

8 APRIL 2021

TAX & EXCHANGE CONTROL ALERT

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SARS urges taxpayer compliance on rentals in the property sector

Many individuals who own residential property located in South Africa, for various reasons, consider leasing out their property and in return receive rental income from their tenants. Private property rentals are a common consideration for individuals seeking to generate income from a pastime activity to supplement their main income streams, and in some cases, can be a profitable way of doing business.

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SARS urges taxpayer compliance on rentals in the property sector

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Many individuals who own residential property located in South Africa, for various reasons, consider leasing out their property and in return receive rental income from their tenants. Private property rentals are a common consideration for individuals seeking to generate income from a pastime activity to supplement their main income streams, and in some cases, can be a profitable way of doing business.

It is widely known from a South African tax perspective, that the rental income received by or which accrues to a South African property-owner letting out their property (whether short-term or long-term) located in South Africa or abroad, must be included as part of the gross income of that person and is subject to income tax. This would be the case unless it can be proved that the receipt or accrual of that rental income is of a capital nature and stands to be excluded.

Therefore, the principle applies to resident taxpayers on their worldwide income, as well as non-residents specifically in relation to any residential property located in South Africa and from which rental income is derived.

On 11 March 2021, the South African Revenue Service (SARS) published a statement urging property owners whose properties are located in South Africa and who derive rental income from hosting fee-paying guests to declare the rental income which they receive, in their income tax returns (Statement). SARS emphasised that property owners who host fee-paying guests and receive rental income have the same obligation to declare such income to SARS, just as homeowners letting out their property. Although the legal position is fairly clear, it appears that SARS may have identified the need to focus on improving taxpayer compliance in the property sector. In particular, amongst property owners who derive rental income from hosting fee-paying guests, and therefore on an *ad hoc* basis, rather than property owners who enter into lease agreements for longer periods of time, retaining the same lessees in many such instances.

Practical considerations and certain allowable expenditure

In practice, the rental income received by the property owner should be added to any other income which that person may have received or accrued. However,

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Cliffe Dekker Hofmeyr

SARS urges taxpayer compliance on rentals in the property sector...*continued*

In the Statement, SARS encourages property owners who to date, have not declared their rental income to regularise their affairs with immediate effect, which can be done in terms of SARS' Voluntary Disclosure Programme (VDP).

such person's tax liability on the rental income can be reduced by claiming a deduction in respect of certain expenses which have been incurred during the period in which that person rented out the property, provided that those expenses meet the requirements of the general deduction formula in section 11 of the Income Tax Act 58 of 1962 (ITA). To this extent, private expenses or expenses of a capital nature cannot be claimed as an expense and will therefore not be allowed as a deduction.

The ITA also permits the deduction of expenditure actually incurred in relation to the repairs of property which is occupied for trade purposes. At this stage, it will become crucial for the property owner to distinguish between repairs and maintenance costs, as well as costs pertaining to the improvement of the property. SARS generally regards a repair and maintenance cost as a cost relating to the upkeep of an asset, while improvement costs are generally regarded as those costs relating to the enhancement of an asset which are differentiated from the costs associated with ordinary upkeep. Based on guidance documents published by SARS, it appears that in the property rental context, the list of expenses that can be claimed as a deduction includes the following:

- rates and taxes;
- bond interest;
- advertisements;
- agency fees of estate agents;
- homeowner's insurance;
- garden services;
- repairs in respect of the area rented out; and
- security and property levies.

Options for non-compliant taxpayers

In the Statement, SARS encourages property owners who to date, have not declared their rental income to regularise their affairs with immediate effect, which can be done in terms of SARS' Voluntary Disclosure Programme (VDP), failing which, non-compliant taxpayers may be selected by SARS for an audit and more stringent processes will be adopted. The potential downside of an audit is also that pursuant to its finalisation, SARS could issue additional assessments in terms of which additional tax, interest and penalties of up to 200% on the additional tax could be imposed. Under the VDP, only additional tax and interest will be imposed, if the VDP application is approved. SARS has expressed their enthusiasm to provide clarity and certainty for taxpayers to enable them to meet their obligations effortlessly, however it is not clear what measures (and the severity thereof) SARS will adopt to ensure taxpayer compliance in addition to current processes.

When considering letting out residential property, taxpayers must be cognisant of the tax obligations arising from their trading activities, as well as the tax benefits available to them in the short and long term. As it remains to be seen how SARS will ensure compliance with tax obligations in the property sector, taxpayers are encouraged in the meantime, to take active steps and seek professional advice to regularise their tax affairs and utilise the VDP availed to them to avoid the payment of penalties.

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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