



Property Syndicates – what's the right structure?

The current environment of interest rate hikes and spiralling inflation can make it difficult to raise sufficient funds to purchase, develop or improve a property. Whether you're an individual investor, a company or a trust, banding together to form a property syndicate can be a solution. This strategy spreads the attendant risks, but also invites certain tax and legal implications.

Three syndicate alternatives to consider are a partnership, a company or a joint venture.

Partnerships

The main advantage of a partnership is that if losses are incurred, these can be deducted from income or from any capital gains the partners derive from other sources.

Because of this, using a partnership to form a property syndicate is particularly advantageous where most, or all, of the money needed is borrowed at interest and where it's likely that it will take several years before the income from the property, for example rental, exceeds interest and other expenses.

The biggest disadvantage of a partnership is that partners are jointly and severally liable for debts and losses. If one of the partners can't meet his share, the others will have to make up the difference.

A partnership also should not be used if it's likely that a further partner will have to be introduced at a later stage to raise funds to develop or improve the property. This is because in order to admit a new partner the original partners need to dispose of some of their interests in the building acquired by the partnership. This results in a capital gain and therefore Capital Gains Tax (CGT) exposures for the original partners.

Compare this to the scenario where the building is owned by a company, and the company raises further capital by issuing additional shares to a new shareholder (or existing shareholders) – the issue of the additional shares would usually have no CGT consequences.

Using a company as the syndication vehicle

Using a company as the syndication vehicle has the following advantages:

- at 28%, the corporate tax rate is significantly lower than the peak individual marginal rate of 40%

Should you buy your home through a trust?

The ideal property to own through a trust is a holiday home, which will be used by several generations over many years, not a primary residence. This is because buying a primary residence through a trust can give rise to conflicting tax and estate duty considerations.

The classic way to shelter assets from estate duty is to hold them through a trust, usually a family discretionary trust. Assets held in this way aren't subject to estate duty. But then there is Capital Gains Tax (CGT) to consider. Once sold, primary residences qualify for an exemption of R1.5 million from the capital gain. But not if they're held in a trust.

If you hold property in your own name, it may be included amongst your dutiable assets at the time of your death. SARS (South African Revenue Service) allows you an initial deduction of R3.5 million from the value of your assets as well as a deduction for assets left to a surviving spouse, before estate duty applies. The balance of the estate is subject to duty at 20%.

Holding a residential property through a trust is the preferable approach only if you already have a significant exposure to estate duty because of your other assets, or because the property itself is so valuable that, on its own, it would give rise to a significant exposure to estate duty.

Because of these considerations, owning a home through a family trust is largely confined to the wealthy. Holding the family home through a trust has the advantage of sheltering the growth in value of that asset from estate duty, but exposes you to CGT complications when the property is sold.

When the trust sells the property, the effective rate at which CGT is payable will either be 20% if the capital gain is retained by the trust or 10% if the capital gain is allocated to a South African resident beneficiary within the year in which it was derived by the trust.

The problem is that if the capital gain is allocated to a resident in order to qualify for the lower 10% tax rate you

may simply, at the level of that beneficiary, be recreating the estate duty exposure you set out to avoid by using a trust to hold the property in the first place. But if the property you're buying won't be your main residence, and will be kept as a family asset to be enjoyed by two or more generations, then CGT considerations are not an issue. The saving in estate duty will be the main consideration, and the eventual exposure to CGT if the property is sold after several generations will be a lesser concern.

Finally, don't forget to factor in transfer duty when deciding whether to buy a property in a trust. If a trust is the purchaser, transfer duty will be levied at a flat rate of 8%, whereas if it's bought by an individual, transfer duty will be payable at progressive rates, peaking at 8%.



Swallows, take note!

If you're a 'swallow' – a foreigner who arrives in South Africa in summer to escape the northern hemisphere winter – make sure you time your visits strategically. Or you might just wind up a South African tax resident which could expose your worldwide assets to Capital Gains Tax (CGT) in South Africa.

Whether you're a South African tax resident or not, if you own property here, you'll be subject to CGT when you sell it; and your estate might have to fork over a substantial amount of estate duty when your last real estate holding is marked by a 'gravestone'.

When you buy a property in South Africa, SARS treats it differently than other local assets from a CGT perspective. If you buy shares on our local stock exchange, you won't be subject to CGT* but with property you are. Whether you're selling that property as an individual, a trust or a company will impact on the rate of CGT that you pay.

If you're an individual, you'll pay CGT at an effective rate of 10%. If the property is sold by a South African company, the rate will be 14% and if through a trust, the rate will be 20%. Looking at these rates, you could be forgiven for thinking that you should always buy a South African property in your own name. But there's something else to consider: estate duty.

A foreigner owning a South African property will be subject to estate duty at a rate of 20% on the dutiable value of the property on that individual's death. If you leave property to a surviving spouse, no estate duty will be charged, and the problem is deferred until the death of the surviving spouse. Where the property is not left to a surviving spouse, you will be able to deduct R3.5 million from the value of the property, and any South African debts relating to that property, with the balance being subject to duty.

