareholder;

The deemed dividend excludes any consideration paid for the residence [s 64C(4)(*b*A)(i)].

Such a deemed dividend will be exempt under s 64B(5)(*k*A) because it relates to the disposal of the residence by way of a sale. However, any amount returned to a shareholder after the sale of the residence, which comprises a dividend as defined in s 1, will not qualify for exemption from STC, since its distribution does not comprise the disposal of a residence. Such a sale may also carry donations tax consequences – see **8**.

Any distribution of a capital profit resulting from a sale of the residence at market value will likewise not qualify for exemption from STC under s 64B(5)(*k*A) because that distribution does not constitute the disposal of a residence.

The distribution of assets other than a residence will not qualify for the STC exemption. However, to the extent that there are pre-31 March 1993[6] profits or pre-1 October 2001 capital profits available for distribution the distribution of these other assets before 1 January 2011 may qualify for exemption under s 64B(5)(*c*).[7]

6. The dividends tax exemption

The dividends tax exemption is contained in s 64F(*i*) and (*i*A).

> **64F. Exemption from tax.—**A dividend is exempt from the dividends tax if the beneficial owner is—
>
> (*i*) a shareholder that is a natural person and the dividend constitutes a disposal of an interest in a residence as contemplated in paragraph 51A of the Eighth Schedule;

[6] Profits derived during any year of assessment which ended not later than 31 March 1993.
[7] Section 64B(5)(*c*) was deleted, with effect from 1 January 2011.

(*i*A) the dividend constitutes a disposal of an interest in a residence as contemplated in paragraph 51A of the Eighth Schedule; or . . .

Effective date

Section 64F(*i*) and (*i*A) come into operation on the date on which Part VIII of Chapter II of the Act comes into operation and apply in respect of dividends paid on or after that date. The dividends tax comes into operation on a date determined by the Minister by notice in the *Gazette*, which date must be at least three months after the date of the notice.[8] The Minister announced in his Budget Speech on 23 February 2011 that the new tax will be introduced on 1 April 2012.

It appears that s 64F(*i*A) was intended to deal with a multi-tier structure in which a company distributes a residence to a trust. However, the wording needs to be amended because it does not identify a beneficial owner and is thus not aligned with the opening words of s 64F.

A distribution of a qualifying residence *in specie* will constitute the disposal of a residence for the purposes of s 64F(i) (see **5**).

7. The CGT relief

Paragraph 51A deals with the following matters:

- Paragraph 51A(1) sets out the requirements for a qualifying disposal from a company or trust and makes provision for the termination of the company or trust holding the residence. It also indirectly identifies who qualifies as an acquirer of the residence.
- Paragraph 51A(2) provides for a disposal at base cost for the company or trust disposing of the residence.
- Paragraph 51A(3) determines the base cost of the residence in the hands of the shareholder. It applies when the shareholders acquired their shares in a company already holding the residence. The base cost of the residence is deemed to be the cost of the shares plus subsequent improvements.
- Paragraph 51A(4) determines the base cost of the residence for the acquirer by means of a roll-over. It applies when the company acquired the residence after the shareholders acquired their shares.
- Paragraph 51A(5) determines the base cost of the residence for an acquirer from a trust by means of a roll-over.
- Paragraph 51A(6) deals with a multi-tier structure.
- Paragraph 51A(7) defines the term "share" by reference to para 74.

7.1 The law

Paragraph 51A of Eighth Schedule

51A. Disposal of residence by company or trust and liquidation, winding up, deregistration or revocation of company or trust.—(1) Subject to subparagraph (6), this paragraph applies where a company or trust disposes of an interest in a residence and—

(*a*) the disposal takes place on or before 31 December 2012;

[8] Section 53(2) of the Taxation Laws Amendment Act 17 of 2009.

(*b*) the residence to which that interest relates is mainly used for domestic purposes during the period commencing on 11 February 2009 and ending on the date of the disposal contemplated in item (*a*) by one or more natural persons who ordinarily resided in that residence during that period;

(*c*) the natural persons contemplated in item (*b*) are connected persons in relation to the company or trust;

(*d*) within a period of six months commencing on the date of the disposal contemplated in item (*a*)—

(i) in the case of a company making the disposal, that company has taken steps to liquidate, wind up or deregister as contemplated in section 41(4); or

(ii) in the case of a trust making the disposal—

(*aa*) the founder, the trustees and the beneficiaries of that trust have agreed in writing to the revocation of the trust; or

(*bb*) application has been made to a competent court for the revocation of the trust.

(2) Where a company or a trust makes a disposal of an interest in a residence as contemplated in subparagraph (1), that company or trust must be deemed to have made that disposal for an amount equal to the base cost of that interest as at the date of that disposal.

(3) Where—

(*a*) an interest in a residence has been acquired by a person as a result of a disposal by a company of that interest to that person as contemplated in subparagraph (1);

(*b*) that person (together with all other persons holding shares in that company) acquired all the shares in the company subsequent to the date of acquisition by the company of that interest; and

(*c*) 90 per cent or more of the market value of the assets held by the company during the period commencing on 11 February 2009 and ending on the date of the disposal contemplated in subparagraph (1)(*a*) is attributable to that interest,

that person must—

(i) disregard the disposal of all shares held by that person in that company for purposes of determining his or her taxable income, assessed loss, aggregate capital gain or aggregate capital loss if that disposal is made in anticipation of or in the course of the liquidation, winding up or deregistration of that company; and

(ii) be deemed to have acquired that interest at a cost equal to the base cost of the shares contemplated in subitem (1) as at the date of the acquisition by the person of those shares plus the cost of any improvements effected in respect of that interest subsequent to that date of acquisition.

(4) Where an interest in a residence has been acquired by a person as a result of a disposal by a company of that interest to that person as contemplated in subparagraph (1) and where subparagraph (3) does not apply—

(*a*) that person must disregard the disposal of any share in that company for purposes of determining his or her taxable income, assessed loss, aggregate capital gain or aggregate capital loss if that disposal is made in anticipation of or in the course of the liquidation, winding up or deregistration of that company; and

(*b*) that person and that company must be deemed to be one and the same person with respect to—

(i) the date of acquisition of that interest by that company;

(ii) the amount and date of incurral by that company of any expenditure in respect of that interest allowable in terms of paragraph 20; and

(iii) any valuation of that interest effected by that trust as contemplated in paragraph 29(4).

(5) Where an interest in a residence has been acquired by a person as a result of a disposal by a trust of that interest to that person as contemplated in subparagraph (1), that person and that trust must for purposes of determining any capital gain or capital loss in respect of the disposal by that person of that interest so acquired be deemed to be one and the same person with respect to—

(*a*) the date of acquisition of that interest by that trust;

(*b*) the amount and date of incurral by that trust of any expenditure in respect of that interest allowable in terms of paragraph 20; and

(*c*) any valuation of that interest effected by that trust as contemplated in paragraph 29(4).

(6) This paragraph does not apply to any disposal made to a person that is a company or trust unless—

(*a*) within a period of six months commencing on the date of that disposal—

(i) where that person is a company, that company has taken steps to liquidate, wind up or deregister as contemplated in section 41(4); or

(ii) where that person is a trust—

(*aa*) the founder, the trustees and the beneficiaries of that trust have agreed in writing to the revocation of the trust; or

(*bb*) application has been made to a competent court for the revocation of the trust; and

(*b*) one or more natural persons contemplated in subparagraph (1)*(b)* acquire the residence contemplated in that subparagraph on or before 31 December 2012.

