



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

The Tax Policy Unit, National Treasury of South Africa and the South African Revenue Service is carrying out a study to inform government policy on the economic, administrative and legislative implications resulting from the interaction between the VAT, Transfer Duty and Stamp Duty Acts and to explore possible alternatives to address the complications that arose from the interaction between these three Acts.

Your comments are kindly invited on the following:

- the administrative, compliance or any other problems being experienced with the various taxes on the fixed property transactions in South Africa, and particularly the interaction between the VAT Act and the Transfer Duty Act, and proposals to eliminate or minimise these problems; and
- proposals for alternative approaches to the interrelationship between current taxes on immovable properties and the appropriateness, effectiveness and efficiency of such alternative approaches.

Please submit your comments to Erwin Obermeyer at erwin.obermeyer@treasury.gov.za by 29 February 2008

The terms of reference for this study is listed below.

TERMS OF REFERENCE

The consultancy will assist with an analysis of the nexus between the VAT Act, Transfer Duty Act and Stamp Duties.

Introduction

The consultancy must:

- Evaluate the economic impact, administrative and compliance implications of the various types of taxes on the property sector in South Africa, in particular but not limited to immovable property;
- Focus in particular on the nexus between VAT Act, Transfer Duty Act and Stamp Duties;
- Explore the possibility of de-linking the VAT Act and the Transfer Duty Act;
- Analyse the appropriateness, effectiveness and efficiency of alternative approaches to the interrelationship between current taxes on immovable properties;
- Raise pertinent issues with regard to the nexus between the VAT Act, Transfer Duty Act and Stamp Duties on immovable properties and propose alternative design options; and
- Explore the possibility of designing the Transfer Duty Act as a source of revenue for municipalities to be collected by SARS but revenue earmarked for the particular municipality.

The consultative process and report must be completed by end-March 2008.

2. Background

Transfer Duties on the acquisition of fixed property, together with Stamp Duties, have been on the statute books since early in the previous century. These indirect taxes are some of the earliest form of transaction taxes in South Africa. With the introduction of VAT in 1991, concerns arose that the imposition of VAT and Transfer Duties / Stamp Duties on the same transactions would result in double taxation.

Provisions were therefore created in the VAT Act and Transfer Duty Act to legally impose only one of these taxes on any given transaction. Stamp duties are presently imposed on leases (both residential and commercial) and the sale of unlisted shares:

- Where the supply of fixed property is subject to VAT, no Transfer Duty is imposed;
- Where the supply of fixed property is subject to Transfer Duty, no VAT is imposed. However, a registered VAT vendor purchasing a property that is subject to transfer duties may claim a notional input VAT, limited to the transfer duty payable; and
- Where the supply of a share in a share block company is subject to VAT, Stamp Duty is not imposed.

Assuming there is merit in the attempt to try and prevent or limit the incidence of “double” taxation, in some instances the current dispensation has resulted not only in preventing “double” taxation, but in eliminating the tax in total on certain property transactions that were previously subject to Transfer Duty. The economic consequences of these provisions therefore appear to contradict their intention.

Current application of VAT and Transfer Duty to fixed property transactions:

- The standard VAT rate of 14 per cent applies to the supply of fixed property by registered VAT vendors.
- Transfer Duties payable by natural persons (since 1 March 2006):

Property value	Transfer Duty
R0 – R500 000	0%
R500 001 – R1 000 000	5% on the value above R500 000
R1 000 001 and above	R25 000 plus 8% on the value above R1 000 000

