TAXATION IMPLICATIONS ARISING FROM SOUTH AFRICAN RESIDENTS OWNING OR HAVING A TAX INTEREST IN FIXED PROPERTY IN GREECE

by

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ABSTRACT

South African residents who own or have financed fixed property in Greece have to comply with the Income Tax and Estate Duty Acts in South Africa, as well as the relevant taxation laws in Greece. An amnesty in terms of the Exchange Control and Amendment of Taxation Laws Act gave South Africans with fixed property in Greece an opportunity to voluntarily declare their fixed properties and to regularise their foreign assets and tax affairs without the fear of criminal or civil prosecution.

These residents are subject to the formalities of the various forms of taxation in both South Africa and Greece. The practical application of the various taxation provisions is extremely complex and difficult to identify and understand, and all too often affected residents are not even aware that they apply to them. The consequences of non-compliance can be extremely severe for resident taxpayers.

A detailed case study, being a flexible research strategy, has been combined with an extended literary review to formalise the research design of this study. The case study used was not randomly selected but was identified from a sample of 20 Greek families (78 respondents) resident in South Africa and involved a typical “extended” family of Greek descent resident in South Africa who owned or had a tax interest in fixed property in Greece.

There are three crucial factors that are the cornerstone of this study and are the initial determining factors that must be considered when identifying the taxation and estate duty implications of owning or having a “tax interest” in fixed property in Greece. They also have a significant impact on the future planning opportunities that may exist and are as follows:

- The problem starts and finishes with the definition of “resident” and it is imperative to firstly determine whether a taxpayer is in fact “resident” for the purposes of taxation and estate duty in South Africa.
- Once it has been determined that a person is resident for taxation one needs to ascertain whether the taxpayer owns fixed property directly or has a “tax interest” in fixed property situated in Greece.
- Finally, it is essential to determine how the fixed property or interest in the fixed property was acquired.

South African resident taxpayers (being non-residents in Greece) are heavily taxed on their gross rental proceeds in Greece owing to the non-deductibility of expenses. The limitation of credits in South Africa on income tax paid in Greece on rentals from Greek fixed property leads to the effective tax rate in South Africa being substantially higher than the maximum marginal rate of taxation.

There is also a risk of double taxation on donations and the risk of paying as much as double the estate duty rate in South Africa on Greek fixed property. The limitation of

credits in South Africa on estate duty paid in Greece on Greek fixed property leads to an effective estate duty rate in South Africa that is substantially higher than 20%. However, there are exemptions and deductions for donations tax and estate duty that apply to fixed property in Greece and there are planning opportunities for reducing taxation and estate duty in both South Africa and Greece. Non-disclosure of fixed property held in Greece can have far-reaching implications for South African residents, with SARS having extremely effective sections allowing them to raise estimated assessments on non-conforming or ignorant taxpayers.

The aim of this study is to investigate and identify the various forms of taxation that affect fixed-property ownership by a South African resident in South Africa and to a lesser extent Greece, and then provide a focused and detailed analysis of the relevant legislation in both countries. It will present flowchart summaries of all the relevant aspects set out in a simple and precise format with links back to the relevant paragraphs in the body of the document. This study also provides suggestions for the application of this research to affected residents in order to avoid double taxation.

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CHAPTER 1

INTRODUCTION, BACKGROUND AND DEMARCATION OF THE STUDY

1.1 INTRODUCTION

Many South Africans of Greek descent have inherited fixed properties in Greece from their parents or grandparents or have acquired fixed properties themselves (Adendorff, 2004). Alternatively, many residents may have a “tax interest” in fixed property in Greece having financed the purchase of the fixed property by a relative or non-resident entity by way of an interest-free loan or donation.

The amnesty in terms of the Exchange Control and Amendment of Taxation Laws Act (South Africa, 2003a) gave South Africans an opportunity to voluntarily declare their foreign assets and to regularise their foreign asset and tax affairs without the fear of criminal or civil prosecution (Korten, Erasmus & Bezuidenhout, 2003; National Treasury, 2006). In addition, declarations made in terms of exchange control circular No. D405 (South African Reserve Bank, 2003) allowed residents who had received foreign inheritances prior to 17 March 1998 and immigrants who possessed foreign assets and who had not declared these to the Reserve Bank to regularise their affairs without the need to apply for exchange control relief in terms of the amnesty (South Africa, 2003a). In his budget speech in February 2006, the Minister of Finance, Trevor Manuel,

confirmed that the amnesty unit had completed the adjudication of all the applications and that 42 184 had been approved (National Treasury, 2006).

A total of R68,6 billion worth of foreign assets has been disclosed under the amnesty process (National Treasury, 2006). Approximately 70% of these disclosed assets were illegal while approximately 30% were legal or legalised through the Reserve Bank (National Treasury, 2006). It is estimated that the income tax base has been increased by an estimated R1,4 billion which, according to the South African Revenue Services (SARS), is likely to increase the collection of personal income taxes by an estimated R400 million per annum (National Treasury, 2006). SARS and the Reserve Bank will also be able to update their records on the basis of the assets and information disclosed (Korten et al., 2003).

The Greek Embassy in Pretoria reports that 400 000 Greeks hold South African passports (Adendorff, 2004:133). However, the estimate given in 2007 by the Greek Consulate in Cape Town of approximately 45 000 Greeks in South Africa appears to be more accurate (Adendorff, 2004). Many of these Greeks have strong ties with Greece and may have taken advantage of the amnesty and disclosed their assets held in Greece.

These residents now find themselves subject to the formalities of the various forms of taxation in both tax jurisdictions. The detailed interpretation and practical application of

the various taxation provisions relating to foreign income and assets is extremely complex (Clegg & Stretch, 2007; Loubser, 2007:96–97). Huxham and Haupt (2007: 292-349) devote an entire chapter to the taxation of foreign income and capital, as do Clegg and Stretch (2007).

For the years of assessment commencing on or after 1 January 2001, a person who is a South African resident is subject to tax on his worldwide income in South Africa (Huxham & Haupt, 2007:293; Stretch, Silke & Zulman, 2007; Loubser, 2007:96). However, in many instances this general principle may be varied by the provisions of a double taxation agreement that avoids the double taxation of income in South Africa and the foreign country (Huxham & Haupt, 2007).

South Africa has entered into a double taxation agreement with the Hellenic Republic (Greece) (South Africa, 2003b). The objective of this agreement is the avoidance of double taxation, the prevention of fiscal evasion and the exchange of information (Clegg & Stretch, 2007). However, even with the double taxation agreement in place, there is still a real risk of double taxation as certain taxes such as estate duty, donations tax and transactional taxes such as value added tax/general sales tax and transfer/stamp duty are generally not included in double taxation agreements (Huxham & Haupt, 2007:343). In addition, South Africa does not have a double taxation agreement covering estate duty with Greece (Scholtz, 2005:195–220; Meyerowitz, 2007; LexisNexis Butterworths, editorial staff, 2007).

The deeming (of income) provisions contained in section 7(8) of the Income Tax Act (South Africa, 1962) and the attribution rules (capital gains tax) contained in the Eighth Schedule of the Income Tax Act (South Africa, 1962), together with the transfer pricing provisions set out in section 31(2) of the Income Tax Act (South Africa, 1962), have far-reaching consequences for many unsuspecting South African residents owning or having a tax interest in fixed property in Greece (Mitchell, 2005a:16–18). Add to this the fact that there have been numerous amendments and changes to the relevant provisions of the Income Tax Act relating to the taxation of foreign assets and income and that this is likely to continue for a few more years (Clegg & Smith, 2003:70–72; Kolitz, 2006:12–14).

Broombers (2002:10–11) sums up the situation of the changing laws very aptly as follows: “The secret is to change the law so often and so fast that tax practitioners can’t catch up and this is what has been happening in South Africa in the past few years.”

Income tax is payable on rental income in both countries with a tax credit allowed in South Africa for any tax paid in Greece. This relief from double taxation is contained in section 6*quat* of the Income Tax Act (South Africa, 1962). However, the rebate relief will not be granted in addition to any relief provided under a double tax treaty as referred to above (Clegg & Stretch, 2007). In this regard Huxham and Haupt (2007:325) are of the opinion that the taxpayer has the choice of either double tax treaty relief or section 6*quat* of the Income Tax Act (South Africa, 1962) relief. SARS Interpretation Note No. 18 (Department of Finance, 2003.) supports this view. Even if double taxation is

avoided, there is also the situation that relief provided in terms of the Income Tax Act (South Africa, 1962), or via the double taxation agreement (South Africa, 2003b), is effectively ring-fenced in South Africa making the effective tax rate in South Africa equivalent to the higher rate paid in Greece (Wilson, 2005:8).

Besides the general disclosure obligations for foreign income there are numerous other disclosure formalities that need to accompany the annual tax return (South Africa, 1962). An example of this is contained in section 7(10) of the Income Tax Act (South Africa, 1962), which requires residents to disclose any donation, settlement or other disposition contemplated in section 7(8) of the Income Tax Act (South Africa, 1962), and non-compliance with these disclosure requirements can lead to additional tax assessments and even criminal sanctions (Mitchell, 2005a:16–18). Therefore, a "casual" loan to a family member in Greece to purchase a fixed property could have far-reaching taxation consequences for the South African resident.

Section 78 of the Income Tax Act (South Africa, 1962) allows SARS to estimate an amount of income, or capital gain, on any foreign assets held by a South African resident who fails to disclose the fact that he holds a foreign asset, or fails to declare income or capital gains, from a foreign asset held. Interpretation Note No. 23 (Department of Finance, 2004) has been issued by SARS to provide guidance on the application of the provisions of section 78(1A), (1B) and (1C) of the Income Tax Act (South Africa, 1962). It follows that section 78 of the Income Tax Act (South Africa, 1962) is specifically aimed at ensuring compliance and providing a strong incentive for

taxpayers to make full disclosure of their offshore assets and income in their returns of income. Amnesty (South Africa, 2003a) applicants must accept that SARS will be given a copy of declarations and accordingly will have details of all foreign assets held, which will make section 78 of the Income Tax Act (South Africa, 1962) easy to apply should taxpayers fail to disclose these assets or foreign income from these assets in subsequent tax returns.

Estate duty can become payable on fixed property by a deceased estate in both South Africa and Greece (South Africa, 1955; Taliaki, 2007; Tsakiraki, 2007). Should these assets have been inherited or donated from a non-resident, or acquired before one becomes a resident, estate duty exemptions in terms of section 4(e) of the Estate Duty Act (South Africa, 1955) could apply, as do certain donations tax exemptions in terms of section 56(1)(g) of the Income Tax Act (South Africa, 1962). Stein (2004a; 2004b:95-96) agrees, but does warn that there are significant differences between the concessions that apply to the two taxes. However, should the fixed property have been purchased by the resident or inherited from a South African resident, estate duty is payable both in South Africa and in Greece where the asset is situated (Stein, 2004a; Meyerowitz, 2007). A credit, in terms of section 16(c) of the Estate Duty Act (South Africa, 1955), is allowed in South Africa on any death duty payable in Greece with certain limitations (Stein, 2004a).

It goes without saying that taxation and estate duty problems are not limited to South Africa (Price Waterhouse Coopers, 2006; Tripidakis, 2006; Taliaki, 2007).

In order to identify taxation implications in Greece, a case study of a Greek family resident in South Africa and owning fixed property in Greece, acquired by various means, was undertaken. From this it was found that a natural person owning fixed property in Greece would not be able to deduct the normal operating expenses associated with rental income (Taliaki, 2007). This results in the owner being subject to tax in Greece on gross rental income. Real estate tax (property), inheritance tax (estate duty), parental donations tax, income tax and additional tax all have an effect on the owning of fixed property in Greece (Tripidakis, 2006; Tsakiraki, 2007; Taliaki, 2007). In addition, there may also be a 3% special tax on the objective value of fixed property payable annually in certain circumstances (Price Waterhouse Coopers, 2006; Taliaki, 2007).

In addition, as trusts are not recognised by Greek law and no relevant legal distinction exists between the trustee and the beneficiary, estate planning in Greece can be very complex and difficult to achieve (Taliaki, 2003; 2007). Capital gains tax, transfer taxes, land registry fees, notary public fees and attorneys' compulsory fees, together with a capital duty on share capital can make the transfer of fixed property to Greek companies extremely expensive (Price Waterhouse Coopers, 2006; Taliaki, 2007). However, there are taxation benefits to owning fixed property in a company in Greece, which in turn paves the way for estate planning in Greece (Taliaki, 2007).

