REAL ESTATE
ALERT

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INCORPORATING
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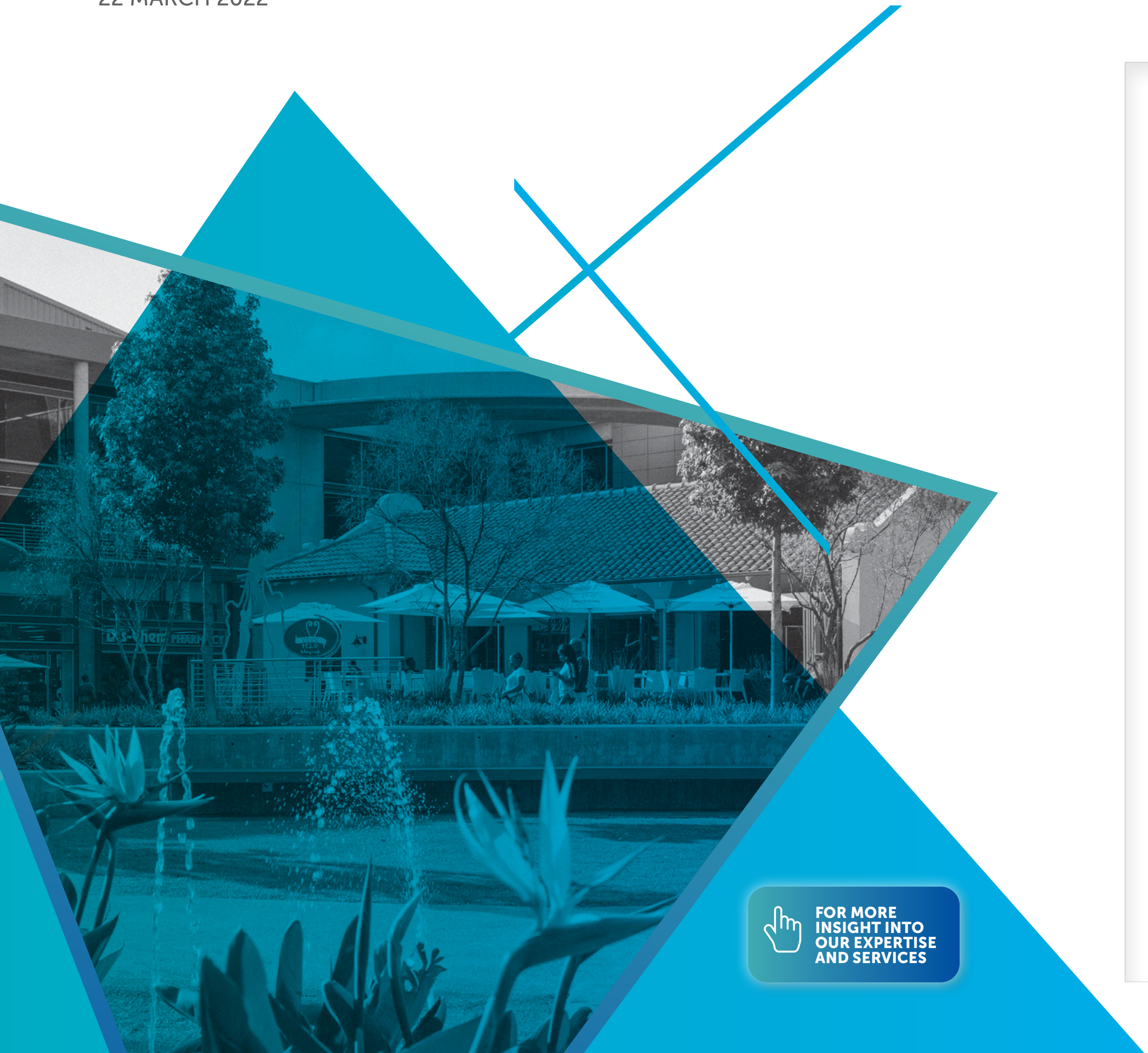

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As more and more property associations are being established to manage estates, complexes and developments (both residential and commercial) in South Africa, CDH's Real Estate practice examines the general types of associations that are being formed and used to govern such estates, complexes and developments, as well as the audit obligation of each type of association.

Are property associations automatically exempt in terms of Section 10 of the Income Tax Act?

Both residential and commercial developments are on the rise in South Africa. Owners (and sometimes tenants) of these estates and developments, are generally obliged to become members of a "*property owners association*". Members of the association are bound by the rules that govern it, to manage and regulate such developments. Generally, the payment of levies by members are required to upkeep and maintain the estate/development. As such, the number of property associations being formed to manage such estates and developments are vastly increasing.