- Properties acquired by a person other than a natural person (e.g. incorporated companies), trusts and deceased and insolvent estates are subject to Transfer Duty at a flat rate of 8 per cent.
- In vendor to vendor property transactions, only VAT is payable and a VAT input tax credit is claimed. No VAT or Transfer Duty burden therefore remains.
- In vendor to non-vendor property transactions, only VAT is payable and no VAT input tax credit is claimed. The VAT burden therefore remains, but no Transfer Duty burden exists.
- In non-vendor to non-vendor property transactions, Transfer Duty is payable and no VAT is imposed. The Transfer Duty burden therefore remains, but no VAT burden exists.
- In non-vendor to vendor property transactions, Transfer Duty is payable and a notional VAT input tax credit is claimed by the vendor equal to the tax fraction (14/114) times the lesser of the purchase price or the real value of the property. As an anti-avoidance provision, the notional VAT input credit is limited to the amount of transfer duty paid. No Transfer Duty burden therefore remains, but a notional VAT burden may persist to the extent that the VAT tax fraction exceeds the allowable notional VAT input tax credit.
- In instances where no transfer duties are payable, i.e. properties with a value below R500 000 a registered VAT vendor cannot claim a notional input VAT credit.

3. Scope of Work

The main objective of this consultancy is to inform government policy on the economic, administrative and legislative implications resulting from the interaction between VAT, Transfer Duties and Stamp Duties on property and to recommend alternative approaches. In addition to the main tasks described in section 1 above, the consultants would be expected to investigate and provide advice on the following issues and options:

Foreclosures:

The limitation on the notional VAT input tax credit on second-hand properties to the Transfer Duty paid causes a disparity for financial institutions acquiring properties on foreclosure, with the extra cost being passed on to the defaulting debtor.

Notional input VAT:

The notional VAT input tax credit for vendors is limited to the Transfer Duty paid, but the ordinary rule for notional input VAT in the case of second hand goods, i.e. the tax fraction (14/114), might dictate a higher amount. Also, no notional VAT input tax credit may be claimed by vendors in respect of properties below R500 000 because no Transfer Duty was paid, yet VAT was initially paid on this property.

Assuming the nexus between the VAT Act and the Transfer Duty Act is retained the anti-avoidance measure of restricting the allowable VAT input tax credit to the Transfer Duty paid appears to be problematic. An alternative anti-avoidance mechanism should be explored

Time of supply:

A vendor purchasing fixed property from another vendor as a going concern must pay the VAT liability in full before the Deeds Office would be authorized to process the transaction. Yet the purchasing vendor may only claim a notional VAT input tax credit equal to the VAT tax fraction (14/114) at the time of the VAT payment. The complete VAT input tax credit may only be claimed when the purchase price is eventually paid in full.

The consultants should explore the use of a bank guarantee to cover the output VAT liability, requiring the buyer to discharge the guarantee before handing over the final payment of the purchase price. The actual payment of the VAT liability would therefore be postponed until final payment of the purchase price, thereby resolving the cash flow problems of the current practice.

Temporary leasing:

When residential property is temporarily let pending the ultimate sale thereof, it constitutes an exempt supply. Output VAT becomes payable the moment the property is let, although it has not been disposed of.

De-link VAT and Transfer Duty:

Both VAT and Transfer Duty could be imposed on all fixed property transactions. VAT and Transfer Duty may be imposed on the same value, with transfer duty being deductible for income tax purposes when property is acquired for business purposes. Under this approach, the implications are:

- When purchasing from registered VAT vendors buyers would be liable for both VAT and transfer duty. This will necessitate a reduction in the current transfer duty rates for both natural and juristic persons;
- Transfer duty would always be payable and will not be rebated through the VAT system as a notional input VAT;
- When buying from non-vendors only transfer duty will be payable;

- When a registered VAT vendor purchase from a non vendor only transfer duty will be payable. However, given that this property was initially subject to VAT (when purchased from a VAT vendor, usually the first time – when the property was new) the principle of a notional input should apply.

4. Deliverables

The final report should provide the following:

- A detailed analysis of taxation in the South African real estate sector;
- Where possible, a review of international ‘best practices’ in both developed and developing countries;
- A description of alternative options and arrangements for the design and administration of VAT, Transfer Duties and Stamp Duties in the South African real estate sector;
- Advice and recommendations on the economic, political and administrative merits of alternative options; and
- Advice and recommendations on the design and implementation of these options.