# Tax & Exchange Control

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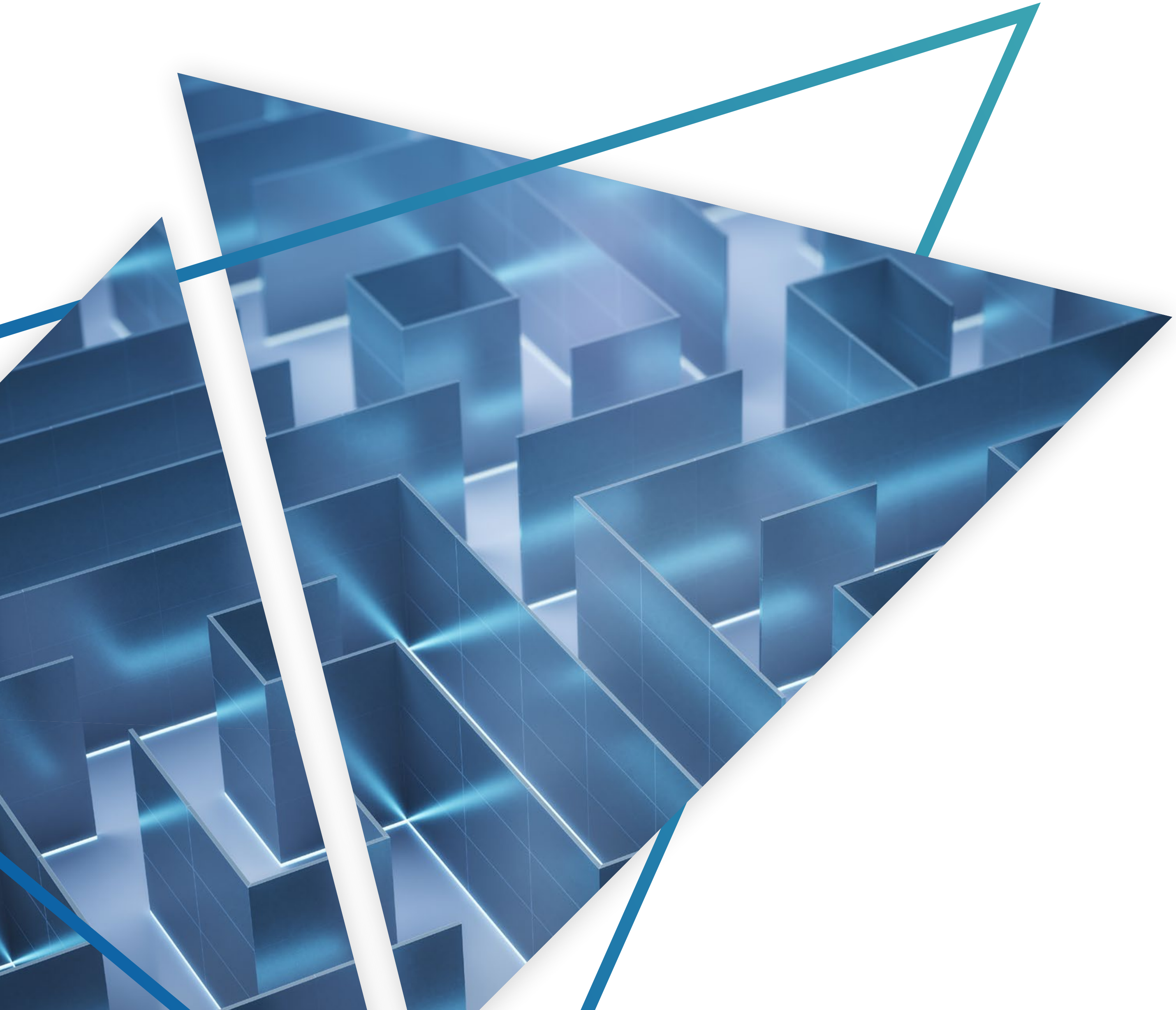

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SOUTH AFRICA

Avoiding unexpected tax liabilities in property investment

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# Avoiding unexpected tax liabilities in property investment


**Property investment is a popular topic of discussion, often accompanied by various anecdotes, tips, and cautionary tales. However, while the potential for profit is frequently emphasised, the importance of tax implications is often overlooked. This article explores some of the different property investment options available in South Africa, their associated tax treatment, and common pitfalls to avoid.**

## Purchasing property for rental income

Purchasing property with the intention of renting it out is a well-established strategy. The rental income generated from such properties is considered income for purposes of South African income tax and must be declared on the taxpayer's return.

It is noteworthy that the law permits the deduction of expenses related to the property, such as bond interest, municipal rates, insurance, and maintenance costs. Proper record-keeping is essential to substantiate these deductions and mitigate the tax burden.