To make matters worse, if you die while still owning the property, SARS will treat you as having sold it at its market value for CGT purposes. Your estate will be taxed at the rate of 10% on the difference between the original cost of the property, plus any improvements, and the market value of the property at the time of your death. Given your potential exposure to both

estate duty at 20% and CGT at 10% if you die while owning the property, it may make sense to buy the property through a trust, as trusts are not subject to estate duty.

But CGT will still apply on a sale of the property. It doesn't matter to SARS whether the trust that buys the property is a local trust or a foreign trust. In either case the property will be subject to CGT when it's sold.

In addition to buying the property through a trust, another way of minimising your overall tax liability is to donate the funds you need to buy the property to the trust. If you are not a tax resident in this country, you're allowed to make a donation to a South African resident trust so that it can buy the property and that donation won't be subject to donations tax.

Of course, you need to establish whether donating funds to an South African trust would have any adverse tax implications under the tax regime of your home country.

So how do you avoid becoming a South African tax resident?

There is an art to being a swallow – if you spend too much time here, you'll be treated as a South African tax resident and there are some potentially nasty consequences:

- on the day you become a tax resident, SARS has the right to include all of your assets, other than any fixed property already owned in South Africa (which is already subject to CGT on sale) in its tax net
- if you then want to sell any of your assets, such as your home in Majorca for example, you'll be subject to CGT in South Africa
- if you ever want to stop being a tax resident, SARS will treat you as having sold all of your assets, other than fixed property in South Africa, at their market value, with consequent CGT liabilities
- when you die, you will be treated as having disposed of all your assets, other than those left to a surviving spouse, at their market value, and your estate will be charged CGT

Swallows become tax residents if they spend more than 91 days in the country every year over six years. If they do so, they're treated as tax residents from the beginning of the sixth year.

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*If 80% or more of the market value of the company you hold shares in comes from a portfolio of fixed property in South Africa, the sale of those shares will be subject to CGT

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- a company can freely raise capital by issuing shares to shareholders, without incurring any CGT liabilities
- shareholders, unlike partners, are not jointly and severally liable for the debts of the company, unless they have extended guarantees to creditors that make them liable, either jointly or severally

If the shareholders want to borrow money to take up an issue of shares in the company, they will not be allowed a tax deduction for the interest paid on the borrowed money. So if you're using a company as a syndication vehicle, it's important that any debt is raised at the level of the company, and not at the level of the shareholders.

But if the company borrows money at interest to purchase an income-producing property, or to develop a property, the interest is tax deductible. The main disadvantage of using a company is that any losses will be locked up in the company and can only be offset against the company's income.

Joint ventures

The term 'joint venture' is often used loosely – and

dangerously so. A perception exists that the perils of partnership can be avoided simply by calling the arrangement a joint venture. But if the parties share in a common pool of profit, it's a partnership.

With a joint venture, on the other hand, the parties make joint contributions to a common project, but do not share in a common pool of profits.

A well-drafted joint venture agreement will provide the benefits of partnership – the ability to offset losses from the project against other sources of income – without the peril of joint and several liabilities.

In conclusion, the parties to any of the three structures can be individuals, companies or trusts.

Using a company or trust confines exposures to any risks to the company or the trust. However, there is little sense in using a company or trust to screen off the shareholders or beneficiaries if, under the agreements concluded with the bank, the shareholders or beneficiaries accept unlimited liability for the debts of the company or trust.

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Which is why experienced swallows plan their visits strategically – at least every sixth year they abstain from spending more than 91 days here.

United Kingdom swallows are a fortunate exception. Because of the double tax treaty between South Africa and the United Kingdom, they can only be a tax resident in one country: the country with which they have the most substantial connections.

Finally, it's important to understand the obligations of local estate agents who you bring on board to help you sell your property. When a buyer pays the purchase price of a South African property to a non-resident seller, or to his or her agent, that buyer must withhold an amount from the payment and

pay it over to SARS as an advance against the non-resident seller's tax liability.

If the non-resident seller is an individual, the amount to be withheld is 5%. In the case of a company it's 7.5% and in the case of a trust it's 10%.

An estate agent acting on behalf of a non-resident seller is obliged to tell the buyer about the non-resident status of the seller. If the agent fails to do so, he or she will be held personally liable to pay the amount that should have been withheld to SARS. However, this liability is limited to an amount that doesn't exceed the commission earned on the sale.



MAZARS MOORES ROWLAND

BLOEMFONTEIN T. +27 51 403 4100 bfm@mazars.co.za	CAPE TOWN T. +27 21 405 4000 cpt@mazars.co.za	DURBAN T. +27 31 313 1000 dbn@mazars.co.za	GEORGE T. +27 44 874 5022 grg@mazars.co.za	JOHANNESBURG T. +27 11 547 4000 jhb@mazars.co.za	PAARL T. +27 21 871 1474 prl@mazars.co.za	PLETTENBERG BAY T. +27 44 533 0510 plt@mazars.co.za	PORT ELIZABETH T. +27 41 501 9700 plz@mazars.co.za	PRETORIA T. +27 12 346 4111 pta@mazars.co.za
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REGISTERED AUDITOR – A FIRM OF CHARTERED ACCOUNTANTS (SA)

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