

LAND BUYING BLUES

A purchase and sale agreement in respect of immovable property is signed. The first question the conveyancer is likely to be asked is "How long will the transfer take?". The response to that question will be influenced *inter alia* by whether the purchasing entity needs to be formed. And thereby hangs part of this tale.

In the past few years the property industry has experienced significant growth. A purchaser will often acquire a property before deciding whether to own the property personally, in a legal entity or through an inter vivos trust. Signing an agreement as trustee for a company or close corporation to be formed keeps some options open for the purchaser. Estate agents sometimes record the purchaser as trustee for a company formed or to be formed. The former is not permissible.

Shelf Companies

A purchaser who elects to use a company to own a property is likely to acquire a shelf company. The "purchase of shelf companies" from businesses which provide secretarial and accounting services has become a regular feature of commercial dealings. The demand for shelf companies has grown because it is cheaper to buy a company than form one with full articles of association and also because of delays in the office of the Registrar of Companies.

The documents of a shelf company typically comprise a certificate of incorporation, a one page memorandum of association and a page recording that the table B articles of association (with minor amendments) are applicable. The shareholder and director of the shelf company will be an employee of the business which registered the company. The shares are transferred to the purchaser who "buys" the company. The purchaser's nominee is appointed as director.

The problem with signing an agreement as trustee for a company to be formed and then buying a shelf company is that the shelf company existed at the time of signing of the sale agreement. Therefore the memorandum of association will lack an objects clause to enable it to adopt and ratify the agreement as a pre-incorporation contract. Even if a company is formed after the conclusion of an agreement, it is unlikely that the memorandum will contain the powers prescribed in Section 35 of the Companies Act of 1973. Henochsberg on the Companies Act comments that if the requirements of Section 35 are not observed, a purported ratification or adoption is without effect. "The contract is void not only by reason of the fact that the company was without capacity or power to make it but by reason of the additional fact that the statutory requirements for its effective ratification or adoption were not observed." How often do contracting parties consider the implications of non-compliance with Section 35?

Transfer Duty

Furthermore, if the shelf company is cited on the transfer duty declarations as the purchaser, SARS may regard the sale to the shelf company as a second sale. The purchaser who purported to act as trustee would then be liable for the payment of transfer duty in addition to the shelf company. That would not be unreasonable because the company would not be empowered in terms of Section 35 to adopt and ratify the first sale. However, what happens in most cases is that the application for a bank loan is made in the name of the shelf company. Accordingly a suspensive condition in the agreement with the trustee that the sale is dependent upon the granting of a loan is not fulfilled. The sale to the trustee lapses. If the seller is willing, a replacement agreement is drawn between the seller and the shelf company. Transfer can then proceed in accordance with that agreement. Were the seller to refuse to sign a new agreement, the purchaser would be stranded.

Nominee

A practice often followed is for a purchaser to add in an agreement the words "or nominee". Section 16 of the Transfer Duty Act authorises a person to act as agent for a principal and to buy a property provided the agent discloses to the seller the name and address of the principal for whom the agent acts "on the day of conclusion of the agreement of sale". In the past SARS would allow the nomination of a principal to be made two or three weeks after the date of conclusion of the sale. SARS now insists on exact compliance with the provisions of Section 16. This makes matters difficult for a purchaser who is anxious to sign a sale agreement but who has not had an opportunity to consult with advisors on what entity to use for the acquisition of a property. Effectively the use of the term "or nominee" has been curtailed.

The strict application of Section 16 by SARS also means it is no longer possible for a purchaser to sign an agreement as a *stipulatio alteri*. A long established common law right has been negated insofar as it relates to property transactions.

Misnomer

The term transfer duty is a misnomer. In reality it is a sale duty. Liability for the duty arises once a sale agreement has been signed. In the case of CIR versus Freddie's Consolidated Mines Limited 1957 (1) SA306 A the Chief Justice held that:

"The word "acquired" in the charging section (Section 2) must therefore be construed as meaning the acquisition of a right to acquire the ownership of property. It has been said to be a misnomer to call the duty a transfer duty : It is in fact a duty imposed, inter alia, on the consideration given by a purchaser of property for the right conferred on him to acquire the ownership of property."

In the case of *Secretary for Inland Revenue vs Hartzenberg 1966 (1) SA405 A*, the court held that transfer duty is imposed on the value of any immovable property "acquired" by any person by way of a transaction. The judge held that

the word "acquired" included "the acquisition of a *jus in personam ad rem acquirendam*. Transfer duty therefore becomes payable under Section 2 of the Act upon the acquisition by a person of a personal right to obtain dominium in immovable property" (405C-D).

A purchaser is obliged to pay transfer duty to SARS prior to lodgement of transfer documents in the deeds office. The Registrar of Deeds may not register a transfer unless a transfer duty receipt or transfer duty exemption receipt (where VAT is payable) is lodged.

If a sale is cancelled before transfer, transfer duty is payable on any sum retained or paid by one party to the other as consideration for the cancellation. Since the amendment of the Transfer Duty Act in 2004, it is no longer possible for a purchaser to cancel a sale and receive as consideration an amount equal to the difference between the purchase price due to the seller and the purchase price payable by the second purchaser. Tripartite agreements have become a thing of the past. They can be used only where there is a genuine cancellation of the first sale and no monies are payable to the first purchaser.

VAT

Liability for value added tax (VAT) arises on signature of a sale agreement. However in terms of Section 9(3)(d) of the VAT Act payment of the VAT is due only after the date of transfer of the property unless any payments have, prior to transfer, been made by the purchaser to the seller or if the purchase price is payable in instalments. VAT is then also payable in instalments. If a transfer of a property does not proceed, VAT does not fall due for payment. It is otherwise with transfer duty. A sale agreement must be cancelled in writing to avoid liability for transfer duty and penalties.