(7) For the purposes of this paragraph, **"share"** means a share as defined in paragraph 74.

Effective date

Paragraph 51A came into operation on 1 October 2010 and applies in respect of disposals made on or after that date and before 1 January 2013.

Paragraph 74 of Eighth Schedule

"share" in relation to a company means—

(*a*) any share, or member's interest, in that company whether or not that share or similar interest carries a right to participate beyond a specified amount in a distribution.

Effective date

The above definition of a "share" came into operation on 1 January 2011.

7.2 Qualifying disposals

In order to qualify under para 51A the disposal of a residence by a company or trust must meet the following requirements:

7.2.1 An interest in a residence must be disposed of

The terms "an interest" and "residence" are defined in para 44 as follows:

"an interest" means—

(*a*) any real or statutory right; or

> (*b*) a share owned directly in a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980) or a share or interest in a similar entity which is not a resident; or
>
> (*c*) a right of use or occupation,
>
> but excluding—
>
> (i) a right under a mortgage bond; or
>
> (ii) a right or interest of whatever nature in a trust or an asset of a trust, other than a right of a lessee who is not a connected person in relation to that trust;
>
> **"residence"** means any structure, including a boat, caravan or mobile home, which is used as a place of residence by a natural person, together with any appurtenance belonging thereto and enjoyed therewith.

Vacant land

Vacant land does not qualify for the relief under para 51A since it does not contain a "residence" as defined above (that is, it does not contain a "structure").

Share block interests

A share in a share block company comprises an interest in a residence (para (*b*) of the definition of "an interest" in para 44). Thus a company or trust holding a share in a share block company can make use of para 51A to dispose of that share to a qualifying acquirer.

While a company or trust may dispose of shares in a share block company under para 51A, the transfer of a unit in a share block company to its members must be dealt with under para 67B.

Size of land

Unlike para 51 which contained a two-hectare limit, para 51A contains no restriction on the size of land on which the residence is situated. It is considered that the common property associated with a sectional title unit or an interest in a share block company is not excluded from para 51A.

Paragraph 51A only refers to the disposal of an interest in a residence. It says nothing about the land on which the residence is situated. Nevertheless, under the common law principle of *accessio* a residence accedes to the land on which it is situated. It is therefore considered that para 51A does not only extend to the bricks and mortar of the residence but also the land on which it is situated. In a decision whether the residence and its land will qualify for the relief, para 51A(1)(*b*) must not be lost sight of. It requires that the residence be used *mainly* for domestic purposes. By implication this requirement also extends to the land on which the residence is situated. Thus a three-hectare plot used for domestic purposes with a residence will qualify. So too would a residence on a three-hectare plot of which one-third is used for trade purposes, since it is still mainly (that is, more than 50%) used for domestic purposes. But the transfer of a residence on a commercial farm of 500 hectares on which only 1 hectare is used for domestic purposes will not qualify.

7.2.2 Disposed of on or after 1 October 2010[9] but no later than 31 December 2012 [para 51A(1)(*a*)]

The residence must be disposed of on or after 1 October 2010[10] but no later than 31 December 2012.[11] The time of disposal rules in para 13 govern when a disposal takes place. Under para 13(1)(*a*) time of disposal of an asset by means of a change of ownership effected or to be effected from one person to another because of an event, act, forbearance or by operation of law is, in the case of

- an agreement subject to a suspensive condition, the date on which the condition is satisfied [para 13(1)(*a*)(i)],
- any agreement which is not subject to a suspensive condition, the date on which the agreement is concluded [para 13(1)(*a*)(ii)],
- the distribution of an asset of a trust by a trustee to a beneficiary to the extent that the beneficiary has a vested interest in the asset, the date on which the interest vests [para 13(1)(*a*)(iiA)], and
- the expropriation of an asset, the date on which the person receives the full compensation agreed to or finally determined by a competent tribunal or court [para 13(1)(*a*)(iv)].

The time of disposal for the distribution of an asset by a company to a shareholder, is the date on which that asset is so distributed as contemplated in para 75 [para 13(1)(*e*)]. Under para 75 the asset is distributed on the "date of distribution" as defined in para 74.

The "date of distribution" as defined in para 74 reads as follows:

> **"date of distribution"** in relation to any distribution, means the date of approval of the distribution by the directors or by some other person or body of persons with comparable authority under a law, regulation or rule to which that company is subject, except where the distribution is made—
>
> (*a*) by a company subject to the condition that it be payable to a shareholder of the company registered in that company's share register on a specified date, in which case it must be that date;
>
> (*b*) by a company to a shareholder of that company otherwise than by way of a formal declaration of a dividend, in which case it must be the date on which the shareholder became entitled to that distribution; or
>
> (*c*) by the liquidator of a company to a shareholder of that company in the course of the winding up or liquidation of that company, in which case it must be the date on which the shareholder became entitled to that distribution;

The time of disposal rules are important for at least two reasons. First, they will determine whether the disposal falls under para 51 or 51A. Secondly, they will determine whether a residence has been disposed of before the cut off date of 31 December 2012. The time of disposal should not be confused with the time of registration in the deeds registry. Paragraph 51A does not lay down any time limit for registration of the property.

For transfer duty purposes the "date of acquisition"[12] of property acquired under a transaction subject to a suspensive condition is the date on which the transaction was

[9] Section 105(2) of the Taxation Laws Amendment Act 7 of 2010.
[10] Section 105(2) of the Taxation Laws Amendment Act 7 of 2010.
[11] Paragraph 51A(1)(*a*).
[12] As defined in s 1 of the Transfer Duty Act 40 of 1949.

entered into. Nevertheless, that date is irrelevant for the purposes of determining whether para 51 or 51A applies, and as indicated above the determination must be done under para 13.

Example 2 – Disposal of residence under an agreement not subject to any suspensive conditions

Facts:

On 30 September 2010 the XYZ Trust sold an interest in a residence to its founder. The sale was not subject to any suspensive conditions.

Result:

The sale falls under para 51 since it occurred between 11 February 2009 and 30 September 2010. Paragraph 51A does not apply.

Example 3 – Disposal of residence under an agreement subject to a suspensive condition

Facts:

On 31 August 2010 the ABC Trust sold an interest in a residence to its trustee. The sale agreement was subject to the trustee obtaining a bond from a bank. The trustee obtained the bond on 15 October 2010.

Result:

The disposal occurred on 15 October 2010 when the suspensive condition was satisfied [para 13(1)(*a*)(i)]. It therefore falls within the qualifying period laid down by para 51A.

Example 4 – Distribution in specie of residence to sole shareholder

Facts:

On 31 December 2012 the directors of ABC (Pty) Ltd pass a resolution approving the distribution of the company's sole asset, a residence to its sole shareholder. The residence is registered in the shareholder's name on 31 March 2013.

Result:

The time of disposal is the "date of distribution" as defined in para 74. In this case it is the date of approval of the directors of the resolution approving the distribution, namely, 31 December 2012. Since the residence was disposed of before 1 January 2013, the disposal falls within the qualifying period laid down by para 51A. The time of registration of the property is irrelevant.