1.2 AIMS OF THE RESEARCH

Accepting that South African residents owning fixed property in Greece have taxation and estate duty obligations in both South Africa and Greece, the aim of this study is to investigate, in detail, the impact this has on the South African resident in South Africa, and to identify the various forms of taxation that affect fixed property ownership in Greece. Associated subproblems are identified and possible solutions to these problems investigated.

In order to investigate the main problem and subproblems, the aim of this study is to

- identify and explain all the relevant sections of the Income Tax Act (South Africa, 1962) in South Africa and to explore their impact on the resident
- identify and explain all the relevant sections of the Estate Duty Act (South Africa, 1955) in South Africa and to explore their impact on the resident
- investigate the shortcomings of the tax relief provided by the double taxation agreement (South Africa, 2003b) and section 6*quat* of the Income Tax Act (South Africa, 1962)
- identify donations tax exemptions in South Africa and explore how these can be used
- explain the impact on a South African resident having a tax interest in fixed property in Greece

- explain the importance of ensuring that South African residents are tax compliant and aware of their taxation obligations and the consequences of non-disclosure
- explain the significance of determining how the fixed property in Greece was acquired by the South African resident
- identify the various forms of taxation in Greece that have an impact on owning fixed property there
- identify possible solutions to problems and identify planning opportunities
- identify areas of future research

1.3 DELINEATION AND LIMITATIONS

According to Spits (2005:62–63) there has been a massive increase in the use of non-resident trusts over the past 30 years, and while non-resident trusts are an integral part of estate planning and are used extensively by South African residents, section 7 of the Income Tax Act (South Africa, 1962) applicable to trusts, section 25B of the Income Tax Act (South Africa, 1962) and other relevant sections specifically affecting the taxation of trusts are not addressed in this study. This is due to the fact that trusts are not recognised in Greece making it not legally possible to own a fixed property registered in Greece through the medium of a trust (Taliaki, 2007).

Accordingly, the effects of the election in terms of section 4(1) of the Exchange Control and Amendment of Taxation Laws Act 2003 regarding previously donated assets to a discretionary off-shore trust have not been addressed. The election of this section resulted in the foreign asset owned in the trust being deemed to be held by the electing

party affecting his taxation obligation in South Africa on income and capital gains (South Africa, 2003c; South Africa, 2003d; Mitchell, 2005b:40–41).

In addition, only a limited study of the taxation impact in Greece was undertaken, as the main focus of this study is the taxation and estate duty impact on a South African resident in South Africa. However, to really appreciate the impact in South Africa, and to provide possible planning opportunities, an understanding of the various forms of taxation affecting fixed property ownership in Greece is required. Accordingly, chapter 4 is limited to identifying the different forms of taxation that affect the ownership of fixed property in Greece and the way it impacts on the South African resident.

The content of chapter 4 as it relates to Greece is limited to information obtained from the researcher's investigation and participation in the case study detailed in chapter 2.

As this research deals with individuals (not companies) owning fixed property in Greece, the implications of section 9D of the Income Tax Act (South Africa, 1962) as it relates to foreign companies owning fixed property is not covered. While the use of a company to own fixed property in Greece is discussed briefly during this research, this only forms part of the suggested recommendations and possible solutions to problems identified in Greece.

This study takes into account the relevant legislation in place up to and including 30 September 2007.

1.4 RESEARCH METHOD

An actual case study, being a flexible research strategy, has been combined with an extended literary review (Hofstee, 2006) to formalise the research design of this study.

As set out above, the detailed interpretation and practical application of the various taxation provisions relating to owning or having a tax interest in fixed property in Greece are extremely complex. There have also been numerous amendments and changes to the relevant provisions of the various Acts relating to the taxation of foreign assets and income. For these reasons, an extended literary review of the relevant sections of the Income Tax Act (South Africa, 1962), which includes capital gains and donations tax, the Estate Duty Act (South Africa, 1955) in South Africa and the double taxation agreement (South Africa, 2003b) with the Hellenic States (Greece), SARS practice notes and a detailed study of accepted authority manuals, textbooks and journals was undertaken.

In addition, an investigation conducted by means of a case study on the general taxation and estate/death duty implications of owing fixed property in Greece has also been undertaken.

Procedure – South Africa

Every section of the Income Tax Act (South Africa, 1962) was analysed to identify sections that might be applicable to the research topic. Once identified, these were then

listed in table format with the specific wording of the sections reproduced. The same approach was adopted with the Estate Duty Act (South Africa, 1955).

A detailed investigation of related textbooks, journals, periodicals, authority manuals and websites was carried out and then reviewed for relevant sections and articles on and interpretations of the topic of this study. Once identified these were tabulated into various subsections with their relevant sources. The SARS website was also visited regularly, as were other websites of academic institutions, accounting and legal firms. In addition to the primary sources, that is, the Income Tax Act (South Africa, 1962), the Estate Duty Act (South Africa, 1955) and the double taxation agreement (South Africa, 2003b), SARS interpretation and practice notes, and secondary sources including leading textbooks, journals and publications were studied. The comments of Professor Haupt (2004) and Professor Morris (2004), taken from interviews conducted with them on exchange control, taxation and estate duty, have also been used and noted. The case study was used to identify specific taxation obligations in Greece and the impact they have on taxation in South Africa.

Procedure – Greece

Owing to language constraints and the fact that the main focus of this study was taxation and estate duty implications in South Africa, the majority of the data as they relate to Greece were obtained from the case study. In addition, websites of leading accounting and legal firms in Greece and relevant documentation available in English were consulted. Information was obtained from professional practitioners in the field of

taxation in Greece appointed to provide advice, input and solutions to relevant aspects of the case study. Aspects mentioned in chapter 4 have been cross-referenced with at least two other sources independent from the data obtained from the case study. In addition the chapter was, once complete, kindly checked by Julia Taliaki to ensure that its contents were accurate and up to date in terms of Greek tax law. Julia Taliaki is a highly respected attorney at law (specialising in taxation) and a member of the International Tax Planning Association in Athens, Greece.

Case study

According to Flyvbjerg (2006:229), the generalisability of case studies can be increased by the strategic selection of cases. When the object is to achieve the greatest amount of information on a given problem or phenomenon, a representative case or random sample may not be an appropriate strategy, as a typical or average case does not normally provide the most information. Extreme or complex cases often reveal more information as they can provide more exposure to the problem being studied (Flyvbjerg, 2006).

With this in mind the case study used in this study was not randomly selected but was identified from a sample of 20 Greek families (78 respondents) resident in South Africa. In order to find a suitable case study, the members of these families were interviewed to determine the extent of their knowledge on the topic of this study and its effect on them specifically. All 20 families interviewed had fixed property or a tax interest in fixed property in Greece. One of the families interviewed, which had many fixed properties in

Greece acquired by various means and was committed to addressing the complex taxation implications in both South Africa and Greece, was then chosen as the case study.

As the purpose of this research is to investigate the taxation and estate duty implications for South African residents owning fixed property in Greece, the affected residents' perceptions, understandings and specific experiences had to be examined and a specific case study identified. However, Greeks are very secretive, especially when it comes to matters concerning family business and tax (Adendorff, 2004).

Although Robson's (2002:273–274) general advice for interviewers was helpful, the researcher initially found it difficult to get respondents to cooperate. However, by sharing ideas and explaining different scenarios and experiences and the possible consequences of non-compliance, the researcher managed to gain their confidence. This resulted in respondents developing an interest in this research, which the researcher believes to have been the key to their eventual willingness to be interviewed. The attitude then changed from scepticism to a willingness to cooperate, and very often more information was volunteered than was asked for. Through their participation the respondents realised that the researcher could help them identify problems and provide them with possible solutions and that the research results could eventually be of benefit to them.

Data collection procedures

Data collection techniques for this research included participant observation, unstructured and in-depth interviews with family members of the case study and their professional advisors in South Africa and Greece, and document analysis. In essence, gaining access is the key to any research (Adendorff, 2004). Without the level of access and information gained from the case study, an understanding on the researcher's part of the taxation implications in Greece would not have been possible. The researcher's access to data resulted from his background and his relationship with the subjects of the case study and the sampling was therefore aimed at providing the researcher with the level of access needed for the depth of data required.

Through the assistance of the professional advisors (lawyers, accountants and tax consultants) of the subjects of the case study, the researcher gained access to and obtained data which proved vital for this research and for an understanding of the taxation and death duty implications in Greece, as well as for identifying possible solutions.

Using interviews for data collection

To obtain the relevant data required on the taxation and death duty implications in Greece, interviews were conducted with the identified respondents (affected residents) and their professional advisors in Greece. Such data is usually collected by means of semi-structured or unstructured interviewing (Robson, 2002:197; Welman, Kruger & Mitchell, 2005:278).

Personal interviews had to be conducted, as personal contact between the researcher and the subjects was the only way the researcher could have the sort of access needed to collect the in-depth data required for this research. As King (1994:14) writes, “it [the qualitative research interview] is capable of producing data of great depth”. According to Robson (2002), semi-structured and unstructured interviews are widely used in flexible qualitative designs and he quotes King (1994) as referring to them as qualitative research interviews.

The type of interview chosen for this study was determined according to the nature of the research question(s) asked. Based on King’s (1994:17) arguments, a structured open-response interview approach was used for the initial interviews for the following reasons:

- A quick, descriptive account of the topic was required that did not include formal hypothesis testing.
- Factual information was to be collected, but there was uncertainty about what and how much information the participants would be able to provide.
- The nature and range of participants’ opinions about the research topic were not known in advance, and could not be easily quantified.

After conducting a number of test interviews, the researcher began to understand the type of data responses that he would be dealing with and the depth of the data that could be obtained. This called for a revision of the type of interviews conducted, as a

structured open-response interview approach had its weaknesses when it came to analysis: the lack of structure meant that it was not suitable for quantitative analysis, and its lack of flexibility meant that qualitative approaches might not be suitable either (King, 1994). With that in mind, and having gained a better understanding of both the data and the research area from the initial interviews, the researcher decided that the qualitative research interview would be more appropriate for this research.

With the information generated from the initial interviews, a more comprehensive interview guide was created consisting of a series of questions that was to be covered in interviews. The order in which the questions and topics was covered varied from interview to interview, as it was the researcher's deliberate intention to use an unstructured approach in order to maximise the amount of data collected from the interviewees.

Conducting interviews

King (1994:19) indicates that "there are three sources for topics to be included in an interview guide: the research literature; the interviewer's own personal knowledge and experience of the area; and informal preliminary work such as unstructured discussions with people who have personal experience of the research area".

The researcher's interview guide comprised all three of these sources, and was developed and constantly changed after the initial interviews in order to maximise its effectiveness in collecting the maximum depth of data available. All interviews were

conducted in complete privacy, with only the interviewees (respondent and relevant professional advisor) and the researcher present. During the first encounter the interviewee would be briefed about the area and purpose of the research. At any stage the interviewee could ask questions about the research area or about any ambiguity in the researcher's questioning. The interviews usually lasted between one to three hours and no recording devices were used except for a notepad.

Most subjects were interviewed at least twice during the course of the initial data collection process, and after each interview the entire interview would be noted within 36 hours. Once the data from the initial interviews had been collected and analysed, many follow-up telephonic interviews were conducted and emails written, with email being used extensively owing to its convenience in data recording and in overcoming the fact that many interviewees were resident in Greece. In excess of 50 one-on-one interviews were conducted in South Africa and Greece with over 200 telephonic and email follow-ups over a period of three years.

Reliability and validity

In order to ensure validity in this research as relates to the taxation and death duty implications in Greece, the following measures were taken when interviewing tax practitioners in Greece:

- Interviews were conducted with at least two professionals specialising in taxation in Greece. This enabled the researcher to check the data collected for any misinterpretation.
- Interviewees were interviewed at least twice and in some cases many more times. After each interview, the transcripts of the interview, or questionnaires, would be returned to the interviewee to ensure that the data collected were valid. In nearly all cases emails were used extensively.
- Interviewees would be asked for further interpretations or explanations of phrases or words taken from previous transcripts of interviews. This would take place at any stage of the research, but mainly during analysis. This avoided the possibility of misinterpreting the terminology used by the interviewees.
- In the event of a contradiction in the data between interviews, or between interviewees, further interviews were conducted to clarify the situation.
- The findings of this research, as they relate to the taxation impact in Greece set out in chapter 4 of this study, were forwarded to interviewees for verification of the accuracy of their content.