What are the audit obligations of property associations?

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Traditionally, there are three types of property associations that are used to govern property estates and developments: sectional title body corporates, non-profit companies, and voluntary associations.

SECTIONAL TITLE BODY CORPORATE

Rule 26(4) of the Management Rules prescribed in terms of the Sectional Titles Schemes Management Act 8 of 2011 (STSMA) states that "*unless all the sections in the scheme are registered in the name of one person, the body corporate must present audited financial statements to a general meeting for consideration within four months after the end of the financial year*". The intention is that it is not necessary to have the annual financial statements audited while the scheme is owned by only one person (e.g., the developer) and/or no body corporate is in existence. However, once a body corporate is in existence (i.e., once a unit in the scheme is transferred which results in two or more owners in the scheme), then there is an obligation on the body corporate to have its financial statements audited.

NON-PROFIT COMPANY

Section 1 of the Companies Act 71 of 2008 (Companies Act) defines a Non-Profit Company (NPC) as a company incorporated for public benefit or another objective as defined in the Companies Act. The income and property of a non-profit company is not distributable to its incorporators, members, directors, officers or persons relating to any of them and must be used to advance the purpose for which it was created, as set out in its memorandum of incorporation (MOI).

Accounting, financial reporting, and external reporting requirements for NPCs are determined by the Companies Act. Section 30 (2)(i) and (ii) of the Companies Act states that the annual financial statements must in the case of any non-profit company-

" (i) *be audited, if so required by the regulations made in terms of subsection (7) taking into account whether it is desirable in the public interest, having regard to the economic or social significance of the company, as indicated by any relevant factors, including—*

(aa) *its annual turnover;*

(bb) *the size of its workforce; or*

(cc) *the nature and extent of its activities; or*

(ii) *be either—*

a) (aa) *audited voluntarily if the company's Memorandum of Incorporation, or a shareholders resolution, so requires or if the Company's board has so determined; or*

b) (bb) *independently reviewed in a manner that satisfies the regulations made in terms of subsection (7), subject to subsection (2A).*"

Accordingly, to the extent that the property association was incorporated as an NPC in terms of the Companies Act, the obligation on the NPC to have its financial statements audited if:

- prescribed by regulations; or
- its MOI, shareholder's resolution or board of directors have elected to do so

Redefining reasonable grounds for the remittance of non-compliance penalties

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VOLUNTARY ASSOCIATION

This is an association of person that has been formed and that has not incorporated in terms of any Act. These are established by adopting a constitution and rules. They are administered and regulated in terms of common law. The type of voluntarily association, its nature and objects are therefore dependent on its constitution (as its founding document). Further, the drafter of the constitution can provide for any of the existing options related to accounting, financial reporting, and external reporting requirements.

Accordingly, to the extent that property association has been incorporated as a voluntary association, we need to review and consider such property association's constitution to determine whether it imposes the obligation to have its financial statements audited.

COMMUNITY SCHEMES OMBUD SERVICE ACT 9 OF 2011

Section 38 read together with 39(1)(d) of the Community Schemes Ombud Service Act 9 of 2011 states that, in the event of a dispute, a party or affected person can make an application for an order requiring the association or scheme to have its accounts, or accounts for a specified period, audited by an auditor.

Save for body corporates established in terms of the Sectional Titles Act, it appears that there is no strict obligation on property associations to have their annual financial statements audited, we do recommend that from a "*good governance*", transparency and reputational standing, that property association do elect to have their annual financial statements audited.

SAMANTHA KELLY

Are property associations automatically exempt in terms of Section 10 of the Income Tax Act?

Both residential and commercial developments are on the rise in South Africa. Owners (and sometimes tenants) of these estates and developments, are generally obliged to become members of a "*property owners association*". Members of the association are bound by the rules that govern it, to manage and regulate such developments. Generally, the payment of levies by members are required to upkeep and maintain the estate/development. As such, the number of property associations being formed to manage such estates and developments are vastly increasing.

Section 10(1)(e)(i)(aa) of the Income Tax Act 58 of 1962 (ITA) provides that any levy received by or accrued to a body corporate established in terms of the Sectional Titles Act 95 of 1986 from its members is exempt from income tax. Section 10(1)(e)(i)(bb) states similarly in relation to share block companies.

