Shepstone & Wylie ATTORNEYS

# IMMOVABLE PROPERTY AND THE BUDGET

## 21 FEBRUARY 2007

Purchasers looking to acquire immovable property but were delaying signing sale agreements in the hope of further reductions in transfer duty being announced in the budget, may continue with their transactions in the knowledge that, unlike in previous years when transfer duty rates were reduced at budget time, they can sign a sale agreement prior to 1 March 2007 and will not be prejudiced by paying higher duties.

No changes in the rates of transfer duty were announced by Finance Minister Trevor Manuel in the Budget today. Given the substantial relief granted last year, it was not unexpected that no adjustments have been made this year.

A summary of some of the aspects affecting immovable property dealt with in the budget are detailed below:

**Transfer duty**

After the many reductions in transfer duty rates over the past few years, culminating in the substantial reductions announced in the 2006 budget, effective from 1 March 2006, transfer duty brackets are to remain the same for the next financial year with the exempt threshold for transfer duty at R500 000. The upper threshold remains at R1 million.

For property values above R500 000 the rate of transfer duty remains at 5% up to R1 million, and for properties costing more than R1 million the rate is R25 000 plus 8% on the value above R1 million. Acquisitions of properties by persons other than natural persons also remains at 8% of the value (down from 10% the previous year).

The 2006 transfer duty adjustments were a major attempt by Government striving to grant effective tax relief for lower-income earners by trying to ensure that most homes affordable by low income earners fall under the tax threshold.

While some purchasers argue that as property prices have continued to increase the transfer duty reductions last year were mainly negated by the substantial increase in property prices, it is probably fair to say that property prices have slowed down in the last year compared to the 3 previous years.

**Stamp duty on leases**

The Minister of Finance has announced that stamp duty on leases with a duration shorter than 5 years will be exempted from stamp duty altogether.

Prior to 1 January 2005 stamp duty was levied on leases at different rates, depending on the length of a lease. For leases up to 5 years the rate was 0,25% of gross rental during the lease, for 5-10 years, 0,40%, for 10-20 years, 0.55% and over 20 years, 0,70%. Penalties for late payment of duty beyond the 30 day stamping period were also substantially increased.

In the 2004 budget, the Minister of Finance expressed concern that long-term leases were being taxed at much lower rates than property transfers and that stamp duty on leases should be brought more in to line with transfer duty rates. The budget review this year further provides that the relationship between the VAT Act, Transfer Duty Act and stamp duties on long-term leases will also be examined.

On 1 January 2005 important new provisions governing stamp duty on leases came into effect which included the rates of duty changing from those based on the sliding scale to a flat rate of 0.5% or 50 cents per R100 or part thereof on gross rental, irrespective of the period of the lease. This obviously substantially increased stamp duty for leases of 5 years or less, although one of the other provisions effective from that date was that no stamp duty was payable in circumstances where the duty on a lease amounts to less than R200, that is, a gross rental of R40 000 or less. The 2006 budget provided that the exemption threshold more than doubled from 1 March 2006 to a figure of R500, that is a gross rental of R100 000.

The total abolition of duty for short leases, irrespective of the value of the lease, will further reduce the compliance burden for taxpayers entering into short rental agreements, and the administrative burden on SARS. Unlike the 2005 changes however which clearly targeted low value leases usually involving residential properties, parties involved in leases of commercial and industrial premises, often involving substantial rentals, will perhaps also enjoy the exemption. One will have to wait to see the legislative amendments for this and other issues covered in this note before one is able to establish exactly what is proposed.

While the Stamp Duties Act places the obligation to stamp a lease on the landlord, invariably the landlord provides contractually in his lease that the liability for paying the stamp duty is passed on to the tenant.

## Capital gains tax

A few monetary thresholds are also to be adjusted up to take into account the effects of inflation.

An important asset of a taxpayer is his or her residence and one of the special rules dealing with capital gains and capital losses on the disposal of a person's primary residence is that a natural person may disregard capital gains and capital losses that do not exceed R1 million that arise from the disposal of a primary residence.

The original R1 million threshold which was increased with effect from 1 March 2006 to R1,5 million remains unchanged. What will be increased however is the annual exclusion threshold for capital gains or losses from CGT from R12 500 to R15 000 per year applicable to natural persons and special trusts.

It is also proposed to increase the monetary threshold below which no capital gains tax is imposed at death from R60 000 to R120 000.

## Estate duty

A further monetary threshold to be increased is that of estate duty, which threshold remained at R1,5 million for many years until it was increased to R2.5 million last year. The proposed further generous increase in this threshold to R3.5 million will be welcomed, particularly by property owners following substantial increases in property values in recent years, which have a major impact on potential estate duty. The rate of duty remains at 20%.

## Donations tax

The threshold below which no donations tax is payable will be increased from R50 000 to R100 000. This follows an increase from R30 000 to R50 000 in the previous year.

## Miscellaneous matters

Other matters which have a bearing on immovable property which were dealt with in the various budget documentation, including future tax proposals, include:

### Property rates

A reference to the Local Government Municipal Property Rates Act, 2005 which took effect on 2 July 2005, giving powers to municipalities to impose rates on properties, provides that there should be a responsible phasing in of the new rates regime and that municipalities that historically have not rated on the market value of land and buildings combined are expected to reduce the rate charged (percentage or cents per rand) to ensure that there is a broad continuity in revenue collected from the expanded tax base.

### Taxes on property holding entities

The regulatory and tax regime relating to property holding entities will be reviewed during 2007 as it is felt that the tax treatment of such entities is fragmented and based on the legal form (ie trusts versus companies), rather than their common purpose. This includes collective investment schemes in property and property loan stock companies.

### Urban development zone incentives

Clarification will be given on the 2003 urban development zone tax incentives to encourage the development and renovation of selected urban centres which are available for buildings used for trade, not for personal use although the question has arisen as to the impact of the incentive if an urban development zone building was used for purposes other than trade before renovations commenced.

### Change of use adjustments of fixed property

VAT registered property developers acquiring fixed property for resale claim VAT input credits on property purchases and charge VAT on subsequent sale of the properties, whereas residential leasing is an exempt activity and no VAT inputs are allowed for fixed property acquired for residential rental purposes. Problems have arisen where developers change the use for which the property was originally acquired from resale to rental and the feeling is that this change of intent should result in a VAT adjustment.

### 2010 infrastructure spend

In addition to the R8,4 billion stadium costs, the Finance Minister has allocated an additional R9 billion towards the world cup infrastructure costs which will go towards municipal transport, roads and precinct upgrades relating to the event.

### Depreciation of commercial buildings

The budget review records that the Income Tax Act provides for the depreciation of buildings used for manufacturing and similar processes but not for certain commercial buildings and is proposed that tax appreciation allowances for the economic wear and tear of newly constructed commercial buildings (and upgrades) be implemented, with the rate expected to be 5% per year i.e. a write off over 20 years.

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