

SARS land tax ruling shock for developers

Analysts warn that companies having to pay hefty tax bill on property sales could retard the development of land

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Published: 2011/05/31 06:42:22 AM

COMPANIES selling unused land will now have to pay tax on the proceeds, which the South African Revenue Service (SARS) regards as income.

Paying a hefty tax bill on such sales could retard the development of land, property and tax analysts warned yesterday.

They said a landmark judgment delivered earlier this month by the Supreme Court of Appeal would have profound tax consequences for landowners and property developers.

The Supreme Court of Appeal ruled against chemicals company AECI, which had formed an asset realisation company, Founders Hill, to develop and sell its land.

Founders Hill sold a large portion of land in Modderfontein, Johannesburg, for housing purposes. SARS taxed the proceeds of the sale as income.

The judgment overturns longstanding principles in the income tax laws where the proceeds of property sales were regarded as capital in nature and not taxed.

Property economist Erwin Rode said the judgment could have a long-term effect on the property sector and retard development of land because of the scarcity of funding.

Francois Viruly, of the University of Cape Town's department of construction economics and management, said: "Developers have always been aware of the risk of turning the proceeds of the sale of an asset into income. This is what happens when a developer crosses the Rubicon."

Prof Viruly said the judgment would have an effect on companies planning to embark on large-scale projects that involved selling land and property.

David Green, MD of Pace Property Group, said the effect of the judgment was that there was no point in companies forming realisation companies in future. "The judgment certainly takes away the motivation."

Johan Troskie, a director at audit, accounting, tax and advisory firm Mazars, said the appeal court had overturned longstanding principles in income tax law. "The court has destroyed any case put forward by taxpayers that a realisation company was formed to sell property for a capital amount," he said.

AECI said yesterday it was "evaluating its options". Having lost its appeal against a Tax Court decision, its only recourse now was the Constitutional Court.

Acting on legal advice, AECI formed Founders Hill in 1993, to which the Modderfontein properties were sold with the intention of reselling them for housing.

In the Tax Court, SARS contended that Founders Hill had changed its intention and "crossed the Rubicon". It had started to trade in the land it had acquired from AECI — and those profits were therefore income.

The Tax Court found in Founders Hill's favour, holding the company had not crossed the Rubicon. SARS subsequently took the matter to the Supreme Court of Appeal, which held that a company that acquired assets for the purpose of selling them had traded in those assets.

Mr Troskie said: "What the court said is that the use of a realisation company will ensure that the proceeds of a sale are capital in nature in limited circumstances, for instance where they are owned by different people, or where there is a need to protect assets from the original holder."

Tim Desmond, a partner in the tax and commercial department at law firm Garlicke & Bousfield, said the judgment would affect legal advisers' approach to realisation companies.

"It was widely thought that the case law established a general rule that allowed for realisation companies," he said.