A BASIC UNDERSTANDING OF ASSET FOR SHARE TRANSACTIONS

Section 42 of the Income Tax Act 58 of 1962 (hereinafter referred to as “The Act”) makes provision for roll-over relief in the case of an asset for share transaction. An asset for share transaction is essentially a transaction in terms of which a Transferor disposes of an asset at base cost to a resident company in exchange for the issuing of equity shares by the Company.

The reason why one would consider making use of this mechanism as supposed to transferring an asset in the conventional manner, would be to delay immediate tax implications of such transfer and to avoid transfer duty (in terms of Section 9(15A) of the Transfer Duty Act 40 of 1949), or in other words to transfer an asset in a tax neutral manner. A good example of where this mechanism might be beneficial, would be where immovable property is to be transferred from a trust. The effective Capital Gains Tax rate for a trust (36%) is comparatively high in relation to the effective Capital Gains Tax rate of a company (22.4%).

For illustrative purposes, consider the following example:

In 1999 Savvy Trust (an ordinary trust) acquired an immovable property (which they held as a capital asset) for R10 000 000. In 2022 Savvy Trust decides that it wants to sell the property, which is now worth R20 000 000. If Savvy Trust elects to sell the property in the conventional manner, they would be subject to the effective Capital Gains Tax for trusts of 36%. This would result in a tax implication of R3 600 000 for the trust and approximately R2 400 000 in transfer duty for the purchaser. If Savvy Trust elected to make use of the asset for share transaction as provided for in terms of the Act, Savvy Trust can dispose of the property to a resident company, Company X (Pty) Ltd (hereinafter referred to as “Company X”) at the base cost of R10 000 000 in exchange for the issuing of equity shares in Company X to the value of the property. Seeing as the property is being disposed at base cost, there is no gain or loss and thus no Capital Gains Tax is payable at this point.

Another example of how it could be beneficial for a client to make use of the asset for share transaction, would be where the client holds an immovable property in their own name and elects to sell/move the property to a company that is also owned by the client. In the above example it could be beneficial for a few different reasons. One of these reasons would be if the client is wanting to move the property into another vehicle by reason of longevity in estate planning. In this manner, the property can be moved into another vehicle and one can circumvent the difficulty of transferring the property to family members from the deceased’s estate in the future. The client can do same, without having to pay Capital Gains Tax, seeing as the property is deemed to be sold at base cost, as explained above and additionally, the company will be exempt from paying transfer duty (also explained above). Furthermore, depending on what tax bracket the client personally falls under, the income generated by the property may be taxed in a lower tax bracket if it is held by a company (28%), than when it is held by an individual (who’s income can be taxed at a rate as high as 45%). If the property was held as an income generating property (rental property), it needs to still be held as an asset of the same nature (an income generating property/rental property). By moving the property...
into the company, they will be able to pay less income tax in a lower tax bracket on the income generated from the property, than what would have been payable if the client owned the property in his/her own name (in the case where the client personally earns a total income that place them in a higher tax bracket than that of a company).

However, there are several requirements that need to be met for the Section 42 relief to be implemented. A few important ones to keep in mind are the following. The shares may not be sold within 18 months of acquiring them in what would be considered as a buy-back (there is more intricate details regarding this requirement, which will not be discussed for this articles purposes). The asset that is disposed of must retain its nature, it must be disposed of to a resident company and the market value of the asset that is being disposed of must be equal to or exceed the base cost of the asset. Furthermore, the issued shares must qualify as equity shares and the transferor must hold a qualifying interest in the company at the close of day of the asset for share transaction.

The above is merely a brief overview of an asset for share transaction and in practice it is much more complex. There are many variations that appear in practice, and it is important to consider each individual transaction to establish whether an asset for share transaction would be favourable in the specific circumstances, seeing as it will not always be the best option.