7.2.3 The use-and-occupation requirements [para 51A(1)(*b*)]

A qualifying residence must be mainly used for domestic purposes by one or more natural persons during the period from 11 February 2009 to the date of disposal by the company or trust. In *SBI v Lourens Erasmus (Eiendoms) Bpk*[13] Botha JA held that the word "mainly" prescribed a purely quantitative standard of more than 50%. The measurement of the domestic usage will normally be determined on a floor-area basis. Non-domestic use could

[13] 1966 (4) SA 444 (A), 28 SATC 233 at 245.

take the form of letting a portion of the residence, for example, as a guesthouse, running a business from the premises or using a portion of the residence as an office.

Example 5 – Measurement of domestic usage of residence

Facts:

ABC (Pty) Ltd's sole asset is a double-storey house. From 11 February 2009 until the date of disposal of the residence by the company on 31 December 2010 the bottom portion of the residence comprising 51% of the total floor area was used as a shop. The shareholder occupied the top floor as a residence.

Result:

The residence does not qualify under para 51A since it was not used mainly (that is, > 50%) for domestic purposes.

The natural persons concerned must have "ordinarily resided" in the residence from 11 February 2009 until the date of disposal (both dates included). The term "ordinarily resided" is not defined. In determining whether a person "ordinarily resides" in a residence, the usual common law principles used for determining whether a person is ordinarily resident can be applied. In *Cohen v CIR* Schreiner JA explained the meaning of ordinary residence as follows:[14]

> "But his ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings, as contrasted with other lands it might be called his usual or principal residence and it would be described more aptly than other countries as his real home. If this suggested meaning were given to "ordinarily" it would not, I think, be logically permissible to hold that a person could be "ordinarily resident" in more than one country at the same time."

Temporary absences from the residence, for example, while on vacation or away on business, will not fall foul of the requirement. But in most cases a holiday home will not qualify because a person does not ordinarily reside in such a residence.

Despite the above *dictum*, it is possible that in some rare cases a person could ordinarily reside in more than one residence at the same time. For example, a person may spend six months of the year at a residence at the coast, while spending the other six months at an inland residence.

In the SARS and National Treasury response document dealing with the comments on the Taxation Laws Amendment Bill, 2010 the following is stated:[15]

> "Comment: Liquidating residential entities – Clause 105 (Paragraph 51A of the Eighth Schedule). The revised version of the rollover rules for liquidating residential entities significantly opens the regime. However, the rollover regime appears to exclude holiday homes because relief is technically limited to those persons who ordinarily resided in the residence.
>
> "Response. The current exclusion of holiday homes is no longer intended given other recent changes to the relief. The goal is to limit the relief to property mainly employed for domestic non-business use by family members. It is intended that the language used in the legislation will be changed in 2011 to reflect this intention (with retroactive effect to 1 October 2010)."

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[14] 1946 AD 174, 13 SATC 362 at 371.

[15] 8 November 2010 in Annexure B at 2, available on the SARS website under Legal & Policy/Policy Documents/Response Documents/2010/Taxation Laws Amendment Bills.

However, until any such amendment has been promulgated holiday homes will not qualify for the relief and any applicable taxes and transfer duty will have to be paid. Should the law be amended retrospectively a refund may be sought.

7.2.4 The connected-person requirement [para 51A(1)(*c*)]

The natural persons who used the residence mainly for domestic purposes and ordinarily resided in the residence must be connected persons in relation to the company or trust at the time of disposal by the company or trust of the residence. The term “connected person” is defined in s 1. Some extracts from the definition are set out below.

> **“connected person” means—**
>
> (*a*) in relation to a natural person—
>
> (i) any relative; and
>
> (ii) any trust (other than a portfolio of a collective investment scheme in securities) of which such natural person or such relative is a beneficiary;
>
> (*b*) in relation to a trust (other than a portfolio of a collective investment scheme in securities)—
>
> (i) any beneficiary of such trust; and
>
> (ii) any connected person in relation to such beneficiary;
>
> (*b*A) in relation to a connected person in relation to a trust (other than a collective investment scheme in property shares managed or carried on by any company registered as a manager under section 42 of the Collective Investment Schemes Control Act, 2002, for purposes of Part V of that Act and other than a portfolio of a collective investment scheme in securities), includes any other person who is a connected person in relation to such trust;
>
> (*c*) [relates to partnerships]
>
> (*d*) in relation to a company—
>
> (i) any other company that would be part of the same group of companies as that company if the expression “at least 70 per cent” in paragraphs (*a*) and (*b*) of the definition of “group of companies” in this section were replaced by the expression “more than 50 per cent”;
>
> (ii) . . . . . .
>
> (iii) . . . . . .
>
> (iv) any person, other than a company as defined in section 1 of the Companies Act, 2008 (Act No. 71 of 2008), who individually or jointly with any connected person in relation to himself, holds, directly or indirectly, at least 20 per cent of—
>
> (*aa*) the equity shares in the company; or
>
> (*bb*) the voting rights in the company;
>
> (v) any other company if at least 20 per cent of the equity shares in the company are held by that other company, and no shareholder holds the majority voting rights in the company;
>
> (*v*A) any other company if such other company is managed or controlled by—
>
> (*aa*) any person who or which is a connected person in relation to such company; or
>
> (*bb*) any person who or which is a connected person in relation to a person contemplated in item (*aa*); and

(vi) where such company is a close corporation—

(*aa*) any member;

(*bb*) any relative of such member or any trust (other than a portfolio of a collective investment scheme in securities) which is a connected person in relation to such member; and

(*cc*) any other close corporation or company which is a connected person in relation to—

(i) any member contemplated in item (*aa*); or

(ii) the relative or trust contemplated in item (*bb*); and

(*e*) in relation to any person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person:

In relation to a company

A natural person will be a connected person in relation to a company if he or she individually or jointly with any connected person in relation to himself, holds, directly or indirectly, at least 20% of the company's equity shares or voting rights (para (*d*)(iv) of the definition of a "connected person").

Example 6 – Connected person in relation to a company

Facts:

Jack and Jill, a married couple, own 50% and 49% respectively of the shares in ABC (Pty) Ltd, while Bruce, their minor child holds the remaining 1%. Are they connected persons in relation to ABC (Pty) Ltd?

Result:

Yes, Jack and Jill individually own at least 20% of the company's shares. Bruce's parents are connected persons in relation to him, being relatives (para (*a*)(i) of the definition of a "connected person"). Bruce, together with his parents holds at least 20% of the shares in ABC (Pty) Ltd (50% + 49% + 1% = 100%).

In relation to a close corporation

The following persons are connected persons in relation to a close corporation:

- Any member of that close corporation, no matter the size of that member's interest.
- Any relative of a member.
- Any trust (other than a portfolio of a collective investment scheme in securities) which is a connected person in relation to a member.
- Any other close corporation or company which is a connected person in relation to a member.
- Any other close corporation or company which is a connected person in relation to a relative of a member.
- Any other close corporation or company which is a connected person in relation to a trust which is a connected person in relation to a member.

The range of connected persons in relation to a close corporation is thus much wider than in relation to a company.