As is usual with interviews, an overwhelming amount of information was generated from the transcripts, which was then processed. This entailed converting the notes made during the interviews into write-ups, which were read, edited for accuracy, commented on and analysed (Welman et al., 2005).

1.5 THE ACADEMIC VALUE AND PRACTICAL RELEVANCE

Academic value

This study will provide a *focused and detailed* analysis of all the relevant sections of the Income Tax Act (South Africa, 1962) and the Estate Duty Act (South Africa, 1955) in South Africa that affect a resident holding fixed property in Greece. It explores the impact these sections have in South Africa and the significance and resulting consequences of a resident having a tax interest in fixed property in Greece. It addresses the importance and resulting benefits of establishing how the fixed property in Greece was acquired and identifies various shortcomings, ambiguities and areas of future research related to the problem of this study.

A limited investigation of the taxation implications in Greece is undertaken but in sufficient detail to show how both tax jurisdictions can impact on the holding of fixed property and how important an understanding of both tax jurisdictions is.

Universities and students may use this study for further research in similar areas (assets classes) or other foreign countries.

This study may also assist other researchers to identify new research areas.

Practical relevance

This study will assist South African residents holding fixed property in Greece

- to identify and then understand their problems as they relate to taxation and estate duty in both South Africa and Greece
- to remain tax compliant with both SARS and the Greek authorities
- to limit their exposure to interest, penalties and prosecution, and reduce the real possibility of overpaying tax
- by providing taxation and estate planning opportunities

Tax practitioners, tax lawyers, accountants and other professionals in the financial planning profession would be able to benefit, firstly, by having these problems brought to their attention (especially from a Greek point of view) in a detailed and concise manner and, secondly, this research might provide solutions for their clients.

Thirdly, this study may be of benefit to SARS by identifying some of the South African taxation problems that may need to be addressed and help it to understand the problems when South African residents have fixed property in Greece. It might also assist SARS in developing guidelines for its staff (assessors and auditors).

1.6 CHAPTER OVERVIEW

Chapter 1 comprises an introduction and general discussion relating to the taxation and estate duty implications for a South African resident owning, or having a tax interest in, fixed property in Greece. It sets out the problems being researched and what this study aims to achieve. It defines the limitations of the study, and the academic value and practical relevance of conducting this research.

Chapter 2 provides specifics of the case study used during this research. It provides a background of the family, their fixed property in Greece, how their fixed property was acquired and how it was financed. It describes the problem areas that were addressed in both South Africa and Greece.

Chapter 3 provides a detailed explanation of the taxation and estate duty implications in South Africa and explores the impact they have on South African residents owning or having a tax interest in fixed property in Greece. This chapter also provides specific examples and explains the importance of key terms such as “resident” and “tax interest”. The chapter concludes with flowchart summaries (figs 4 & 5) of all the relevant aspects set out in a simple, concise format with links back to the relevant paragraphs in the body of the document for more detail.

Chapter 4 discusses the various forms of taxation that affect the ownership and transfer of fixed property in Greece by a South African resident. Inheritance (estate duty) and gift (donations) tax are also addressed, as are the different tax treatments when properties are owned by non-resident and resident individuals. The taxation benefits of companies resident in Greece are also briefly discussed. The chapter concludes with flowchart summaries (figs 9 & 10) of all the relevant aspects set out in a simple, concise format with links back to the relevant paragraphs in the body of the document for more detail.

Chapter 5 presents the results and research findings of this study. It analyses the results and provides a general discussion and the planning opportunities which, if implemented, could reduce the taxation and estate duty payable on property in both South Africa and Greece.

The final chapter of this study, chapter 6, summarises the research, offers conclusions and considers the impact of the study. It makes recommendations for affected South African residents and government agencies (policymakers) and suggests areas for future research.

1.7 CONCLUSION

The focus of this chapter has been to provide an overall summary of the research topic setting out the reasons for the study, the aim of the research, its academic value and practical relevance. The chapter concluded with a short overview of the chapters in this study.

Chapter 2 will set out the specifics of the case study used during this research and provides some background on the family making up the case study. It details the way in which their fixed property in Greece was acquired and financed and describes the problem areas that were addressed in both South Africa and Greece.

CHAPTER 2

SPECIFICS OF THE CASE STUDY

2.1 BACKGROUND

The case study used as part of this research involved a typical extended family of Greek descent resident in South Africa who owned, either directly or indirectly, fixed property in Greece.

The family that comprised the case study consisted of two siblings who had been born in South Africa from Greek immigrant parents, their children, their cousin, an uncle and some close family and friends. The siblings inherited fixed property from their grandparents who had lived in Greece their entire lives. Some of the family referred to in the case study move between South Africa and Greece regularly and have homes in both countries.

The members of this family have held some of these properties for many years oblivious to the fact that they may have been contravening both exchange control legislation and the Income Tax Act and unaware of the pending estate duty obligations in South Africa and Greece.

2.2 DETAILS OF THE FAMILY

The family comprises the following:

- the deceased grandparents, who lived in Greece their entire lives and left various properties to their two grandchildren
- the grandchildren, two brothers who inherited property from their grandparents. They were born in South Africa and have lived here all their life. They are described as sibling A and sibling B in this study.
- the parents of the siblings, described in this study as either the father or mother of the siblings
- a cousin of the siblings
- an uncle of the siblings
- close family and friends resident in both South Africa and Greece

Sibling A holds the following properties:

1. a commercial property in Athens
2. a substantial office block in Athens owned jointly with sibling B
3. agricultural farmlands owned jointly with sibling B
4. residential properties owned jointly with sibling B in Athens and let out permanently
5. a residential home on one of the islands used as a holiday home by the sibling and his direct family and occasionally let out to family and friends

Properties listed as nos. 2, 3 and 4 were inherited from his grandfather and the residential home listed as no. 5 was acquired from the proceeds of the properties inherited. The commercial property listed as no. 1 was bought with South African funds.

Sibling B holds the following properties:

1. a substantial office block in Athens owned jointly with sibling A
2. agricultural farmlands owned jointly with sibling A
3. residential properties owned jointly with sibling A in Athens and let out permanently
4. a residential home on one of the islands used as a holiday home by the sibling and his direct family and occasionally let out to family and friends (This is not the same property as the one owned by sibling A.)

Properties listed as nos. 1, 2 and 3 were inherited from his grandfather and the residential home listed as no. 4 was acquired with the proceeds of the properties inherited.

The father of the siblings owns an olive grove on one of the islands in Greece. This was purchased in December 2001 at a cost of €112 200 and sold in January 2007 for €200 000.

The siblings' mother made a donation of €2 000 and advanced a gratuitous loan of €100 000 to a close family member resident in Greece. These facts were disclosed to SARS. The family member in Greece then used these funds to purchase a fixed

property in Greece and was not prepared to provide details of the property or what income was earned.

The siblings' cousin, a South African resident, lent €200 000 to a family member resident in Greece in 2004, who used the funds to buy an income-producing fixed property in Greece. No interest was charged on the loan. The family member earned rental income for a few years on the property and then sold the property and made a handsome capital gain.

The siblings' uncle, who has lived in Greece his entire life, donated fixed property to his child, hereafter referred to as child A, who is resident in South Africa. Child A took advantage of the amnesty and declared the fixed property he received from his father.

Many friends and some extended family members resident in South Africa and Greece, who have acquired fixed property in Greece by various means, have donated some of their fixed properties to the next generation (children or grandchildren) as part of what appears to be a popular estate planning technique in Greece used to take advantage of certain tax-free donations (gifts) allowed in Greece.

2.3 PROCEDURE

Interviews were held with the family to identify the specific assets held and to establish by whom and how and when they were acquired. Their professional advisors both in South Africa and Greece were consulted. It was found that some of these assets were

indeed held in contravention of exchange controls and that in certain cases the income had not been declared for income tax purposes in South Africa. The properties had, however, been disclosed to the relevant tax authorities in Greece and the income was declared by means of annual tax returns.

Advice was taken on how these assets could be regularised from an exchange control and taxation point of view in South Africa. As a result, the relevant family members took advantage of the amnesty (South Africa, 2003a) and made D405 declarations (South African Reserve Bank, 2003) on certain of the inherited properties. This entailed completing and submitting the relevant amnesty applications to the Amnesty Unit and making written declarations of the market value of the foreign fixed property inherited in Greece through their bank in South Africa. Once their amnesty applications and declarations had been approved by the Amnesty Unit, their fixed properties in Greece were regularised from an exchange control point of view and any taxation transgressions were also covered by the amnesty. A levy was payable on some assets but on certain of the inherited properties no levy was payable at all.

Once the amnesty process was finalised, the family had to ensure that these assets were declared on all subsequent tax returns and that all income was declared to the South African tax authorities as required in terms of the Income Tax Act (South Africa, 1962). It was also important to ensure that all the disclosures and other formalities were adhered to and that they clearly understood how the relevant sections of the Income Tax Act (South Africa, 1962) and the Estate Duty Act (South Africa, 1955) affected

them. At the same time the family embarked on an income tax and estate planning exercise so as to limit their exposure to double taxation in South Africa and Greece and to lay a platform for perpetual succession and asset protection of their properties in Greece.

The small business tax amnesty (South Africa, 2006b) was also taken by various family members.

The holding of fixed property in Greece has far-reaching taxation and estate duty implications for all the members of the family in both South Africa and Greece. Aspects of the case study are used to explain some of these implications discussed in chapter 3 and chapter 4.

2.4 IMPLICATIONS IN SOUTH AFRICA

With some family members constantly moving between South Africa and Greece it was imperative to determine who complied with the definition of “resident” for taxation purposes in South Africa. This turned out to be a very complex exercise. However, once this had been established all the family who were “resident” in South Africa had to declare their rental income earned on the fixed property they owned in Greece. In addition, a detailed understanding of all the relevant legislation was imperative, including the taxation implications of ring-fencing, currency conversions, capital gains and losses on disposals and the relevant relief from double taxation. Disclosure

obligations and possible relief in terms of the small business tax amnesty were also relevant.

Donations tax on any foreign donations and estate duty on fixed property on death were also applicable. However, the way in which these impacted on the family differed vastly depending on how the assets were acquired.

The cousin who had loaned money to a relative in Greece to acquire fixed property had his own set of problems. These emanated from the interest-free loan he had made and the subsequent tax interest he had in the fixed property owned by the relative in Greece. The complex deeming provisions of section 7 resulted in him having to make an income declaration in South Africa and the attribution rules applicable to any capital gains were also relevant.

The impact that taxation and estate duty has had on the various members of the family in South Africa will be discussed in detail in chapter 3 of this study.

2.5 IMPLICATIONS IN GREECE

The family had disclosed the properties in Greece to the Greek taxation authorities and had paid tax on all rentals earned. These taxation obligations covered normal income tax, additional tax, real estate tax, municipal real estate duty and capital gains.

With the family having embarked on an estate planning exercise, the full extent of all the taxation obligations in Greece was investigated. This was done firstly to ensure that their declarations in Greece were correct and secondly to identify planning and restructuring opportunities.

A good understanding of all the different forms of taxation was necessary to establish how and when the relevant taxes could impact on any restructure. Taxes such as real estate and municipal transfer tax, inheritance and gift tax had to be investigated. Tax attorneys, accountants and other relevant specialists were consulted in Greece who made representations to the family and provided detailed information on all the taxation aspects of holding fixed property in Greece. Recommendations for restructuring the family's holdings in Greece in order to reduce taxation and death duty were also made.

These tax specialists not only provided details of the various forms of taxation applicable to fixed property in Greece, but also elucidated the advantages of using Greek companies and the difficulties associated with forming trusts in Greece.

This aspect (Greece) of the case study was extremely useful to the researcher as it helped provide a lot of detail on the taxation and death duty implications in Greece. The impact that taxation and estate duty has had on the various members of the family in Greece will be discussed in detail in chapter 4 of this study.