The net amount will be subject to income tax at a maximum rate of 45% for individuals, a flat rate of 45% for trusts, and a flat rate of 27% for companies.

## Property flipping

For those who prefer not to manage rental properties, flipping properties may be a more suitable option. This involves purchasing a property, potentially renovating it, and selling it for a profit. It is important to note that profits from property flipping are generally classified as trading income rather than capital gains, resulting in taxation at the individual's marginal tax rate, which is higher than the capital gains tax rate.

Things to keep in mind are that property transfers are subject to transfer duty, payable by the transferee, or alternatively value-added tax (VAT), ultimately charged to the purchaser, where the seller either registers voluntary or makes sufficient taxable supplies to become liable to register as a vendor for VAT purposes.

## Long-term capital growth

Investors who adopt a long-term approach may benefit from purchasing property and holding it for an extended period to achieve capital growth. Upon the sale of the property, capital gains tax (CGT) will apply to the extent that there is a profit. In South Africa, up to 40% of the capital gain is included in an individual's taxable income, which is then subject to income tax at the tax rate applicable to the individual (maximum 45%). Individuals may benefit from a R2 million exclusion to the extent that the property constitutes a primary residence.

For companies, the inclusion rate is 80%, subject to income tax at 27%.

# Avoiding unexpected tax liabilities in property investment

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Again, transfer duty will generally apply (charged to the transferee), unless the seller is a VAT vendor and the property relates to its enterprise, in which case VAT would apply, ultimately charged to the purchaser.

## Real estate investment trusts (REITs)

REITs offer an alternative means of investing in property without the need to own physical real estate. By acquiring shares in these publicly traded entities, investors gain exposure to income-generating properties. REITs are required to distribute at least 75% of their taxable income to shareholders as dividends, which are taxed at the investor's applicable income tax rate. Dividends tax does not apply.

REITs provide liquidity, diversification and a lower capital requirement compared to direct property ownership. However, market fluctuations and the performance of underlying properties can impact share prices and dividend yields. Accurate reporting of dividends to the South African Revenue Service (SARS) is essential to avoid penalties.

## Property ownership via legal entities

How one chooses to invest in property is a crucial consideration, as the decision can significantly impact tax liabilities and estate planning outcomes. Some investors opt to purchase property through a company or trust for purposes such as estate planning, limited liability, or tax efficiency. Rental income earned by a company is taxed at 27%, and 80% of capital gains are included in taxable income. Trusts, on the other hand, are taxed at 45% (also with an 80% capital gain inclusion rate), but with strategic estate planning, amounts can be distributed to beneficiaries in lower tax brackets. While this approach may offer benefits, it requires careful consideration and consultation with a tax advisor to determine its suitability for the specific investor's objectives.

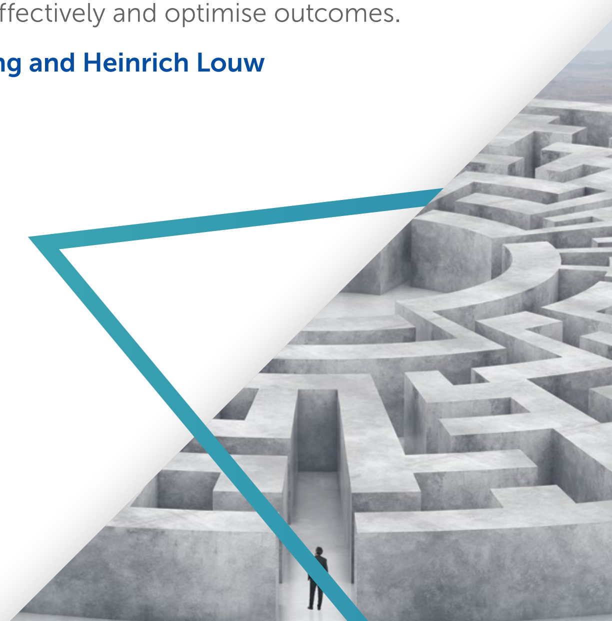
## Common tax pitfalls to avoid

While property investment can be highly appealing as a wealth-building strategy, novice investors should be vigilant about potential tax mistakes that could expose them to liability. Common errors include failing to declare rental income, overestimating deductions, and neglecting to account for tax when selling a property. Proper documentation and adherence to tax laws are crucial to avoid audits, penalties, and interest from SARS.

## Conclusion

While this article highlights key aspects of property investment and taxation in South Africa, it only scratches the surface of this complex interplay. Other critical elements, such as transfer duty, VAT, and specific deductions available for different trades or investment types involving property, must be considered. The specific tax consequences will largely depend on the investor's intention and goals, and the investment strategy ultimately chosen. Seeking professional advice is essential to navigate these intricacies effectively and optimise outcomes.

**Puleng Mothabeng and Heinrich Louw**



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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.

**PLEASE NOTE**


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