> **Example 7 – Connected person in relation to a close corporation**
>
> *Facts:*
>
> Homer, Marge, Abe, Bart, Maggy and Thelma each hold 16,67% of the members' interest in ABC CC. Are they connected persons in relation to the close corporation?
>
> *Result:*
>
> Every member of a close corporation is a connected person in relation to it, no matter what the size of the member's interest (para (*d*)(vi) of the definition of a "connected person").

In relation to a trust

Every beneficiary is a connected person in relation to a trust. So too is every connected person in relation to a beneficiary of a trust. The term "beneficiary" is defined in s 1 as follows:

> **"beneficiary"** in relation to a trust means a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust;

A founder or trustee of a trust may well be a connected person in relation to a trust if that person is, for example, a relative of a beneficiary.

7.2.5 The termination of the company or trust requirement [para 51A(1)(*d*)]

Within six months of the date of disposal certain specified steps must be taken to terminate the existence of the company or trust holding the residence. This does not mean that the company or trust must actually be terminated within this period; rather it means that the required steps to initiate the process must be taken.

Companies

A company is required to take the steps specified in s 41(4).

Care should be taken to ensure that the relevant steps laid down in s 41(4) are capable of being taken before declaring dividends in anticipation of liquidation or deregistration.

Since the procedure for winding-up and deregistration differ, different steps are specified for these two termination procedures.

Steps to liquidate

The table below sets out the required winding-up or liquidation steps when a company is to be placed in voluntary liquidation.

Table 1 – Steps under voluntary liquidation

Section 41(4)	Steps to be taken within six months of disposal of residence
(*a*)(i)(*aa*)	*Companies* Lodge special resolution under s 200 of the Companies Act 61 of 1973

(*a*)(i)(*bb*)	*Close corporations* Lodge written resolution under s 67(2) of the Close Corporations Act 69 of 1984
(*a*)(i)(*cc*)	*Foreign companies* Comply with similar liquidation procedure under foreign law
(*a*)(ii)	Dispose of all assets and settle all liabilities except for assets required to satisfy any • reasonably anticipated liabilities to any sphere of government of any country, and • costs of administration relating to the liquidation or winding-up
(*c*)	Submit a copy of the required special or written resolution to SARS
(*d*)	Submit all outstanding returns or information to SARS required under any law administered by the Commissioner or obtain the necessary extension from SARS. This must be done by the end of the six-month period.

Steps to deregister

The table below sets out the necessary steps to initiate the deregistration of a company.

Table 2 – Steps under deregistration

Section 41(4)	**Steps to be taken within six months of disposal of residence**
(*b*)(i)	*Companies* Submit written statement signed by all directors confirming that the company has ceased to carry on business and has no assets or liabilities to Registrar of Companies under s 73(5) of the Companies Act 61 of 1973.
(*b*)(ii)	*Close corporations* As above, but submit to the Registrar of Close Corporations under s 26(2) of the Close Corporations Act 69 of 1984.
(*b*)(iii)	*Foreign companies* As above, but submit to equivalent of a Registrar, if required under foreign law.
(*c*)	Submit copy of the required written statement to SARS.
(*d*)	Submit all outstanding returns or information to SARS required under any law administered by the Commissioner or obtain the necessary extension from SARS. This must be done by the end of the six-month period.

Note: The references in s 41(4) to the Companies Act 61 of 1973 need to be amended to reflect the position under the Companies Act 71 of 2008. Until then, the equivalent provisions in the Companies Act, 2008 must be applied. In the latter regard s 12(1) of the Interpretation Act 33 of 1957 provides as follows:

> (1) Where a law repeals and re-enacts with or without modifications, any provision of a former law, references in any other law to the provision so repealed shall, unless the contrary intention appears, be construed as references to the provision so re-enacted.

The equivalent provisions in the Companies Act, 2008 are as follows:

- *Voluntary winding up:* The company must file a special resolution approving the voluntary winding up of the company together with the prescribed notice and filing fee under section 80(2) of the Companies Act, 2008;

- *Deregistration:* A request for the deregistration of the company must be lodged in the prescribed manner and form under section 82(3)(*b*)(ii) of the Companies Act, 2008.

Section 67 of the Close Corporations Act, 1984 now provides as follows:

> **67. Dissolution of corporations.—**(1) Part G of Chapter 2 of the Companies Act, read with the changes required by the context, applies to a solvent corporation.
>
> (2) This Part of this Act must be administered in accordance with the laws mentioned or contemplated in item 9 of Schedule 5 of the Companies Act.

Part G (ss 79 to 83) of the Companies Act, 2008 deals with the winding-up of solvent companies and the deregistration of companies. It follows that the equivalent provisions applicable to the voluntary winding up and deregistration of companies will also apply to close corporations.

Trusts

Either one of the following steps must be taken in the case of a trust:

- The founder, the trustees and the beneficiaries of the trust must agree in writing to the revocation of the trust.
- Alternatively, application must have been made to a competent court for the revocation of the trust.

The *Oxford English Dictionary*[16] defines the term "revocation" in so far as it is relevant for current purposes as follows:

> "1. The action of revoking, rescinding, or annulling something; withdrawal or abrogation of an Act of Parliament, decree, grant, licence, etc.; an instance of this."

The ordinary meaning of "revoke" is to annul from inception.[17] However, it was not intended that the term "revocation" bear such a restrictive meaning, and it should therefore be taken to include a valid termination of the trust under the trust deed. According to the Final National Treasury and SARS Response Document on the 2010 Taxation Laws Amendment Bills[18]

> "termination by valid agreement will be accepted".

Nevertheless, para 51A(1)(*d*)(ii)(*aa*) and (6)(*a*)(ii)(*aa*) are explicit in requiring the agreement of the founder, the trustees and beneficiaries, even if the trustees could legally terminate the trust under the trust deed without the consent of the founder or beneficiaries. This presents a problem when the founder is deceased, and in such event the only alternative under the present law is a court application.

7.3 No gain or loss treatment of the company or trust [para 51A(2)]

The company or trust is deemed to dispose of the interest in a residence at its base cost at the time of the disposal. As a result the company or trust will make neither a capital gain nor a capital loss on the disposal. The "no gain / no loss" treatment is confined to an interest in a residence. Other assets which need to be disposed of before the company or trust can be terminated will trigger capital gains and losses in the normal way.

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[16] [OED Online] above [Accessed 21 February 2011].

[17] See *Pangbourne Properties Ltd v Nitor Construction (Pty) Ltd & others* 1993 (4) SA 206 (W) in which the ordinary meaning of the term "revoke" was discussed and the alternative meaning of "terminate" was considered in the context of an agreement of suretyship.

[18] 8 November 2010 Annexure A in 3.8.

Paragraph 51A(2) only applies for CGT purposes. The sale of a residence held as trading stock will result in the consideration being included in the gross income of the company or trust. The distribution of such a residence as a dividend *in specie* will trigger a recoupment and consequent inclusion in income at market value under s 22(8)(*b*)(iii). In any event, a residence that was "ordinarily resided in by one or more natural persons" would probably have ceased to be held as trading stock at the time it was first so resided in, thus triggering a recoupment at that time under s 22(8)(*b*)(v).

The disposal of a residence on which capital allowances have been claimed will also be subject to recoupment under s 8. In particular, see s 8(4)(*k*) which deems the disposal to take place at market value for the purposes of s 8(4)(*a*) when, for instance, an allowance asset is disposed of by a company to a shareholder or by a person to a connected person in relation to that person.