2.6 INTERESTING FACTS THAT EMERGED WHEN IDENTIFYING THE CASE STUDY

After interviewing 20 Greek families (respondents) in order to identify the case study, the following interesting facts emerged:

- More than half had taken advantage of the exchange control and tax amnesty (South Africa, 2003a). Many via the D405 declaration on foreign inheritances.
- Most families interviewed had unintentionally transgressed, in some way or other, South African taxation laws.
- Many were not aware of the extent of their taxation and estate duty obligations in South Africa, or the complexity of these obligations.
- None were aware of the impact that the definition of “resident” in the Income Tax Act (South Africa, 1962) had on their taxation obligations in South Africa.
- Fourteen families had inherited fixed property or other assets held in Greece from a non-resident family member.
- None understood the importance of identifying the way in which they acquired their fixed property in Greece.
- Five families had a least one family member who moved between South Africa and Greece regularly and considered themselves resident in South Africa for tax purposes but considered Greece their home.
- Nine families had made loans to a family member in or other residents of Greece and none of those nine families had the slightest idea that they had created a tax interest in Greece resulting in significant taxation consequences in South Africa.

- Most seemed to be more aware of their obligations in Greece than in South Africa.
- Many had embarked on estate planning techniques in Greece without considering the taxation and estate duty consequences in South Africa.

It is therefore clear that most of those interviewed had a very limited idea of the taxation and estate duty implications of owning or having a tax interest in fixed property in Greece, which gave the researcher some indication of how little affected South African residents know about this aspect of their taxation and estate duty obligations.

2.7 CONCLUSION

The focus of this chapter has been to give details of the case study used during this research and describe the problem areas that were addressed in both South Africa and Greece. In addition, it provided some background on the family making up the case study and gave details of the way their fixed property was acquired and financed. It also listed some interesting findings emanating from the interviews conducted to identify the specific case study used.

The next chapter will identify the relevant sections of the Income Tax Act (South Africa, 1962) and the Estate Duty Act (South Africa, 1955) in South Africa that impact on the holding of fixed property in Greece by a South African resident. It sets out each section in detail and provides relevant interpretations, discussions and explanations.

CHAPTER 3

TAXATION AND ESTATE DUTY IMPLICATIONS IN SOUTH AFRICA

3.1 INTRODUCTION

The income tax system in South Africa has changed from a source-based to a residence-based system of taxation (Stretch et al., 2007; Huxham & Haupt, 2007) with effect from years of assessment commencing on or after 1 January 2001. The amendments to the Income Tax Act (South Africa, 1962) that followed had the effect that South African residents are, except for certain exclusions and exemptions, subject to income tax on their worldwide income, that is, income earned or deemed to be earned within and outside South Africa (Stretch et al., 2007).

Accordingly, South African *residents* are liable for taxation in South Africa on any rental income earned or deemed to be earned from fixed property situated in Greece. In addition, in terms of section 54 of the Income Tax Act (South Africa, 1962), donations tax is payable by *residents* on any donation of fixed property. In addition, in terms of section 3 of the Estate Duty Act (South Africa, 1955), estate duty is applicable on all fixed property owned by all natural persons *ordinarily resident* in South Africa. It therefore, firstly, becomes imperative to determine whether a taxpayer is in fact

"resident" for taxation purposes in South Africa. Once this has been determined one needs, secondly, to ascertain whether the taxpayer owns fixed property in Greece directly in his or her name or has a tax interest in fixed property in Greece. Finally, it is essential to determine how the fixed property or interest in the fixed property was acquired.

These three requirements make up the cornerstone of this study, as they determine how taxation and estate duty will impact on owning fixed property in Greece and what estate and tax planning opportunities may exist.

3.1.1 Chapter outline

This chapter starts with a detailed investigation into what constitutes a resident for taxation purposes in South Africa. Once the definition of resident has been discussed, the chapter will identify and discuss the relevant sections of the Income Tax Act (South Africa, 1962) that become applicable when a South African resident owns fixed property in Greece. This includes the taxation implications on capital gains on disposal of the property or death of the taxpayer. We will then investigate the complex deeming provisions of the Income Tax Act that apply when fixed property owned in Greece by a non-resident was donated or financed by an interest-free loan from a resident.

The various donations tax exemptions and the estate duty ramifications of owning fixed property on death will then be addressed, followed by the consequences of non-

disclosure. The recent small business tax amnesty and its relevance will also be addressed. Finally, this chapter ends with flowchart summaries of all the relevant aspects set out simply and concisely showing the links to the relevant paragraphs in the body of the document for more detail (figs 3 & 4).

3.2 DEFINITION OF RESIDENT

3.2.1 General discussion

Although most family members in this case study were resident in South Africa, it became evident that they were unaware of the importance of understanding exactly what is meant by resident from a taxation point of view. Some family members visited Greece regularly, owned homes there and had plans for spending more time there in the future. Others were investigating the possibility of moving to Greece permanently.

From the case study it is evident that South Africans of Greek origin need to be very aware of what constitutes a resident in South Africa for taxation purposes as this will have a profound effect on their taxation and estate duty liability in South Africa. Many Greeks may consider themselves to be Greek nationals and may be paying tax in Greece on fixed property and, as such, be of the opinion that they have no South African taxation obligations. However, they may very well be considered resident in South Africa for taxation purposes by the authorities here and may be unaware of their obligations in such cases. In addition, many Greeks move between South Africa and Greece on a regular basis and this could also result in them becoming resident in South

Africa for taxation purposes or alternatively could result in them having “emigrated” from South Africa from a tax point of view resulting in severe tax consequences.

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According to Clegg and Stretch (2007), for the first 87 years of its existence, South African income tax legislation contained no definition of resident; the term “ordinarily resident” (adopted from legislation in the United Kingdom) was used in the case of individuals and artificial persons other than companies (Clegg & Stretch, 2007). However, consequent to the introduction of the residence basis of taxation with effect from years of assessment commencing in 2001, a definition of “resident” was introduced into the Income Tax Act (South Africa, 1962) (Huxham & Haupt, 2007:14; Stretch et al., 2007). The definition of “gross income” in section 1 of the Income Tax Act (South Africa, 1962) was also amended to include a reference to the word “resident” (Clegg & Stretch, 2007).

“*Resident*” is defined in section1 of the Income Tax Act (South Africa, 1962), as follows:

> *“resident” means any—*
>
> *(a) natural person who is—*
>
> *(i) ordinarily resident in the Republic; or*
>
> *(ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic—*
>
> > *(aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding*

91 days in aggregate during each of the five years of assessment preceding such year of assessment; and

(bb) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment,

in which case that person will be a resident with effect from the first day of that relevant year of assessment: Provided that—

(A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a "port of entry" as contemplated in section 9 (1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act; and

(B) where a person who is a resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic; or

(b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic,

> *but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation;*

Two tests are applicable for determining whether or not a person is a resident of South Africa: the *ordinarily resident test* and *physical presence test* (Mazansky, 2005:35; Department of Finance, 2006a; Stretch et al., 2007; Clegg & Stretch, 2007)**.**

It is important to note that both residence tests are subject to the proviso set out at the end of the definition of resident referred to above. This has the effect that, if the person concerned is to be treated exclusively as a resident of Greece for the purposes of the double taxation agreement between Greece and South Africa, then that person will also be treated as a non-resident in South Africa for the purposes of all the provisions of the Income Tax Act (Huxham & Haupt, 2007).

3.2.2 The ordinarily resident test

The Income Tax Act (South Africa, 1962) does not define the term “ordinarily resident” and there is limited authority in our law on its meaning (Huxham & Haupt, 2007:295). The interpretation given by the courts must therefore be followed (Stretch et al., 2007). In addition, Interpretation Note No. 3 (Department of Finance, 2002) was released by SARS specifically to assist with determining what constitutes “ordinarily resident”.

The term “ordinarily resident” is considered to have a somewhat narrower meaning than the word “resident” (in its undefined sense) (Clegg & Stretch, 2007). The question as to whether a person is ordinarily resident in the Republic is therefore a question of fact, which must be answered according to the circumstances of each individual case (Clegg & Stretch, 2007).

It is important to note that the ordinarily resident test in the definition of resident applies regardless of how many days in the tax year a person is in the Republic. In other words, ordinarily resident is not determined by physical presence, but it is in effect a state of mind (Huxham & Haupt, 2007:295). A person who is ordinarily resident in South Africa in terms of the principles set out below is a resident even though he may not be physically present in the Republic for the required number of days (Huxham & Haupt, 2007:295; Stein, 2007:21).

The courts have interpreted this concept to mean the country to which a person would naturally and as a matter of course return from his or her wanderings (Stretch et al., 2007). It might therefore be called a person’s usual or principal residence and it would be described more aptly, in comparison with other countries, as the person’s real home (Stretch et al., 2007). The above approach was followed in the case Cohen v CIR (13 SATC 362), and confirmed in the case CIR v Kuttel (1992 (3) SA 242, 54 SATC 298).

If a person has been physically absent from South Africa during a year of assessment, it does not mean that he is not ordinarily resident in South Africa, even if he has been

absent and living in, say, Greece throughout that year. It is the character in which a person is physically present in a country that is the determining factor. A physical presence in a country must be combined with continuity which would exclude any element of chance (Clegg & Stretch, 2007). Although the question is always whether or not a person was ordinarily resident in the Republic during a particular year of assessment, this does not mean that his actions during that year of assessment alone should be taken into account in determining his ordinary residence (Cohen v CIR, 13 SATC 362).

According to Jooste (2006:159), a person can be ordinarily resident in a country that he was absent from throughout the year of assessment. Stein (2007:2.1) supports this view. The question whether a person is ordinarily resident in South Africa does not depend solely upon his actions during a particular year. An investigation of his lifestyle before, or even after, the year of assessment may be necessary to reach a conclusion (Jooste, 2006).

The fact that a person owns a home in Greece which they occupy from time to time may indicate that they are ordinarily resident in that country, but it is not necessarily conclusive proof of this (Robinson v COT, 1917 TPD 542, 32 SATC 41). Similarly, it is not essential for an individual to have an establishment in a country to characterise his physical presence as “residence” in the ordinary sense of the word (H v COT, 1960 (2) SA 69 (SR), 23 SATC 292).

Can a person be ordinarily resident in more than one country at the same time? The answer to this question is of great importance to this study, because if a person can be ordinarily resident in only one country, the fact that he is ordinarily resident in Greece would mean that he is not ordinarily resident in South Africa (Clegg & Stretch, 2007). This question was raised, but not decided, in Cohen v CIR (13 SATC 362). At the time, Schreiner JA was of the view that the precise meaning to be given to the word "ordinarily" is linked to the question of whether a man can be "ordinarily resident" in more than one country:

> If, though a man may be "resident" in more than one country at a time, he can only be "ordinarily resident" in one, it would be natural to interpret "ordinarily" by reference to the country of his most fixed or settled residence … But his ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings, as contrasted with other lands it might be called his usual or principal residence and would be described more aptly than other countries as his real home. If this suggested meaning were given to "ordinarily" it would not, I think, be logically permissible to hold that a person could be "ordinarily resident" in more than one country at the same time."

These comments suggest that a person can only have one real home and in CIR v Kuttel (1992 (3) SA 242, 54 SATC 298) the above formulation of Schreiner JA was quoted with approval by the Appellate Division (Stretch et al., 2007).

The court held in CIR v Kuttel (1992 (3) SA 242, 54 SATC 298) that a person is ordinarily resident where he has his usual or principal residence, that is, what may be described as his real home. Accordingly, if a taxpayer's real home is in Greece, he cannot be said to be ordinarily resident in South Africa even if he visits South Africa on a regular basis (Stretch et al., 2007).

The guide issued by SARS, *Residence basis for taxation of individuals* (Department of Finance, 2006b), sets out a nice summary of what the courts have held in ascribing a meaning to the concept "ordinarily resident". It states that the person must be living in the country with some degree of continuity and his living in that country must be part of his regular and ordinary course of life with a degree of permanence and he must be regarded as ordinarily resident. It is a residence that is settled, not temporary, and the place where his personal belongings are kept. It is the place where the person normally resides and the place to which he regularly returns after his absences.