Trusts

A problem arises when a purchaser wishes to acquire property through an *inter vivos* trust. As stated by Honoré in the Law of Trusts, "a trust does not possess juristic personality unless endowed with it by statute." There is no statutory provision for a purchaser to sign an agreement as trustee for a trust to be formed. Instead what transpires is that a natural person enters into an agreement as purchaser but agrees with the seller that once a trust has been formed that the agreement will be replaced with an agreement citing the trustees of the trust as purchaser. No prejudice is suffered by the fiscus as no consideration is payable or receivable arising from the cancellation of the first sale. The transfer duty declarations however require the seller to declare whether there has been a previous sale which did not proceed to transfer. Declarations of cancellation are required to be prepared and signed in respect of the first sale. This is an unnecessary requirement.

While *inter vivos* trusts are stated to be *sui generis*, they nonetheless are recognised for defined purposes as legal personae both in the Vat Act and in the Income Tax Act. A trust which is a vat vendor is liable for the payment of VAT on vatable supplies made by it. Income earned by a trust and not distributed to beneficiaries on the *conduit* principle is taxed in the hands of the

trust. In 2003 the Deeds Registries Act of 1937 was amended by the insertion in Section 102 (1) of the definition of "person" to record that "for the purpose of the registration of immovable trust property only, includes a trust." Whilst the definition is a little ambiguous, it recognises a trust as a legal *persona*. It would be a simple step for the legislature to amend the Trust Property Control Act to enable a purchaser to sign an agreement on behalf of a trust to be formed. To avoid confusion with the persons who will be appointed by the Master as Trustees of the trust, the purchaser who signs on behalf of a trust to be formed could be termed a "progenitor" or by some such term. Perhaps "Representative or Initiator for a trust to be formed".

The law is not static. It evolves and changes to take account of changes in commercial practice. Legislation which imposes taxes on property transactions should be framed in a manner that takes account of practical commercial realities. Regrettably the approach of SARS in recent years has been to tighten transfer duty legislation and to make it more restrictive and onerous. That approach hampers rather than facilitates the speedy conclusion of commercial and even residential transactions. Furthermore, the new transfer duty forms require the parties to disclose their income tax and vat registration numbers. If tax returns are not up to date, SARS withholds the issue of the transfer duty receipt and that results in prejudice to the other party in the transaction.

Delays

It is of concern that significant delays in property transactions occur because of the time taken and the information required to register a legal entity as a VAT vendor. If a purchaser applies for voluntary registration, SARS calls for a business plan and much information. As an input tax credit cannot be claimed unless a purchaser is registered as a vat vendor on the date of transfer, transfers of properties are delayed because of the need by the purchaser first to achieve registration as a vat vendor.

Zero-rating

If a transaction is not zero rated, the seller pays output tax. After registration of transfer the purchaser claims an input tax credit. Accordingly, SARS does not increase its revenue but obtains an interest free loan for a period of approximately two months. The request for payment of the input tax credit can however give rise to a vat audit and delays. SARS adopts a restrictive approach towards the zero rating of a sale of an enterprise as a going concern. The reason being that zero rating does not afford SARS an opportunity to set off any outstanding VAT against the input tax credit claimed by the purchaser!

The VAT Practice Note No. 14 prescribes the circumstances in which a sale of an enterprise as a going concern can be zero rated. SARS is rigorous in its application of the principles in the Practice Note. It thoroughly investigates applications for zero rating. Staff of SARS sometimes visit the premises of a property sold as a letting enterprise to ensure that more than 50% of the area of the property is leased to tenants. Many branches of SARS require sight of certified copies of each lease in the premises. If a multi-tenanted property is

sold, this becomes a time consuming exercise. To add insult to injury, SARS may use the opportunity to scrutinise each lease to ascertain whether it has been properly stamped in terms of the Stamp Duties Act! The issue of a transfer duty receipt is thereby held up pending the payment of relatively small amounts of additional stamp duty or penalties.

Tax Compliance

Legal practitioners support the endeavours of SARS to enhance and improve tax compliance. However, should SARS delay transfers in order to extract the last cent of income tax, vat or stamp duty from its citizens? The delays impact adversely upon economic activity.

A zero tolerance approach is admirable but should SARS treat most business persons as potential evaders of tax? It is not uncommon for zero rated transactions to be re-examined years after the date of transfer of the property so that SARS can ascertain whether subsequent rentals earned by the purchaser of the property provided sufficient taxable supplies to merit zero rating. Does SARS have a surfeit of personnel to trawl through files of transactions registered years ago in the hope of eliciting a few more Rands from a hard working business person? If zero rating is reversed after the event, SARS not only demands payment of the VAT from the Seller but is entitled to impose penalties of up to 200%

Suggestion

It is submitted that SARS should review the Transfer Duty Act in the light of current commercial practice. Transfer duty should be due and payable not on the date of sale but only if and when a transaction is registered in the Deeds Office. Transactions prior to transfer should not be relevant to the calculation of the duty. Purchasers should be entitled to sign agreements in any capacity and to reserve to themselves the right to nominate a third party as transferee. A close examination of a sale agreement by SARS is not necessary. All that is required should be the payment of the prescribed transfer duty and the issue of a receipt. A reversal of the practice of taxing sales instead of transfers would simplify the conclusion of property transactions.

The implementation of the above suggestion would result in SARS losing transfer duty. However the small loss of revenue would be outweighed by the commercial convenience and the greater flexibility which would be given to parties to freely negotiate a property transaction. In the last four years, SARS increased its take of transfer duty from R2 billion to R10 billion. A loss of a few million rands would not impact adversely on the fiscus. It would however help to remove some of the blues which currently afflict land buyers.

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