7.4 Base cost of residence acquired from a company – shares acquired in company already holding the residence [para 51A(3)]

Paragraph 51A(3) applies when

- an interest in a residence has been acquired by a person as a result of a disposal by a company of that interest to that person as contemplated in para 51A(1);
- that person (together with all other persons holding shares in that company) acquired all the shares in the company after the date of acquisition by the company of that interest; and
- 90% or more of the market value of the assets held by the company during the period commencing on 11 February 2009 and ending on the date of disposal (which must be on or before 31 December 2012) is attributable to that interest.

The first bullet point confirms that the disposal must comply with para 51A(1), for example, it must take place on or before 31 December 2012.

Under the second bullet point all the current shareholders must have acquired their shares in a company that already owned a residence. If any of them acquired their shares before the company acquired the residence, para 51A(3) will not apply and the acquirer will have to establish a base cost for the residence under para 51A(4) on a roll-over basis. This provision at least confirms that the acquirer must be a shareholder (see **7.8** for the other attributes of an acquirer).

The third bullet point requires that 90% or more of the market value of the assets in the company must comprise an interest in a residence. This requirement applies throughout the period from 11 February 2009 until the date of disposal. The reason for this requirement is to prevent the inflation of the base cost of the residence in the hands of the acquirer, since it is based on the cost of the shares in the company. The test is based on the value of the assets, not on the company's net assets (that is, assets less liabilities). The 90% test also does not apply at the time of acquisition of the shares – only on or after 11 February 2009.

When the above requirements have been met, the acquirer must

- disregard the disposal of all shares held by that person in that company for purposes of determining his or her taxable income, assessed loss, aggregate capital gain or aggregate capital loss if that disposal is made in anticipation of or in the course of the liquidation, winding up or deregistration of that company; and

- be deemed to have acquired that interest at a cost equal to the base cost of the shares contemplated in the above bullet point[19] as at the date of the acquisition by the person of those shares plus the cost of any improvements effected in respect of that interest subsequent to that date of acquisition.

Under the first bullet point above the acquirer disregards any capital gain or loss on disposal of the shares. The disposal must occur in anticipation of the deregistration or liquidation of the company or during the course of its winding up. Thus it covers a part-disposal of the shares that occurs as a result of the receipt or accrual of a capital distribution under para 76A and a full disposal of the shares under para 77 (that is, on dissolution, deregistration or when a liquidator issues a certificate indicating that no reasonable grounds exist to believe that further distributions will occur).

Under the second bullet point above the acquirer is deemed to acquire the residence for an amount equal to the "base cost" of the shares on the date of their acquisition plus the cost of any improvements effected to the residence after the shares were acquired. The "base cost" of the shares in this context is the expenditure incurred under para 20 in acquiring the shares. It is clearly not a base cost under para 25 (valuation date value plus post-valuation date expenditure) since it must be determined at the date of acquisition. The implications of this provision in the context of shares acquired before 1 October 2001 is that

- the residence will also be a pre-valuation date asset since it takes its date of acquisition from the shares,
- it is therefore necessary to consider which methods may be used to determine the base cost of the residence,
- an acquirer of the residence will not be able to use any market value of the shares determined on 1 October 2001 for determining the valuation date value of the residence because no provision is made for the market value of the shares to be carried across to the residence,
- an acquirer of the residence will only be able to use the "time-apportionment base cost" method or the "20% of proceeds" method in determining the base cost of the residence when it is ultimately disposed of, and
- presumably any improvements made by the company after the acquisition of the shares must be treated as being made by the acquirer on the same date that those improvements were effected, though the provision is silent on this point. This is an important issue because the timing of the improvements can have a significant impact in determining the base cost of the residence. For example, "N" in the time-apportionment formula is limited to 20 when improvements occur in more than one year of assessment before the valuation date, while post-valuation date improvements trigger the proceeds formula in para 30(2) and result in a greater proportion of the overall gain or loss forming part of the capital gain or capital loss. The "20% of proceeds" method is applied by first deducting the post-valuation date improvements from the proceeds before multiplying the result by 20%.

The rule may not yield a satisfactory outcome in all cases. For example, if less than 90% of the market value of the company's assets at the time of acquisition of the shares comprised a residence the acquirer's base cost would be unduly inflated. Conversely the rule ignores the fact that the shareholder's interest may comprise shares and a substantial loan account. No account is taken of the loan account in determining the acquisition cost of the residence.

[19] The reference to "subitem (1)" in para 51A(3)(ii) should read "item (i)".

Example 8 – Shares acquired in company already owning a residence

Facts:

Husband and wife formed a company in 1995. The company purchased a house in the following year for R360 000. In 2004 the couple sold their shares in the company to an unrelated individual for R650 000. In 2011 the individual liquidated the company and transferred the house into the individual's own name. In 2011 the house was worth R920 000. Improvements costing R25 000 were made to the house before the 2004 sale, and another R30 000 of improvements were made afterwards.

Result:

The liquidation does not give rise to any CGT, transfer duty or STC. The individual's base cost in the house is R680 000 (the R650 000 amount paid for the shares by individual plus the R30 000 improvements undertaken after the acquisition).

7.5 Base cost of residence acquired from a company – residence acquired by company after the acquisition of its shares [para 51A(4)]

Paragraph 51A(4) applies to the acquisition of a residence by a person from a company under circumstances other than those set out in para 51A(3). This covers, for example, a case in which the company acquired the residence after the shareholders acquired their shares. It also applies when some of the shareholders acquired their shares before the company acquired the residence and others acquired them afterwards.

Paragraph 51A(4) does not identify who may be an acquirer of the residence – see **7.8**. It does, however, confirm that the disposal must comply with para 51A(1), for example, it must take place on or before 31 December 2012.

When para 51A(4) applies

- the acquirer of the residence must disregard the disposal of any share in that company for purposes of determining his or her taxable income, assessed loss, aggregate capital gain or aggregate capital loss if that disposal is made in anticipation of or in the course of the liquidation, winding up or deregistration of that company; and
- the acquirer and that company must be deemed to be one and the same person with respect to
    - the date of acquisition of that interest by that company;
    - the amount and date of incurral by that company of any expenditure in respect of that interest allowable in terms of para 20; and
    - any valuation of that interest effected by that trust (should read "company") as contemplated in para 29(4).

Unlike para 51A(3), para 51A(4) operates on a roll-over basis and the cost of the shares in the company is not taken into account for purposes of determining the acquirer's base cost. The acquirer "steps into the shoes" of the company for the purpose of applying the time-based apportionment, market value and "20% of proceeds" methods for determining the valuation date value of the residence and any post-CGT costs.

Example 9 – Residence acquired by company after current shareholders acquire its shares

Facts:

Alan and Betty are spouses married in community of property. In 1995 they formed a company which purchased a house in the following year for R360 000. The company financed the acquisition of the residence using a mortgage bond secured over the property. The couple provided the bank with a guarantee and undertook to pay off the bond plus interest in exchange for a loan account with the company. The couple have stayed in the house with their children from the date that the company acquired the residence until the present time. By 2011, the company owed R200 000 to the bank and R420 000 to the couple. The house is worth R920 000. Improvements costing R50 000 were made to the house on 30 June 2005. On 1 March 2011 the company was placed into voluntary liquidation. The couple settled the outstanding bond and waived the amount owing to them on loan account. The house was distributed as a dividend *in specie* shortly afterwards to the couple and is registered in their names jointly.