It is frequently said that a person's domicile is the place to which he would return to die, despite the fact that he might have been resident in another place for many years (Clegg & Stretch, 2007). It is considered, however, that the "wanderings" referred to in Cohen are not the long-term absences that might occur in the context of domicile – rather, they are short-term absences, typically driven by business or vacation (Clegg & Stretch, 2007). Clegg (2004:118) agrees, stating that in his view the wanderings that Schreiner JA referred to in Cohen v CIR (13 SATC 362) would generally be of relatively short-term duration, perhaps measured in weeks, months or a few years. Thus, it may

be relevant when an individual has homes in both South Africa and Greece and whose pattern of life generally makes it difficult to determine in which territory he is ordinarily resident, to ascertain whether he departs on short-term holidays from his South African or Greek home (Clegg & Stretch, 2007).

Interpretation Note No. 3 (Department of Finance, 2002) was released by SARS specifically to assist with determining what constitutes “ordinarily resident” and confirms that a physical presence at all times is not a prerequisite to be ordinarily resident in South Africa.

Interpretation Note No. 3 (Department of Finance, 2002) cites the following two requirements that need to be present:

- an intention to become ordinarily resident in a country
- steps indicative of this intention having been or being carried out

The note goes on to state that it is not possible to lay down any clearly defined rule or period to determine ordinarily resident, confirming that a natural person may be resident in South Africa even if that person was not physically present in South Africa during the relevant year of assessment. The purpose, nature and intention of the taxpayer’s absence must be established to determine whether the taxpayer is still ordinarily resident.

The interpretation note lists the following factors as being relevant when considering the two requirements above and states that the list is not intended to be exhaustive or specific – merely a guideline – and that the circumstances of the person must be examined as a whole, and the personal acts of the individual must receive special attention:

- most fixed and settled place of residence
- habitual abode, that is, present habits and mode of life
- place of business and personal interests
- status of individual in country, that is, immigrant, work permit periods and conditions
- location of personal belongings
- nationality
- family and social relations (schools, church, etc)
- political, cultural or other activities
- application for permanent residence
- period abroad
- purpose and nature of visits
- frequency of and reasons for visits

Domicile and residence are completely different concepts, although certain tests may be used in establishing both. A person's domicile (whether of origin or of choice) can be changed only by, among other things, definite intent to cut ties with the country concerned in favour of another country: this means that there must be a clear intent to relocate one's allegiances on a permanent basis (Clegg, 2004:118). A natural person who becomes ordinarily resident in South Africa will become a resident as from a

specific date. That date will be the date on which they become ordinarily resident in South Africa. A continuous physical presence is not a prerequisite for being ordinarily resident in South Africa (Department of Finance, 2006a; Clegg & Stretch, 2007).

3.2.3 The physical presence test

If a natural person is not ordinarily resident in South Africa for the purposes of taxation as set out above, then the physical presence test is applied to determine whether a natural person is a resident in South Africa (Mazansky, 2005:35; Department of Finance, 2006a; Stretch et al., 2007).

The physical presence test is dealt with by SARS in Interpretation Note No. 3. (Department of Finance, 2002) and issue 3 of Interpretation Note No. 4 (Department of Finance, 2006a) incorporating the amendments (2005) to the days' presence test. In addition to the interpretation notes, SARS general guide, *Residence basis for taxation of individuals* (4th edition) (Department of Finance, 2006b) states that the physical presence test, also known as the day test or time rule, is based on the number of days during which a natural person is physically present in South Africa (Mazansky, 2005:35; Stretch et al., 2007).

According to SARS (Department of Finance, 2006b), the application of the physical presence test must be done annually and consists of three requirements. These are that the person must be physically present in the Republic for a period or periods exceeding

(i) 91 days in aggregate during the year of assessment under consideration

(ii) 91 days in aggregate during each of the five (previously three) years of assessment preceding the year of assessment under consideration and

(iii) 915 days (previously 549) in aggregate during the five (previously three) proceeding years of assessment

A natural person has to meet all three requirements before they become a resident (Clegg & Stretch, 2007). The purpose of their presence in South Africa is irrelevant and a day is counted irrespective of the purpose or nature of the visit or presence in the Republic (Stretch et al., 2007). It is important to note that the days' presence test was extended from 1 March 2005 from three to five years (Mazansky, 2005:35; Stretch et al., 2007).

A natural person's year of assessment starts on 1 March and ends on the last day of February in the subsequent year. According to the definition of "resident" in the Income Tax Act (South Africa, 1962), a day includes a part of a day. According to Stretch et al. (2007) a day begins at 00:00 and both the day of arrival and departure are included in the count. Therefore, a person who arrives in South Africa at 23:55 would be regarded as being present in South Africa for a full day (Department of Finance, 2005a; Stretch et al., 2007). Accordingly, a person who is not ordinarily resident in South Africa can only become a resident in South Africa, in terms of the physical presence test, in the sixth year of assessment after having been physically present in South Africa for the first time (Kruger, 2007:54–55; Stretch et al., 2007; Clegg & Stretch, 2007).

A natural person who became a resident as a result of the physical presence test will become a resident as from the first day of the year of assessment during which they met all three requirements referred to above (Kruger, 2007:54–55; Stretch et al., 2007). The natural person will then be liable for tax in South Africa on their worldwide income (including rental income in Greece) received by or accrued (or deemed to accrue) to them as from the first day of that year of assessment (Department of Finance, 2006a).

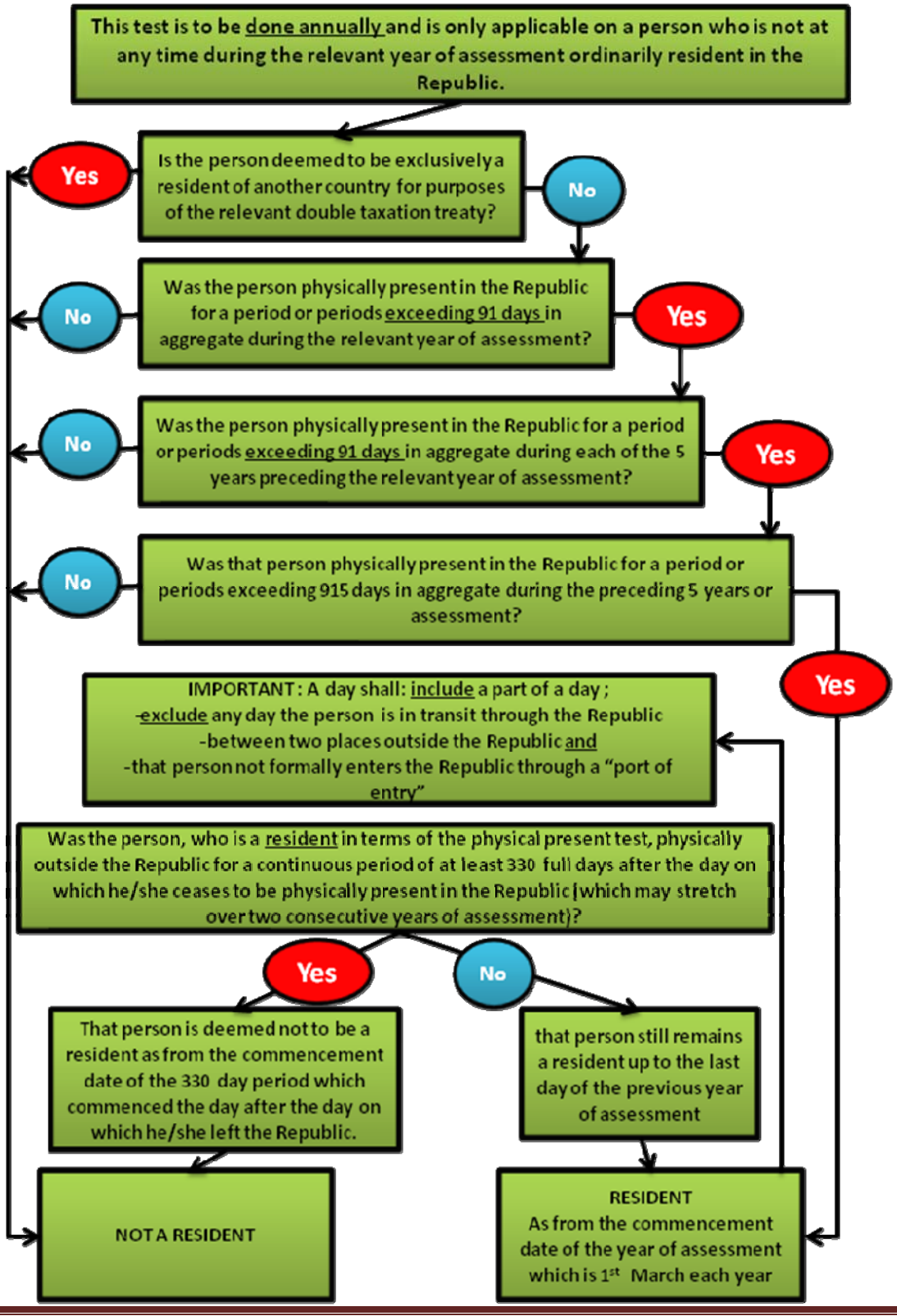
In terms of paragraph (B) of the proviso to the definition of **"**resident" in the Income Tax Act (South Africa, 1962), a natural person who is a resident by virtue of the physical presence test ceases to be a resident if they are physically outside South Africa for a continuous period of at least 330 full days. The continuous period commences the day after the day on which they physically left South Africa and the person ceases to be a resident as from the day immediately after the day on which they left South Africa for a continuous period of at least 330 full days (Stretch et al., 2007). If the pattern of a person's existence indicates that they are ordinarily resident in South Africa, the time-based positive and negative rules are irrelevant, although it is relatively unlikely that a person who spends 330 continuous days outside South Africa would remain ordinarily resident in any event (Clegg & Stretch, 2007).

A presence of 91 days or less every four years will remove any possibility of the time-based residence rule applying, although the ordinarily resident rule may continue to apply depending on the circumstances (Kolitz, 2004; Clegg & Stretch, 2007). Kolitz (2004:10) points out that the situation of a person becoming resident in South Africa

through the physical presence test differs from the situation where a person becomes resident by becoming ordinarily resident.

The following diagram clearly sets out the application of the physical presence test and was adapted from SARS Interpretation Note No. 4 (Department of Finance, 2006a).

Figure 1 - Physical Presence Test



It is important to remember that a natural person, who is ordinarily resident, who spends time outside South Africa and has the intention of returning to South Africa as their permanent home, is regarded as a resident regardless of the period of time spent outside South Africa (Stretch et al., 2007; Stein, 2007:21).

Once a taxpayer is considered resident in South Africa they will have to be aware of their taxation obligation on not only actual income accruals from properties in Greece, but also deemed accruals resulting from having a tax interest in fixed property in Greece.

South African immigrants and emigrants will need to be aware that their movements to and from South Africa could result in them either becoming resident or no longer being considered resident in South Africa from a taxation point of view and should take into consideration the subsequent taxation implications.

In addition, the definition of resident and when a person becomes resident for the first time in South Africa can have a significant impact on a resident's estate duty obligations on their death in South Africa. It is vital that taxpayers are aware of these implications before they make any donations of foreign fixed property or embark on any estate planning exercise. These implications are identified in parts 3.5 and 3.6 of this chapter and discussed in detail in part 5.3 of chapter 5.

3.3 TAXATION IMPLICATIONS OF DIRECTLY OWNED FIXED PROPERTY

3.3.1 Rental Income

Once a person is considered resident in South Africa, as discussed above, any rental income earned from fixed property in Greece is taxable in South Africa by virtue of the definition of "gross income" in section1 of the Income Tax Act (South Africa, 1962). The term "trade" is defined in section 1 of the Income Tax Act (South Africa, 1962) as follows:

> "trade" includes every profession, trade, business, employment, calling, occupation or venture**,** including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act, 1978 (Act No. 57 of 1978), or any design as defined in the Designs Act, 1993 (Act No. 195 of 1993), or any trade mark as defined in the Trade Marks Act, 1993 (Act No. 194 of 1993), or any copyright as defined in the Copyright Act, 1978 (Act No. 98 of 1978), or any other property which is of a similar nature.