In the case of body corporates and share block companies, the general view is that the exemptions apply automatically given the wording in sections 10(1)(e)(i)(aa) and (bb). Paragraph 5.1 of SARS' Interpretation Note 64 (Issue 4) (IN64) corroborates this "*automatic exemption*" and states as follows:

> *"A body corporate or share block company is not required to apply for exemption under section 10(1)(e)(i)(aa) or (bb) respectively. These entities are not registered at the TEU for income tax, but are required to register at a branch office and submit annual income tax returns even if they are unlikely to have an income tax liability. The levy income exemption and the basic exemption are applied on assessment."*

Accordingly, to the extent that a property association is not a body corporate established in terms of the Sectional Titles Act 95 of 1986, it can be asserted that this automatic exemption does not apply to such property association. The question then arises as to whether this exemption automatically extends to property associations.

Section 10(1)(e)(cc) of the ITA provides that "*associations of persons*" shall be exempt from normal tax as contemplated below:

> "*(e)(i) any levy received by or accrued to—*
>
> (cc) *any other association of persons (other than a company as defined in the Companies Act, any co-operative, close corporation, and trust, but including a non-profit company as defined in that Act) from its members, <u>where the Commissioner is satisfied</u> that, subject to such conditions as he or she may deem necessary, such association of persons—*
>
> (A) *has been formed solely for purposes of managing the collective interests common to all its members, which includes expenditure applicable to the common immovable property of such members and the collection of levies for which such members are liable; and*
>
> (B) *is not permitted to distribute any of its funds to any person other than a similar association of persons:*
>
> *Provided that such body, company or association is or was not knowingly a party to, or does not knowingly permit or has not knowingly permitted, itself to be used as part of any transaction, operation or scheme of which the sole or main purpose is or was the reduction, postponement or avoidance of liability for any tax, duty or levy which, but for such transaction, operation or scheme, would have been or would become payable by any*

Are property associations automatically exempt in terms of Section 10 of the Income Tax Act?

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> *person under this Act or any other law administered by the Commissioner; and*
>
> (ii) *any receipts and accruals other than levies derived by a body corporate, share block company or association contemplated in subparagraph (i), to the extent that the aggregate of those receipts and accruals does not exceed R50 000;*" [Our underlining]

Most property associations would fall within these provisions to the extent that they are established to manage the collective interests of their members, which members pay levies for purposes of expenditure applicable to common immovable property. It should be noted that Section 10(1)(e)(i)(cc) of the ITA is worded differently in the sense that it provides that the "*Commissioner must be satisfied*" that certain requirements have been met for the relevant exemption to apply. It is not entirely clear whether these words require an upfront application to SARS or whether an alternative approval mechanism is envisaged. This is particularly the case when one compares the wording in section 10(1)(e)(i)(cc) to the wording used in section 30 of the ITA which explicitly refers to an "*approval process*" in the case of public benefit organisations.

Nevertheless, SARS' is of the view that "*associations of persons*" contemplated in section 10(1)(e)(i)(cc) of the ITA must first apply to SARS to obtain approval in relation to being exempt from normal income tax under that section. Paragraph 5.2 of IN64 thus states as follows:

> "*An association of persons must lodge an application with the Commissioner at the TEU to qualify for exemption from income tax under section 10(1)(e)(i)(cc)… It will be determined on application whether the [relevant] requirements have been met. Additional conditions may be prescribed to ensure that the above requirements are met.*"

Accordingly, a property association is not automatically exempt from income tax on its levies received (as is the case with a body corporate). While there is some debate, SARS' view is that these associations must first apply to SARS to obtain approval for the exemption under the relevant section of the ITA.

In order to apply to SARS for income tax exemption in terms of section 10(1)(e)(i)(cc), the property association will be required to complete and submit an EI1 "*Application for Exemption from Income Tax application*" form to SARS, together with supporting documents including the founding documents of the property association (i.e. its memorandum of incorporation or its constitution). IN64 states that the following should be included in the founding document:

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- the sole object of the association of persons must be to manage the collective interests common to all its members, which includes expenditure applicable to the common immovable property and the collection of levies for which such members are liable;
- the association of persons is not permitted to distribute its funds to any person other than to a similar association of persons;
- any amendments to the founding document of the association of persons must be submitted to the Commissioner;
- on dissolution of the association of persons, its remaining assets must be distributed to a similar association of persons that is also exempt from income tax under section 10(1)(e).

It is critical that property associations are compliant with section 10(1)(e)(i)(cc) of the ITA should they want to apply for the exemption. Furthermore, property associations that have not applied for tax exemption would be well advised to seek advice to consider their circumstances and regularise their tax affairs (if necessary).

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