Result:

The liquidation does not give rise to any CGT, transfer duty or STC. The initial R360 000 cost of the house (plus the R50 000 of improvements) is deemed to be incurred by the couple as if the couple incurred those costs directly (with the same 2001 CGT transition rules applying). The waiver of the shareholders' loans does not give rise to a capital gain in the company because of the exclusion contained in para 12(5)(*a*)(*cc*). The couple must disregard the capital loss on waiver of their loan accounts under para 56(1).

7.6 Base cost of residence acquired from a trust [para 51A(5)]

Paragraph 51A(5) applies when a person acquires a residence from a trust. It does not identify who may be an acquirer of the residence – see **7.8**, but does confirm that the disposal must comply with para 51A(1). Thus, for example, the disposal must take place on or before 31 December 2012.

When para 51A(5) applies, the acquirer and the trust must for purposes of determining any capital gain or capital loss in respect of the disposal by that person of that interest so acquired be deemed to be one and the same person with respect to

- the date of acquisition of that interest by that trust;
- the amount and date of incurral by that trust of any expenditure in respect of that interest allowable under para 20; and
- any valuation of that interest effected by that trust as contemplated in para 29(4).

Example 10 – Residence acquired from trust

Facts:

Founder formed a discretionary trust in 1995 for the benefit of Husband and Wife and their children. In the same year, the couple lent the trust R60 000 on loan account. Also in the same year, the trust obtained a mortgage bond from the bank of R300 000 and purchased a house for R360 000 using the funds from the bank and the couple. The couple guaranteed payment of the bond. The couple have resided in the house with their children from the date on which the trust acquired the residence until the present time. The interest on bond, rates and other expenses have been paid by the couple in lieu of rent. By 1 March 2011, the bond was paid up and the house was worth R920 000. Improvements costing R50 000 were made to the house in 2004. On 31 August 2004, one month before the cut-off date of 30 September 2004 under para 29(4), the trustees obtained a market valuation of the residence as at 1 October 2001 for CGT purposes.

On 31 March 2011 the house was sold to the couple for R920 000 and registered in their names jointly. In the process the couple's loan accounts totalling R410 000 (R60 000 + R300 000 + R50 000) were discharged. The balance of the purchase price of R510 000 (R920 000 – R410 000) was paid by the couple in cash.

The capital profit of R920 000 – R410 000 = R510 000 was vested by the trustee in the couple and their children in equal shares.

On 20 July 2011 the couple and their children, the founder and trustees agreed to the revocation of the trust.

Result:

The sale of the residence does not give rise to any CGT or transfer duty. Since the loan accounts were discharged for full consideration there are no CGT implications under para 12(5). The trust is deemed to have disposed of the house at base cost under para 51A(2), and no capital gain arises in the trust. The distribution of the capital profit of R510 000 to the couple and their children accordingly does not represent the vesting of a capital gain under para 11(1)(*d*) and there is therefore no capital gain to be attributed to the beneficiaries under para 80(2).

The initial cost of the house (R360 000) and the cost of improvements of R50 000 are deemed to be incurred by the couple under para 51A(5)(*b*) as if they incurred those costs directly. Each spouse is therefore deemed to incur expenditure of R360 000/2 = R180 000 in 1995 and R50 000/2 = R25 000 in 2004. The actual consideration paid by the couple for the residence of R920 000 is disregarded for base cost purposes. The residence will be a pre-valuation date asset in the couple's hands, and they will have a choice of the time-based apportionment, market value and "20% of proceeds" methods available to them for the purpose of determining the valuation date value of the residence when they ultimately dispose of it.

7.7 Multi-tier structures [para 51A(6)]

A residence may not be disposed of to a company or trust unless

- within a period of six months commencing on the date of disposal of the residence
  - in the case of a company, it has taken steps to liquidate, wind up or deregister as contemplated in s 41(4); or

- in the case of a trust
  - the founder, the trustees and the beneficiaries of that trust have agreed in writing to the revocation of the trust; or
  - application has been made to a competent court for the revocation of the trust; and

  [para 51A(6)(*a*)]
- one or more natural persons contemplated in para 51A(1)(*b*) acquire the residence contemplated in para 51A(1) on or before 31 December 2012 [para 51A(6)(*b*)].

This provision was introduced mainly to deal with the case in which a trust holds shares in a company which in turn holds a residence. But it also deals with the situation in which a holding company holds shares in a subsidiary which in turn owns a residence. There is no limit on how many companies or trusts can be in the chain, but all the companies or trusts in the chain will have to be terminated within six months of their respective disposals of the residence, and the necessary termination steps will have to be taken on or before 31 December 2012.

The CGT, STC and transfer duty relief does not extend to any other assets that may be held by the companies or trusts in the chain.

Paragraph 51A(6)(*b*) identifies the ultimate acquirers of the residence as the persons referred to in para 51A(1)(*b*), namely, persons who ordinarily resided in the residence and used it mainly for domestic purposes from 11 February 2009 until the date of acquisition by them of the residence. The acquirer must also be a connected person in relation to the company or trust. This is because para 51A(1)(*c*) states that

> "the natural persons contemplated in item (*b*) are connected persons in relation to the company or trust".

In other words, para 51A(6)(*b*) states that the residence must be acquired by a person contemplated in para 51A(1)(*b*), and a person contemplated in that subparagraph is by virtue of para 51A(1)(*c*) also a connected person in relation to the trust. For more on who can be an acquirer, see **7.8**.

Example 11 – Multi-tier structure

Facts:

Angus and Brenda, a married couple, are contingent beneficiaries of the ABC Discretionary Trust. The trust holds all the shares in Propco (Pty) Ltd. In 1998 the company purchased a house in which the couple have resided ever since as their main residence. On 30 November 2010 the company distributed the house to the trust as a dividend in anticipation of its deregistration. By 31 March 2011 the company was deregistered.

On 1 April 2011 the trust distributed the house to the couple. On 12 April 2011 the couple made an application to court for the revocation of the trust.

Result:

The disposal of the house from the company to the trust qualifies for the relief under para 51A(6)(*a*). The distribution of the house from the trust to the couple also qualifies for the relief under para 51A(6)(*b*).

7.8 Who qualifies as an acquirer?

In the case of the multi-tier structure para 51A(6)(*b*) states that the residence must ultimately be disposed of to one or more natural persons who ordinarily reside in it. Paragraph 51A(1)(*c*) states that such persons must also be connected persons in relation to the company or trust.

In the case of a company the shares of which are held directly by natural persons, para 51A(3)(*a*) refers to an interest in a residence being acquired by a person

> "as a result of a disposal by a company of that interest to that person as contemplated in subparagraph (1)".

Similar wording is employed in para 51A(4) and (5). What is contemplated is a disposal of a qualifying residence occurring before 31 December 2012 rather than a disposal to a particular person.[20]

Paragraph 51A(5) does not provide any information on who can be an acquirer from a trust.

In summary, only para 51A(3) identifies who may be an acquirer for the purposes of that provision, namely, a shareholder. Paragraph 51A(4) and (5) are silent on who may acquire a residence.