Although rental income earned from letting fixed property in Greece may not require an active involvement normally associated with "trade", the letting of fixed property is specifically included in the definition of trade and accordingly a resident taxpayer must declare his rental earnings on any fixed property situated in Greece (Huxham & Haupt, 2007:59). All tax deductible expenditure and allowances are generally deducted against income in terms of the provisions of sections 11(a), 11(d) and 11(e) read with section

23(g) of the Income Tax Act (South Africa, 1962) (Dachs, 2006; Clegg & Stretch, 2007; Huxham & Haupt, 2007:302).

Section 11(a) and (d) of the Income Tax Act (South Africa, 1962) read as follow:

> *11 General deductions allowed in determination of taxable income.—For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—*
>
> *(a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;*
>
> *(d) expenditure actually incurred during the year of assessment on repairs of property occupied for the purpose of trade or in respect of which income is receivable, including any expenditure so incurred on the treatment against attack by beetles of any timber forming part of such property and sums expended for the repair of machinery, implements, utensils and other articles employed by the taxpayer for the purposes of his trade.*

In the case study, most of the expenses that were incurred by the siblings on their properties were deductable in terms of these sections in South Africa. These were real

estate tax, municipal real estate duty, accounting fees, bank charges, stamp duty on leases and repairs and maintenance.

Section 11(e) of the Income Tax Act (South Africa, 1962) allows a deduction if the Commissioner is satisfied that the value of an asset has diminished as a result of wear and tear (Huxham & Haupt, 2007:107; Clegg & Stretch, 2007). Most of the properties owned by the siblings in the case study were fitted with air conditioners, while the residential properties that were let out contained furniture, fittings and equipment. Accordingly, depreciation (wear and tear) was claimed against rental income on all these assets in terms of section 11(e) of the Income Tax Act (South Africa, 1962).

Section 23(g) of the Income Tax Act (South Africa, 1962) prohibits the deduction of certain types of expenditure such as private and domestic expenses (Dachs, 2006:138; Huxham & Haupt, 2007:67–68; Clegg & Stretch, 2007).

Therefore, in terms of section 11(a) of the Income Tax Act (South Africa, 1962), all expenditure and losses actually incurred during the year of assessment in the production of rental income from Greece, which are not of a capital nature, will be deductible from the rental income. In addition repairs, as defined in section 11(d) of the Income Tax Act (South Africa, 1962) and wear and tear on capital assets as set out in section 11(e) of the Income Tax Act (South Africa, 1962), will be deductible.

In the case study, various members of the family held a number of properties in Greece. Some of these were in the form of farmlands, some were commercial properties and some were residential properties. Some of the residential properties were used as holiday homes while others were let out to family and friends.

Accordingly, it is important for resident taxpayers to record their rental income and expenditure from the properties they have in Greece accurately for each tax year. These obligations are in addition to the taxation requirements in Greece where rental income and the deductibility of expenses are treated significantly differently to South Africa (Price Waterhouse Coopers, 2006). This is discussed in detail in chapter 4 of this study. The fact that the two countries have different calendar tax years complicates matters even further (Internaxx, 2007; Worldwide-Tax, 2007).

Owing to the possible implications of section 20A of the Income Tax Act (South Africa, 1962) (ring-fencing of losses discussed below) the resident taxpayer has to keep separate records for each fixed property held in Greece, as some may be considered suspect trades and others not, as was the case in this case study as discussed below.

3.3.2 Ring-fencing of tax benefits

If a South African resident incurs losses in Greece as a result of letting fixed property, they will need to be aware of the implications of section 20(1) and 20A of the Income Tax Act (South Africa, 1962).

3.3.2.1 Section 20(1) implications

In terms of section 20(1) proviso (b) of the Income Tax Act (South Africa, 1962) *should* a *resident taxpayer incur a rental loss from the letting out of their foreign property this loss may not be set-off against their South African income*. However, a rental loss from one Greek fixed property may be set off against the rental profit of another Greek fixed property or any foreign trade; although these losses could be ring-fenced, as section 20A may be applicable to these losses, since section 20(1) is subject to section 20A (Huxham & Haupt, 2007).

If there is no income from another foreign trade, the rental loss in Greece is carried forward to subsequent years and may only be set-off against non-South African income (Huxham & Haupt, 2007:196). Interestingly, one is able to set-off an assessed loss from a South African trade against foreign rental profit. This is, however, subject to section 20A of the Income Tax Act (South Africa, 1962) discussed below (Huxham & Haupt, 2007:196).

3.3.2.2 Section 20A implications

Section 20A of the Income Tax Act (South Africa, 1962) is aimed at ring-fencing losses of certain trades in certain circumstances and came into operation for the years of assessment commencing on or after 1 March 2004 (Huxham & Haupt, 2007:201). Section 20A of the Income Tax Act (South Africa, 1962) prevents expenditure and losses normally associated with suspect (i.e. the letting of residential accommodation) activities from being deducted as a means of reducing taxable income. Section 20A of

the Income Tax Act (South Africa, 1962) (ring-fencing) applies only to natural persons whose taxable income in South Africa equals or exceeds the amount at which the marginal tax rates become applicable (Huxham & Haupt, 2007:201). This is determined before the set-off of any "assessed losses" incurred from any trade that arises during the tax year at issue or any loss carried forward from a previous year (Clegg & Stretch, 2007).

In section 20(2) of the Income Tax Act (South Africa, 1962), "assessed loss" is defined as any amount by which the deductions allowable under section 11–19 of the Income Tax Act (South Africa, 1962) inclusive exceed the income in respect of which the deductions are allowable. According to the brochure issued by SARS (Department of Finance, 2005b) on Ring-Fencing of Assessed Losses, trade losses (this includes rental losses) of natural persons whose taxable income exceeds the maximum marginal rate can only be ring-fenced if any one of the following requirements are met:

i) the "three out of five year" loss rule applies or

ii) the trade has been explicitly listed as a suspect trade

Huxham and Haupt (2007:201) agree with this principle, as do Clegg and Stretch (2007). Losses incurred in any year of assessment ending on or before 29 February 2004 will not be taken into account. The rental of residential accommodation, unless at least 80% of the residential accommodation is used by people who are not relatives of that person for at least half of a year of assessment, is listed as a suspect trade. According to SARS (Department of Finance, 2005b) residential accommodation includes holiday homes, bed and breakfasts, guesthouses and dwellings. Therefore, if a

South African resident owns residential accommodation as defined above, together with other income-producing fixed property in Greece, any assessed losses resulting from the letting of that residential property would not be allowed to be offset against any other properties producing a taxable profit in Greece.

In terms of section 20A(3) of the Income Tax Act (South Africa, 1962), a taxpayer's losses will not be ring-fenced if he is able to prove that the suspect trade is in fact a business with a reasonable prospect of deriving taxable income within a reasonable time (escape clause). In its guide to ring-fencing, SARS (Department of Finance, 2005b) sets out what would need to be addressed in order to qualify for the escape clause referred to in terms of section 20A(3) of the Income Tax Act (South Africa, 1962). It states that, when determining whether a trade constitutes a business, it is necessary to look at the activities conducted as a whole. It lists the basic features of an activity which it believes may indicate that a business is being conducted and emphasises the importance of the meaning of "reasonable prospect" and "reasonable period" and discusses in detail the special factors that must be taken into account. Section 20A of the Income Tax Act (South Africa, 1962) gives no indication of what is considered a "reasonable prospect or period"; however, the guide indicates that the facts and circumstances of each different category of trade will have to be considered.

However, where a taxpayer has incurred six years of losses during the last ten years of assessment, section 20A(3) of the Income Tax Act (South Africa, 1962) will not provide

an escape route. Ring-fenced losses falling within the provisions of section 20A of the Income Tax Act (South Africa, 1962) are ring-fenced and may only be offset against income from that trade (Department of Finance, 2005b).

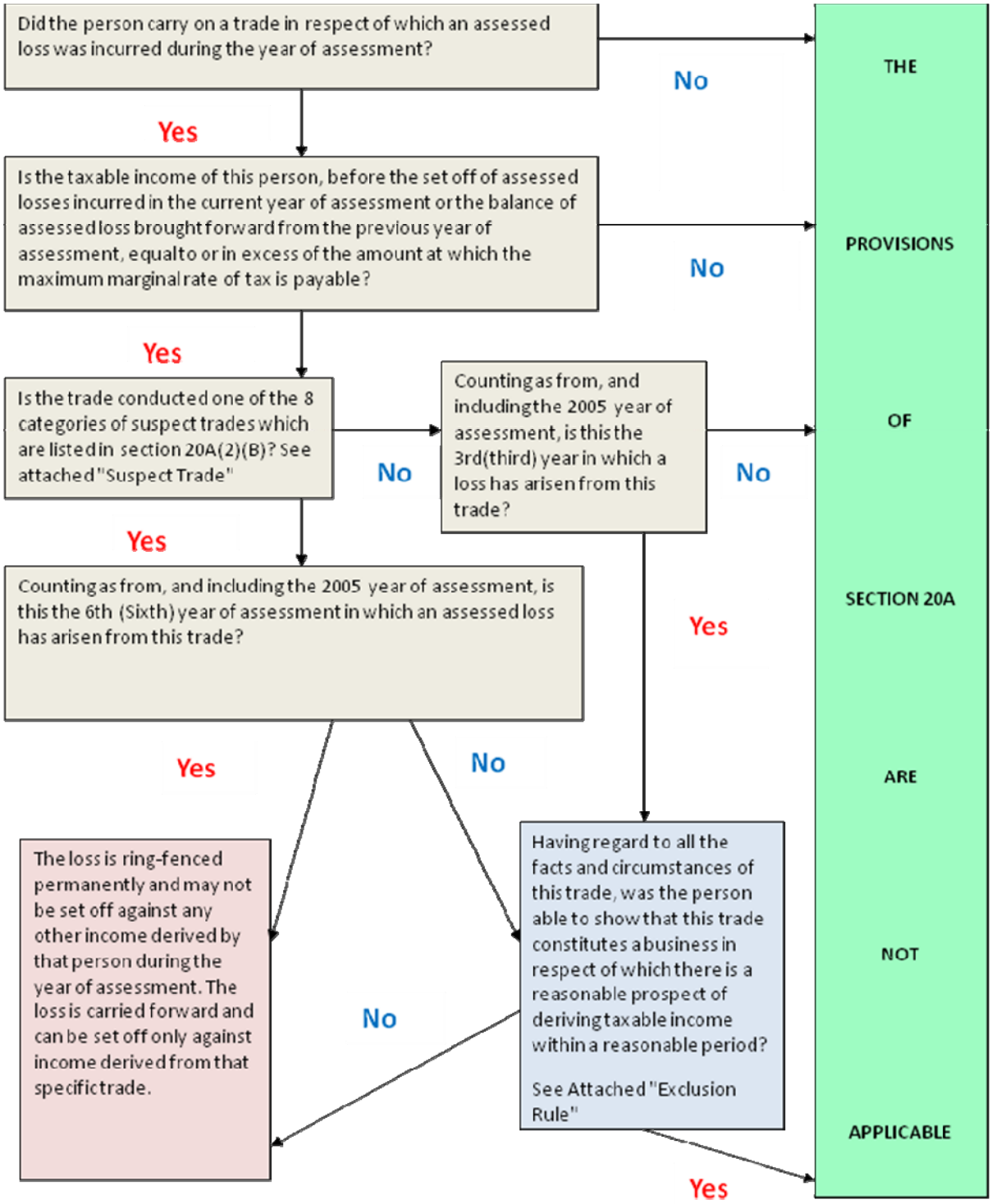
The renting of residential property in Greece to a relative would be a suspect trade and would result in section 20A of the Income Tax Act (South Africa, 1962) being applicable if a loss is made should the resident owning the residential property have a taxable income equal to or greater than the maximum marginal tax rate applicable to individuals. *This loss would then be ring-fenced and cannot reduce the other foreign trade income.*

As set out in chapter 2, sibling A in the case study owned an office block, commercial properties and various residential properties, including a holiday home that was occasionally let out to family and friends and also used by him as a holiday home from time to time. The office block owned together with his brother (sibling B) ran at a substantial rental profit, as did the residential properties they owned; however, the second commercial property and the holiday home ran at a loss. Here only the holiday home was considered a suspect trade. Sibling A was able to reduce his rental profits with the rental losses on the commercial property but the rental losses of the holiday home were ring-fenced in terms of section 20A(3) of the Income Tax Act (South Africa, 1962) and not allowed to reduce his other rental profit in Greece.

