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TAX ALERT

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TRANSFEREE LIABLE FOR TAX DEBTS OF TAXPAYER

If a person (transferor) transfers an asset to another person (transferee) for no consideration or for a consideration which is below the market value of the asset, tax consequences arise, including:

- The transferor may become liable for donations tax.
- If the transferor and transferee are connected persons in relation to each other then, for capital gains tax purposes, the transferor is deemed to have transferred the asset to the transferee for proceeds equal to the market value.

The Tax Administration Act, No 28 of 2011 (TAA), which took effect on 1 October 2012, adds another item to that list. In terms of s182(1) of the TAA, if the transferee receives an asset from a taxpayer who is a connected person in relation to the transferee without consideration or for consideration which is below the fair market value of the asset, the transferee is liable for the tax debt of the taxpayer. Put simply, a tax debt is an amount of tax due in terms of any law administered by the South African Revenue Service (SARS).

In terms of s182(2) of the TAA, the liability of the transferee is limited to the lower between:

- The tax debt that existed at the time of receipt of the asset or would have existed had the transferor complied with its tax obligations.
- The fair market value of the asset at the time of the transfer, reduced by the fair market value of any consideration paid, at the time of the payment.

The transferee's liability only extends to an asset received by the transferee within one year before SARS notifies the transferee of liability under s182 of the TAA. That is, if the transferor transferred an asset to the transferee in 2013 then SARS could not invoke the provision in 2015.

'Fair market value' is defined in s1 of the TAA as the price that could be obtained on a sale of an asset between a willing buyer and willing seller dealing at arm's length in an open market. The term 'connected person' is defined in the Income Tax Act, No 58 of 1962 (Income Tax Act) and is defined widely. For instance, spouses are connected persons in relation to each other; parents are connected persons in relation to their children; a beneficiary of a trust is a connected person in relation to the trust (and vice versa); and a shareholder holding more than 20% of the shares in a company could be a connected person in relation to the company.

A person who wilfully and without just cause fails or neglects to comply with the provisions of s182 of the TAA, if that person was given notice by SARS to pay the amount to SARS, is guilty of a criminal offence.

The provision is no doubt aimed at the case where a taxpayer is indebted to SARS and, in an attempt to shield the asset against attachment in the event that SARS takes steps to enforce the tax debt, the taxpayer, for instance, donates a valuable asset to a close relative.

Conceivably, however, the provision may find a much wider application in practice. For instance, if an heir receives an asset on the death of a close relative or if a major shareholder receives a distribution from a company, the recipients – who received the asset for no consideration – may become liable for the tax debts of the person bequeathing the asset or the company making the distribution.

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The provision may also find application in the context of arm's length commercial transactions. Consider if company A buys all the shares in company B from its shareholders. The shareholders of company B weren't amenable to company B selling its assets to company A. Company A wishes to wind up company B promptly and procures that company B distributes all its assets to company A in terms of s47 of the Income Tax Act to ensure that the transfer is free of immediate tax consequences. As company B is a connected person in relation to company A at the time of the distribution (it is a wholly-owned subsidiary), and because company A receives the assets without consideration, company A becomes liable for the tax debt of company B, limited to the value of the asset limited to the lower of the value of the asset and the tax debt.

In my view, the Legislature has cast its net too wide. The examples above show that a person who receives an asset from a taxpayer may become liable for the tax debt of the taxpayer, despite that the taxpayer or the recipient may have been unaware of the tax debt, or not have purposefully participated in a scheme to dissipate the assets of the taxpayer with a view to putting the assets beyond the reach of SARS.

In my opinion, the provision should be amended to add an element of knowledge, intention or fault on the part of the taxpayer and the recipient to ensure that *bona fide* third parties are not hit by the provision.

Persons who acquire assets from connected persons free of charge or for a low charge should be aware of the implications of s182 of the TAA.

Ben Strauss

THE MISNOMER OF TRANSFER DUTY

Transfer duty is not actually payable on the transfer of property.

Section 2 of the Transfer Duty Act, No 40 of 1949 (TD Act) provides that transfer duty shall be payable on the value of any property 'acquired' by a person by way of a transaction. In *CIR v Freddies Consolidated Mines Ltd 1957 (1) SA 306 (A)* it was held that:

> "The word 'acquired' in the charging section (s2) 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."

Importantly, transfer duty is triggered on the acquisition of a personal right that entitles the person to acquire the property, to claim transfer (referred to in law as the *jus in personam ad rem acquirendam*). Actual transfer of the property is not necessary (as per paragraph 3.1.2 of the South African Revenue Service Transfer Duty handbook).

As a result, taxpayers who have previously acquired *a jus in personam ad rem acquirendam* but not actually taken transfer of a property, have been caught out by this provision and in their mind triggered double transfer duty. In *CIR v Collins 1992 (3) (SA 698 (A)* the taxpayer had purchased a property from a company. The agreement between the parties provided that it shall become binding on the purchaser as a contract of purchase and sale only if the purchaser shall not have nominated a purchaser who has accepted same within a designated period. The taxpayer nominated a purchaser. However the nomination and acceptance thereof was not done timeously. Initially the taxpayer had successfully approached the High Court for a declaratory order that he was not obliged to pay transfer duty but only the nominee who actually took transfer of the property.

However, the Appellate Division held that:

- The taxpayer fell squarely within the TD Act, which provided that transfer duty was levied, "not on the transfer of property, but on the value of property … acquired by any person … by way of transaction or in any other manner …."
- That the condition on the fulfilment of which the taxpayer became bound under the contract had been fulfilled and the legal effect thereof was that the contract of sale became binding on the taxpayer and, in consequence, he had become vested with the right to acquire the property.
- The substitution of the nominee as the purchaser in place of the taxpayer did not constitute a cancellation of the contract, which would have negated the transfer duty liability in terms of s5(2) of the TD Act. Instead, the court said that "… the legal effect achieved by the nomination and acceptance of the new purchaser was merely the transfer to it of the respondent's rights and obligations; those rights and obligations were not extinguished and did not come to an end; nor was the contract wiped out – all of its terms (embodying the 'transaction' as such) remained intact and operative as between the seller and the substituted purchaser."

Taxpayers who are contemplating ceding, assigning or otherwise substituting their rights under an offer to purchase agreement (or similar agreement) should therefore carefully consider whether or not they have already 'acquired' the property for purposes of the TD Act. If there is any doubt it may be preferable to cancel the existing offer to purchase and a new offer to purchase entered into between the seller and the substituted purchaser allowing one to rely on s5(2) of the TD Act.

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