In interpreting para 51A it would not be unreasonable to assume that the legislature would be consistent in its approach to who can be an acquirer. It is inconceivable that the legislature would specify who must occupy the residence (one or more natural persons who ordinarily reside in it and are connected persons in relation to the company or trust) without requiring that the residence should be disposed of to those persons. The opening words of para 51A(1) commence with the words "subject to subparagraph (6)". Although para 51A(6) specifically deals with the multi-tier structure it must be assumed that it was intended to identify the ultimate acquirer of a residence in all circumstances.

In conclusion, it is submitted that the ultimate qualifying acquirers of a residence are

- one or more natural persons who ordinarily resided in the residence from 11 February 2009 until the date of disposal by the company or trust, and
- connected persons in relation to the company or trust at the time of that disposal.

In the case of para 51A(3) the acquirer must also be a shareholder.

The implication is that a disposal of a residence to any other person will not qualify for the relief.

A deceased estate cannot be an acquirer because it is not a natural person. If a natural person acquires a residence from a company or trust under an unconditional agreement on or after 1 October 2010 but dies before the residence can be registered in his or her name, the relief will still apply, since the residence was disposed of to a natural person at the time of disposal determined under para 13.

An individual who inherits shares after 11 February 2009 in a company holding a residence can acquire that residence under para 51A provided that individual is a connected person in

[20] Paragraph 51A(1) does not contemplate a disposal to a particular person. Instead, it sets out the attributes of a qualifying residence.

relation to the company at the time of the disposal and ordinarily resided in that residence from 11 February 2009 until the date of disposal.

Example 12 – Qualifying and non-qualifying persons

Facts:

A mother and son each hold a 50% member's interest in a close corporation which in turn owns a residence. The close corporation acquired the residence after the mother and her son had acquired their interests upon formation of the corporation. Only the son resided in the residence during the period 11 February 2009 until the date of disposal. Since the mother is not a qualifying acquirer she disposed of her member's interest to her son on 15 December 2010.

Result:

The mother will be subject to CGT on the disposal of her member's interest to her son. Under para 38 the disposal must take place at market value since the mother and her son are connected persons in relation to each other. The son must pay transfer duty on the acquisition of the 50% member's interest from his mother. The duty is calculated on 50% of the fair market value of the full property. No account is taken of liabilities in the close corporation in determining the duty payable.

Once the son holds the 100% interest in the close corporation the residence can be distributed to him free of CGT, dividends tax, STC and transfer duty. The son's base cost must be determined on a roll-over basis under para 51A(4) despite him having paid a market value consideration for the 50% interest he acquired from his mother. This can result in economic double taxation. However, at least the son should be entitled to the primary residence exclusion in future.

Example 13 – Disposal by close corporation to relative of member

Facts:

A father holds 100% of the member's interest in XYZ CC (XYZ), which owns a residence. The father and his son have ordinarily resided in the residence from 1 July 2002 to date. The close corporation's balance sheet appears as follows:

	R
Member's interest	100
Member's loan	100 000
	100 100
Residence – at cost (1 July 2002)	100 100

The father initially lent XYZ cash of R100 000 which it used to acquire the residence from a third party on 1 July 2002.

The residence has a current market value of R1 million.

The father waived his loan account and approved the sale of the residence to his son for R100. The R100 is returned to the father as repayment of his member's interest and the close corporation is deregistered.

Result:

The son is a qualifying acquirer because

- he has ordinarily resided in the residence from 11 February 2009 to date, and
- being a relative of his father, is a connected person in relation to XYZ (para (*d*)(vi)(*bb*) of the definition of a "connected person" in s 1).

The son is exempt from transfer duty under s 9(20) of the Transfer Duty Act.

Under para 38 of the Eighth Schedule XYZ is deemed to dispose of the residence at market value. However, XYZ must disregard the capital gain of R1 000 000 – R100 100 = R899 900 on disposal of the residence under para 51A(2).

The son is deemed to acquire the residence at a deemed cost of R100 100 on 1 July 2002 under para 51A(4).

XYZ has declared a deemed dividend of R999 900 under s 64C(2)(*a*) because it has transferred an asset for the benefit of a connected person in relation to a member. This deemed dividend is exempt from STC under s 64B(5)(*k*A) because it comprises the disposal of an interest in a residence under para 51A.

The waiver of the father's loan to XYZ gives rise to a capital gain in XYZ but this must be disregarded under para 12(5)(*a*)(*cc*). The father must disregard the capital loss on waiver of the loan under para 56(1)

XYZ has made a donation of R999 900 to the son at the instance of the father. The father is deemed to be the donor under s 57(1) and must therefore pay donations tax on R999 900 – R100 000 = R899 900 x 20% = R179 980. It is assumed that the father has not made any other donations during the year of assessment and that the full amount of the annual exemption of R100 000 under s 56(2)(*b*) is available to him.

Example 14 – Disposal of residence by company to spouse of shareholder

Facts:

H acquired all the shares in ABC (Pty) Ltd (ABC) upon its formation, after which the company acquired an interest in a residence.

H and W are married out of community of property. H desires to transfer the residence from ABC to H and W in equal shares. H and W have ordinarily resided in the residence since 11 February 2009 until the date of disposal. On 1 March 2011, H cedes 50% of the dividend and voting rights in the shares to W for no consideration. On 30 April 2011, ABC distributed the residence to H and W as a dividend *in specie*.

Result:

H's cession of 50% of the dividend rights to W is subject to securities transfer tax at the rate of 0,25%.[21]

The cession is exempt from donations tax under s 56(1)(*b*), since it comprises a donation between spouses.

[21] Under para (*c*) of the definition of a "security" in s 1 of the Securities Transfer Tax Act 25 of 2007, a security includes "any right or entitlement to receive any distribution from a company or close corporation".

No transfer duty is payable on the cession because para (*d*) of the definition of "property" in the Transfer Duty Act only refers to a "share" in a residential property company. Under its ordinary meaning a right to dividends is not a share. There is no CGT on the cession because it is subject to roll-over treatment under para 67. H and W are qualifying acquirers under para 51A since they have ordinarily resided in the residence from 11 February 2009 until date of disposal. In addition, they are both connected persons in relation to the company (para (*d*)(iv) of the definition of a "connected person" in s 1). W is a connected person because she holds 50% of the voting rights in the company. H is a connected person because he holds at least 20% of the equity shares in the company. The company will be exempt from STC under s 64B(5)(*k*A). The disposal of the residence will be exempt from transfer duty under s 9(20) of the Transfer Duty Act. The company is treated as having disposed of the residence for an amount equal to its base cost under para 51A(2). H and W will take over the history of the residence from the company for base cost purposes under para 51A(4).

7.9 Waiver of loan accounts [para 12(5)]

Before a company can be liquidated or deregistered it is necessary for its liabilities to be discharged. The waiver of a loan account for no consideration or for a consideration that is less than the face value of the loan account will normally give rise to a capital gain in the company under para 12(5). However, para 12(5)(*a*)(*cc*) does not apply to the waiver of a loan owed by a company provided that

- the creditor is a connected person in relation to the company, and
- the loan is waived in the course or in anticipation of the liquidation, winding up, deregistration or final termination of the corporate existence of the company.