Interestingly, in a subsequent year when the net rental results on all properties owned by sibling A ended up as a loss owing to substantial repairs that needed to be made and vacancies in the office block, these losses were not allowed to be used to reduce his other South African income, as those losses were also ring-fenced but in terms of 20(1) of the Income Tax Act (South Africa, 1962).

The flowchart below, adapted from the brochure on Ring-Fencing of Assessed Losses released by Department of Finance (2005b) clearly sets out how section 20A of the Income Tax Act (South Africa, 1962) is applied.

Figure 2 – Ring-Fencing of Assessed Losses



Whether or not the renting of different foreign properties can be treated as a single trade will depend on the facts of each specific case. The way in which the trade of letting fixed property in Greece is conducted will give some indication of whether they are, in fact, conducted as a single trade. It is important that a distinction be made between fixed property that is held as an investment and fixed property that is held as a business asset, that is, fixed property that is held with the intention of carrying on a business as a lessor of fixed property. Activities that are regarded as suspect trades, such as holiday homes and guesthouses, could constitute separate trades and the income and expenditure of each trade should be examined on a separate basis in order to determine whether the losses of those activities should be ring-fenced (Department of Finance, 2005b:33).

In terms of section 20(1) proviso (b) of the Income Tax Act (South Africa, 1962), it is important to remember that foreign trade/rental losses may not, in any event, be offset against South African income, and section 20A of the Income Tax Act (South Africa, 1962) therefore goes a step further and limits foreign rental losses from reducing any other foreign trade profits or other rental profits not considered part of a “single rental trade”.

3.3.3 Capital gains and losses

3.3.3.1 General discussion

All South African residents who hold fixed property in Greece as a capital asset will have to account for all capital gains or losses resulting from the disposal of any of their properties in Greece (Clegg & Stretch, 2007; Stein, 2007:1.1–1.2).

Paragraph 43(1) and (2) of the Eighth Schedule of the Income Tax Act (South Africa, 1962) deals with immovable (fixed) property held and disposed of outside South Africa. The Eighth Schedule of the Income Tax Act (South Africa, 1962) is not a taxing provision, but determines what capital gains or capital losses are included as taxable income in terms of section 26A of the Income Tax Act (South Africa, 1962) (Stein, 2007:1.1).

Paragraph 2 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) provides that the disposal of all assets on or after 1 October 2001 will result in the application of the Eighth Schedule of the Income Tax Act (South Africa, 1962). Therefore, before capital gain or capital loss determination can take place in terms of Paragraph 2 of the Eighth Schedule of the Income Tax Act (South Africa, 1962), there must be an *asset* and there must be a *disposal* (Stein, 2007:4.1)**.**

3.3.3.2 Capital losses on foreign assets

A very important point is that, in terms of the definition of "assessed capital loss" paragraph 9 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) and section 20(1) proviso (b) of the Income Tax Act (South Africa, 1962), *capital losses on foreign currency assets are not ring-fenced and can be set off against South African capital gains.* Therefore, if a South African resident makes capital gains in South Africa, and suffers capital losses on assets owned in Greece, those must be combined for the purposes of calculating the net capital gains/loss for the year.

As indicated in part 3.3.2.1 above, it is important to remember that section 20(1) proviso (b) of the Income Tax Act (South Africa, 1962) does not allows *a resident taxpayer to deduct a foreign rental loss against his South African income*.

Therefore, unlike foreign rental losses, there is no prohibition on offsetting foreign capital losses against South African capital gains (Clegg & Stretch, 2007).

3.3.3.3 What constitutes a disposal?

When fixed property owned in Greece by a South African resident is disposed of, as defined in the Eighth Schedule of the Income Tax Act (South Africa, 1962), a capital gains tax "event" occurs. The Eighth Schedule of the Income Tax Act (South Africa, 1962) deals with deemed disposals as well as actual disposals.

"Disposal" is defined in paragraph 1 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) as an event, act, forbearance, or operation of law, as envisaged in paragraph 11 of the Eighth Schedule of the Income Tax Act (South Africa, 1962). Paragraph 11 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) is very broad and states that, among other things, a disposal includes the sale of a fixed property or the donation of a fixed property, while paragraph 12 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) deems a disposal to have taken place, at market value, when a South African resident ceases to be a resident (i.e. on emigration) (Huxham & Haupt, 2007:634; Stein, 2007:5.1–5.2). Only fixed properties situated in South Africa are excluded (Huxham & Haupt, 2007; Stein, 2007: 5.1).

Therefore, a South African resident will have to account for any capital gains or losses on all their properties in Greece during any year when they are no longer considered a resident as discussed in part 3.2. As was evident from the case study and the respondents interviewed, many South Africans of Greek origin "drift" between South Africa and Greece without understanding the consequences this might have on their taxation liability in South Africa, emphasising the importance of understanding the concept of "resident" by taxpayers owning fixed property in Greece.

Resident taxpayers will also need to be aware of the above reference to donations when embarking on any estate planning, especially if they are taking advantage of the various exemptions to donations tax set out in part 3.5.2 below. All too often an asset is donated by a parent to the next generation as part of estate planning in Greece without

investigating the tax consequences in South Africa. The case study and the respondents interviewed suggest that this is a popular estate planning technique conducted by South Africans with Greek assets, as there are significant donations tax and estate duty savings in Greece when parents donate assets to children (Taliaki, 2007; Tsakiraki, 2007). These are discussed in detail in part 4.3.2 of chapter 4. In addition, while spouses may donate fixed property to each other and avoid donations tax in South Africa in terms of section 56(1)(b) of the Income Tax Act (South Africa, 1962), the exposure to capital gains is rolled over rather than avoided (paragraph 67 of the Eighth Schedule of the Income Tax Act [South Africa, 1962]).

Another relevant section is paragraph 40 of the Eight Schedule of the Income Tax Act (South Africa, 1962) which provides that when a person dies they are deemed to have disposed of all their assets at market value at date of death.

According to Clegg and Stretch (2007) a disposal is not necessarily a bilateral transaction and can be triggered by an act of God (an event), a conscious action (typically the act of entering into a transaction), the failure to do something (forbearance) or the action of a third party (through the operation of law). Stein (2007:4.1) supports this view.

Generally, capital gains tax is triggered by the disposal of an asset from one person to another in such a manner that ownership passes (Clegg & Stretch, 2007). In terms of paragraph 13(1)(a)(ii) of the Eighth Schedule of the Income Tax Act (South Africa,

1962), if an agreement (written or verbal) that is intended to result in a change of ownership, and that is not subject to a suspensive condition, is entered into, the date the agreement is concluded is the effective date of disposal. In the case of an agreement which is subject to a suspensive condition, paragraph 13(1)(a)(i) of the Eighth Schedule of the Income Tax Act (South Africa, 1962) stipulates that the effective date is the date of disposal on which that condition is satisfied. A resolutive condition does not delay the trigger. Therefore, in the case study when the father sold his olive grove in Greece, subject to the granting of finance to the purchaser, until that finance had been approved capital gains tax was not triggered. The date of occupation or registration of transfer was irrelevant (Clegg & Stretch, 2007).

3.3.3.4 Base cost market valuations

As was evident from the case study and the various respondents interviewed, most of the properties owned by South African residents in Greece were inherited or acquired prior to 1 October 2001. Capital gains legislation is intended to apply only to those increases in the value of an asset that arise on or after 1 October 2001. Accordingly, a method of valuing assets at that date is then required (Stein, 2007:7.9).

In terms of paragraphs 25(1) and 26(1) read together with paragraphs 28 and 32(3A) of the Eighth Schedule of the Income Tax Act (South Africa, 1962), where the total proceeds from the disposal of fixed property acquired before 1 October 2001 exceed the total expenditure allowable for base cost purposes over the entire period of holding,

the taxpayer can adopt whichever of the following alternatives produces the best result from a capital gains tax perspective:

- the actual market value on1 October 2001(paragraph 29), or
- the time apportionment base cost (paragraph 30), or
- 20% of the proceeds less post-transition date expenditure (this can vary depending on the application of paragraph 26)

Where proceeds do not exceed expenditure, paragraph 27 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) deals with the valuation date value (Huxham & Haupt, 2007:646).

It was therefore important to have had all fixed property in Greece valued at “market value” as at 1 October 2001 on or before 30 September 2004 (Stein, 2007:35). The general definition of market value is contained in Part IV of the Eighth Schedule of the Income Tax Act (South Africa, 1962). The market value of an asset is “the price which could have been obtained upon a sale of the asset between a willing buyer and a willing seller dealing at arms length in an open market”. If a resident wishes to be able to elect market value, he must have had the fixed property valued by 30 September 2004 (paragraph 29(4) of the Eighth Schedule of the Income Tax Act (South Africa, 1962)). Paragraph 29(5) of the Eighth Schedule of the Income Tax Act (South Africa,1962) initially required the resident to submit proof of that valuation with his first tax return submitted by him after 30 September 2004, if the valuation of the fixed property exceeded R10 million.

Many taxpayers have not done this and fortunately the legislature has now amended the Income Tax Act (South Africa, 1962) by way of the Revenue Laws Amendment Act (South Africa, 2006a) to allow the Commissioner the discretion to extend the time period within which the capital gains tax valuation was to be submitted by a taxpayer. This should now allow residents to use the market value method of determining base cost, which would otherwise not have been available, because the valuation was not submitted to the Commissioner in time (Croome, 2007:4–5).

3.3.3.5 Same currency transactions

When a South African resident disposes of a fixed property held in Greece, the "currency of expenditure" and the "currency of disposal" should be the same foreign currency. Such "same currency" transactions are regulated by paragraph 43(1) of the Eighth Schedule of the Income Tax Act (South Africa, 1962), which stipulates that the capital gain or capital loss must be determined in the foreign currency and then translated into rand in accordance with the provisions of section 25 D of the Income Tax Act (South Africa, 1962) (Montocchio, 2006:147–148). The effect of this is that one first calculates the capital gain or loss in the foreign currency (euro) and then converts the capital gain or loss into rand by applying the average rate for the year of assessment (Montocchio, 2007:61; Scholtz, 2005:31). Therefore, when the siblings' father (in the case study) purchased an olive grove in Greece in December 2001 at a cost of €112 200 and sold it during the 2007 tax year for €200 000, his capital gain in South Africa amounted to €87 800 (€200 000 – €112 200) times the average exchange rate for

2007 (R9,78 to the euro) resulting in a capital gain in South Africa of R858 684 and a taxable capital gain of R214 671 (25% inclusion rate).

Section 24I of the Income Tax Act (South Africa, 1962) is not applicable to this study as it is only applicable to a natural person who holds a unit of currency or a loan, advance or debt in a foreign currency, such as trading stock (Huxham & Haupt, 2007:400).

3.3.3.6 Amnesty election and base cost calculation

An important aspect for all the members of the case study who took advantage of the Exchange Control Amnesty and Amendment of Taxation Laws Act (South Africa, 2003a) is section 28, which provides that the base cost of a foreign asset in respect of which approval for amnesty was granted cannot exceed the sum of the value in foreign currency of that asset on 28 February 2003 and the allowable paragraph 20 expenditure incurred after that date (Huxham & Haupt, 2007:693).

3.3.4 Currency conversions

Section 25D of the Income Tax Act (South Africa, 1962) contains the general currency conversion provisions which will apply in all cases unless a specific section contains its own currency conversion rules (Huxham & Haupt, 2007:325). In terms of section 25D(3) of the Income Tax Act (South Africa,1962) natural persons may elect to use an average rate of exchange instead of the spot rate. If the average rate is elected it must be applied to all income or expenditure during the relevant year of assessment.

The average exchange rate is defined in section 1 of the Income Tax Act (South Africa, 1962) as the average determined using the closing spot rates at the end of daily or monthly intervals during the year of assessment, which must be consistently applied within that year of assessment (Department of Finance, 2007a; SAIPA, 2005). Spot rate is also defined in section 1 of the Income Tax Act (South Africa, 1962) and means the appropriate quoted exchange rate at a specific time for the delivery of currency.