This exclusion from para 12(5) only applies to the extent that the amount of the reduction or discharge did not exceed the amount of the creditor's expenditure contemplated in para 20 of the debt at the time of that reduction or discharge. For example, if the creditor acquired a loan with a face value of R100 by cession from another creditor for R80, only R80 of the waiver of the loan will be excluded as a capital gain (assuming R100 is outstanding at the time of waiver).

The exemption will be invalidated if

- the company became a connected person in relation to the creditor after the debt or any replacement debt arose, and
- the transactions are part of a scheme to avoid any tax otherwise imposed by virtue of the Act.

In relation to the last two bullet points, both requirements must be met before the exclusion under para 12(5)(*a*)(*cc*) can be invalidated.

When this exclusion from para 12(5) applies, the creditor will forfeit any capital loss under para 56(1).

There is no specific CGT exclusion for loans waived in anticipation of the revocation of a trust.

8. Donations tax

No specific donations tax exemptions were introduced to deal with the disposal of a residence under para 51A. The donations tax consequences must therefore be dealt with under the existing donations tax provisions in ss 54 to 64 contained in Part V of the Act.

Distribution of a residence to beneficiaries

Under s 56(1)(*l*) donations tax is not payable on the value of any property which is disposed of under a donation

> "if such property is disposed of under and in pursuance of any trust".

Thus the distribution of a residence to a beneficiary of a trust will not give rise to any donations tax implications. But the sale of a residence to a connected person in relation to the trust who is not a beneficiary[22] at less than market value will potentially result in the trust becoming liable for donations tax.

Waiver of shareholders' loan accounts

Before a company can be liquidated or deregistered it will be necessary for the shareholders' loans to be discharged. One way of doing this would be to capitalise the loans by issuing further shares at a premium. In such event there should be no donations tax consequences provided the shares are equal in value to the loan account discharged.

Alternatively, the shareholder could waive the loan for no consideration, and in this case the issue arises as to whether any donations tax is payable. The effect of a shareholder waiving a loan account should be to increase the value of that shareholder's shares. If the value of a shareholder's shares increases by an amount equal to the loan discharged by that shareholder, it will be accepted that the consideration given for the loan is adequate for the purposes of s 58 on the basis that the value of the shareholder's estate remains unchanged. This interpretation would not apply, for example, if there is more than one shareholder and the shareholders' loans are disproportional to their respective shareholdings.

Waiver of loans to trusts

The waiver of a loan by a founder to a trust will have donations tax implications. In some cases it may be possible to sell the residence to the founder at market value, thus discharging the loan account. No capital gain will arise on such a disposal under para 51A(2). The proceeds from the disposal can then be distributed to the trust beneficiaries without any CGT implications under para 80(2), since there is no capital gain to be attributed to them.

Differential dividends

While it may have been possible for a company to legally distribute a dividend to a single shareholder as opposed to all shareholders within a particular class under the Companies Act 61 of 1973,[23] such an action in the context of para 51A may well have resulted in donations tax becoming payable. For example, assume that A and B own 99% and 1% respectively of the shares in Company A, which owns a residence. The company distributes the residence to B at the instance of A. Applying substance over form it is clear that what has been dressed up as a dividend is in fact a donation by the company at the instance of A.

[22] For example, a relative of a beneficiary.

[23] P M Meskin, B Galgut, J A Kunst, P Delport and Q Vorster *Henochsberg on the Companies Act* [CD-ROM] (*My LexisNexis*: September 2009) LexisNexis Butterworths Durban in the commentary on s 90 of the Companies Act, 1973. According to the authors of this work such a discriminatory dividend is possible provided that it is sanctioned by the company's articles of association.

In these circumstances A is deemed to be the donor under s 57(1) and will be liable for donations tax. A's consent in this case would be required because the company will be disposing of the "whole or the greater part" of its assets and this would have required a special resolution under s 228 of the Companies Act, 1973.[24]

Under s 37(1) of the Companies Act 71 of 2008

> "[a]ll of the shares of any particular class authorised by a company have preferences, rights, limitations and other terms that are identical to those of other shares of the same class".

It is therefore not possible to declare a dividend to one shareholder to the exclusion of others in the same class under the Companies Act, 2008.

Exemptions that may apply when a company disposes of a residence

A company that disposes of a residence to a qualifying acquirer for no consideration or for a consideration which is less than the market value of the residence will be making a donation for donations tax purposes. When done at the instance of a shareholder, that shareholder will be deemed to be the donor under s 57(1). That shareholder would be exempt from donations tax if

- he or she is not a resident (s 54 provides that donations tax only applies to a resident donor), or
- the residence is donated to the spouse of that shareholder (s 56(1)(*b*) exempts donations between spouses).

9. Value-added tax

The VAT Act contains no specific value-added tax relief measures relating to the disposal of a residence referred to in para 51A since

- the private use of a residence ("dwelling") is not an "enterprise" activity; and
- the letting of a dwelling to another person is an exempt supply and also not an "enterprise" activity.[25]

Accordingly, the normal rules will apply for determining any value-added tax (output tax) which may become payable by a company or trust that is a vendor.

10. Modes of disposal

Paragraph 51A does not specify how the residence must be disposed of by the company or trust, for example, whether by way of a distribution or sale. Nevertheless, care should be exercised when a company disposes of a residence other than by way of a distribution *in specie*, since there could be adverse dividends tax, STC and donations tax consequences.

11. Assets other than a residence

The CGT, dividends tax, STC and transfer duty relief measures do not cover assets disposed of by a company or trust other than an interest in a residence.

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[24] The equivalent provision under the Companies Act 71 of 2008 is s 112 read with s 115, which also requires a special resolution.

[25] Section 12(*c*)(i) of the VAT Act. Under para (v) of the proviso to the definition of an "enterprise" in s 1 of the VAT Act, any activity which involves the making of exempt supplies is not deemed to be the carrying on of an enterprise.

12. Must the residence be disposed of at market value?

Although there are many rules in the Act which deem transactions to take place at market value, most of these are likely to be irrelevant because of the relief provided by para 51A and related provisions.

As a general rule, however, it is advisable to conduct transactions at market value in order to avoid unintended tax consequences such as the imposition of donations tax and to ensure that the correct tax is payable under provisions such as para 12(5), s 8(4)(*k*) and s 22(8). Companies need to comply with generally accepted accounting practice. Under IFRIC 17 "Distributions of Non-cash Assets to Owners" an entity should measure a dividend *in specie* payable at the fair value of the net assets to be distributed. The interpretation is effective for annual periods beginning on or after 1 July 2009.

There is, however, at least one instance in which a sale at less than market value can result in a favourable tax consequence under the current relief measures. Such a disposal to a shareholder by a company may trigger an actual dividend as defined in s 1 or a deemed dividend under s 64C(2)(*a*) which may qualify for the STC exemption under s 64B(5)(*k*A), at least to the extent that the market value of the residence exceeds the consideration actually derived by the company – see **5**. By contrast, a sale by the company at market value will result in the STC exemption not applying.

13. Conclusion

This guide seeks to provide general guidance on the interpretation of para 51A and related exemption provisions. It does not deal with every possible situation which can arise. The wording of para 51A needs to be clarified in a number of respects, which should happen during the latter half of 2011. Taxpayers who find themselves prejudiced by the current wording of the legislation, for example, companies or trusts holding holiday homes, should wait for the amended legislation before taking any action.