The South African Reserve Bank publishes weighted average rates on a quarterly basis based on banks' foreign exchange transactions. These rates will be acceptable for the purposes of determining the average rates as required in the definition of average exchange rate (Department of Finance, 2007a; SAIPA, 2005). A table can be downloaded from the SARS website that lists the banks' average exchange rate of selected foreign currencies from December 2003 (Department of Finance, 2007a). The use of the rates published by SARS is not compulsory. However, taxpayers using average rates that differ from those published by SARS must make full disclosure of this fact and justify the rates and their source in their annual return of income (Department of Finance, 2007a; SAIPA, 2005). The use of an average exchange rate simplifies the calculation of taxable rental income and capital gains for taxpayers holding fixed property in Greece.

3.3.5 Relief from double taxation

3.3.5.1 General discussion

Double taxation arises from the practice of levying tax on a worldwide basis. Most countries adopt this practice which results in a resident of a country being taxed on income from local and foreign sources. Where a South African resident owns fixed property in Greece, any income arising from the investment is subject to two potential tax claims, namely South Africa, being the country of residence, and Greece, being the country in which the income on the investment is earned. If the income in question is taxed in the hands of the same person by two countries, it is said to be subject to international double taxation (Clegg & Stretch, 2007).

International double taxation leads to a deterrent in foreign investment, and this would hamper international trade and economic development. Consequently, countries adopt measures for avoiding or relieving international double taxation (Clegg & Stretch, 2007). Unilateral measures and bilateral tax treaties are the two principal methods whereby the impact of international double taxation is avoided or relieved (Huxham & Haupt, 2007:339).

Bilateral measures: double taxation agreements

Generally, bilateral tax conventions have two main functions. The first is to limit double taxation by trying to achieve an equal allocation of the right to levy tax on the same income between the two contracting countries. The second is to provide a frame of

reference against which the tax jurisdiction of the two contracting states may be determined with a fair degree of certainty. This is achieved, *inter alia*, by the definition of certain key concepts (Clegg & Stretch, 2007).

Income and capital gains are subject to taxation in both South Africa and Greece. In South Africa the taxpayer has the choice of treaty (DTA) relief or section 6*quat* of the Income Tax Act (South Africa, 1962) relief (Dachs, 2006:138). For example, if the treaty provides that the foreign income shall be exempt, it would be preferable to choose treaty relief if the foreign tax is at a rate lower than the domestic rate. Interpretation Note No. 18 (Department of Finance, 2003.) supports this view. Paragraph 2.6 of the Interpretation Note makes it clear that it is the taxpayer who makes the election. It furthermore provides that, if no election is made, the provisions of section 6*quat* of the Income Tax Act (South Africa, 1962) will be applicable. Huxham and Haupt (2007:325) support this view. Taxpayers must be aware that if they elect not to claim a rebate in terms of section 6*quat* of the Income Tax Act (South Africa, 1962), but rather the relief provided for by the treaty, none of the other relief granted in terms of section 6quat of the Income Tax Act (South Africa, 1962), such as the carry forward of the excess credit, will be applicable (Department of Finance, 2003.).

The credit (section 6*quat*) relief is not additional to treaty (DTA) credit relief but may be given in substitution for treaty credit relief (Wilson, 2005:8; Dachs, 2006:138).

3.3.5.2 Double taxation agreement

South Africa has entered into a double taxation agreement with the Hellenic Republic (Greece) (South Africa, 2003b) and, in terms of Article 2, taxes on income and capital are covered. In terms of Article 6 and Article 13 of the double taxation agreement (South Africa, 2003b), rental income and capital gains are taxable in both countries. This is as a result of the use of the wording "may be" in Article 6 and Article 13, as the DTA (South Africa, 2003b) does not prohibit the taxing of the rental income or any capital gains in any one of the states.

Articles 6 and 13 of the DTA (South Africa, 2003b) read as follows:

Article 6

> *Income from Immovable Property*
>
> *1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.*
>
> *2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural*

resources. Ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

Article 13

Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft, shall be

taxable only in the Contracting State in which the profits of such ships or aircraft are taxable according to the provisions of Article 8.

4. Gains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident.

The use of the words "*may* be taxed" as opposed to "*shall* only be taxed" is significant. The use of the wording "may be taxed" is what gives both South Africa and Greece the right to tax the income, as opposed to the phrase "shall only be taxed", which would give only one state the right to tax (Huxham & Haupt, 2007:341).

According to Clegg and Stretch (2007), the word "shall" is normally used as being equivalent to "must". It is imperative or pre-emptory, while the word "may" is usually used in a permissive sense. In general, the word "shall" is used to create a duty. However, the word "may" can also be equivalent to "must". In CIR v King (1947 (2) SA 196 (A), 14 SATC 184) it was held that the word "may" in section 90 of the Income Tax Act 31 of 1941 was equivalent to "must" and a similar conclusion was reached in Stroud, Riley & Co. Ltd v SIR (1974(4), SA 534 (EPD), 36 SATC 143). However, in the absence of proof that the legislature intended that the word "may" is to be interpreted as "must" or "shall", such word is to be given its natural meaning, that is, a permissive (may) and not an obligatory use (Clegg & Stretch, 2007).

However, Article 23 of the DTA (South Africa, 2003b) allows the South African resident relief in terms of the domestic laws of South Africa by granting a credit (deduction) in respect of the tax paid in Greece on income and capital. Such a deduction shall not, however, exceed an amount that bears on the total South African tax payable to the same ratio as the income concerned bears on the total income.

Article 23 of the DTA (South Africa, 2003b) reads as follows:

Elimination of Double Taxation

1. Double taxation shall be eliminated as follows:

(a) In the Hellenic Republic, where a resident of the Hellenic Republic derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in South Africa, the Hellenic Republic shall allow:

(i) as a deduction from the tax on the income of that resident, an amount equal to the South African tax paid on that income,

(ii) as a deduction from the tax on the capital of that resident, an amount equal to the South African tax paid on that capital.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or to capital which may be taxed in South Africa.

(b) In South Africa, the Hellenic tax paid by residents of South Africa in respect of income or capital taxable in the Hellenic Republic in accordance with the provisions of this Convention, shall be deducted from the taxes due according to

South African fiscal law. Such deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income or capital concerned bears to the total income or the total capital.

2. For the purposes of paragraph 1 of this Article, the terms "Hellenic tax paid" and "South African tax paid" shall be deemed to include the amount of tax which would have been paid in the Hellenic Republic or South Africa, as the case may be, but for an exemption or reduction granted in accordance with laws designed to promote economic development in that Contracting State.

3. A grant given by a Contracting State or a political subdivision thereof to a resident of the other Contracting State in accordance with laws designed to promote economic development in that first-mentioned State, shall not be taxable in the other State.

3.3.5.3 Section 6*quat*

The relief from double taxation in South Africa on rental income from a foreign fixed property and/or capital gains is set out in section 6*quat* of the Income Tax Act (South Africa, 1962).

Section 6*quat* of the Income Tax Act (South Africa, 1962) provides for a rebate for a resident whose taxable income includes rental income and/or capital gains received or accrued from a source outside the Republic that is not deemed to be a source within the Republic. The amount of the rebate is equal to the taxes proved to be payable to the government of any other country without the right to recovery by the resident for rental

income and/or capital gains received by or accrued to that resident. In terms of section 6*quat*(4) of the Income Tax Act (South Africa,1962), the foreign tax proved to be payable shall be converted to the currency of the Republic at the end of the year of assessment of the resident by applying the average exchange rate for that year of assessment (Clegg & Stretch, 2007).

Interpretation Note No. 18, issued by SARS (Department of Finance, 2003.), explains the provisions of section 6*quat* of the Income Tax Act (South Africa,1962) as they apply to a resident who is a natural person and who derives income from sources outside the Republic. This interpretation note replaced Practice Note No. 9, issued on 26 June 1989, which is no longer applicable. The following are some of the more important and pertinent areas addressed by the Practice Note:

Internationally, taxes payable on capital gains are regarded as taxes on income. Thus any reference to taxes payable on income includes taxes payable on capital gains.

While only taxes payable to a foreign government are covered, taxes imposed by any level of a foreign government will be regarded as taxes payable to a foreign government, but the taxes should be proved to be payable in respect of an existing foreign tax liability.

The rebate is not only granted for foreign taxes actually paid, but also in respect of taxes for which a legal obligation to pay exists and the taxes are payable without any right of recovery by any person.

The amount of foreign taxes which qualify for the rebate in terms of section 6*quat* of the Income Tax Act (South Africa,1962) is limited to a pro rata amount calculated in accordance with the following formula:

$$\frac{\text{Taxable income derived from all sources (A)}}{\text{Total taxable income derived from all sources (B)}} \times \text{Normal tax payable on (B)}$$

Normal tax is the South African tax calculated on taxable income before the deduction of any rebates.

The amount of the rebate is therefore limited to an amount that in aggregate does not exceed the ratio of South African tax on the included income as a proportion of the income from all sources. Effectively, therefore, South Africa limits the relief on the basis of the average rate of tax (Department of Finance, 2003; Wilson, 2005:8). This restriction is harsh on resident taxpayers as their rental income from Greece is taxed at their marginal rate which is higher than their average rate, with the credit limited to the average rate. The effect of this is illustrated below.

In determining the taxable income derived from foreign sources and South African sources respectively, any deductions sought in terms of sections 11(n), 18 and 18A of

the Income Tax Act (South Africa, 1962) must be apportioned on a pro rata basis between income derived from both sources as determined prior to the deduction of any of the amounts contemplated in sections 11(n), 18 and 18A of the Income Tax Act (South Africa, 1962; Department of Finance, 2003).

When a limitation applies, any excess credit is carried forward to the year immediately succeeding the year of assessment. It is then deemed to be a foreign tax paid in that year. This may then be applied in the reduction of tax payable after any other foreign taxes incurred directly on foreign income included in taxable income in that year (Department of Finance, 2003.). An excess amount may not be carried forward for more than seven years calculated from the year of assessment when it was carried forward for the first time. However, when a determination of an excess amount of foreign taxes is made for more than one year of assessment, the excess amount determined for each year of assessment must be recorded separately and applied on a first-in first-out (FIFO) basis against the normal tax payable in future years of assessment (Department of Finance, 2003.).

This is harsh on resident taxpayers, as it is not likely that they will use up the credit of the tax paid in Greece within the seven-year period. This was evident in the case study where it was found that the credit in South Africa was restricted to the siblings' average rate and that the tax paid in Greece was much higher than in South Africa. This was due to the fact that the *gross rental income* earned (without the deduction of expenses) was subject to tax in Greece at 41,5% (Taliaki, 2007).

In terms of section 6*quat*(2) of the Income Tax Act (South Africa, 1962), a rebate may be granted in substitution of, but not in addition to, any relief to which a resident is entitled under a treaty concluded with the foreign country concerned (Department of Finance, 2003).

In terms of section 6*quat* of the Income Tax Act (South Africa, 1962) any foreign taxes proven to be payable in respect of any income derived from a foreign source, which is included in the taxable income of a resident during a particular year of assessment, shall be converted in terms of section 25D of the Income Tax Act (South Africa, 1962) to rand on the last day of that year of assessment by applying the average exchange rate elected by the resident to translate the amount of taxable income derived by him or her from that foreign source for that year (Department of Finance, 2003.). Generally, the section 6*quat* of the Income Tax Act (South Africa, 1962) rebate is calculated on a *pooled basis,* that is, all foreign income is pooled and all foreign taxes are pooled. It is not necessary to link each amount of foreign tax to each amount of foreign income (Department of Finance, 2003; Huxham & Haupt, 2007:323).

As taxation is payable on both income and capital in Greece and South Africa, the double taxation agreement (South Africa, 2003b) entered into between the two counties and the relief provided in terms of section 6*quat* of the Income Tax Act (South Africa, 1962), as discussed above, are of the utmost importance. It became evident from the case study that a taxpayer resident in South Africa owning fixed property in Greece

would rather rely on the relief granted in terms of section 6*quat* of the Income Tax Act (South Africa, 1962). This is because the DTA (South Africa, 2003b) does not exempt rental income in one of the countries (which would then be a far different story) but allows both counties to tax rental profits and provide relief for the tax paid in Greece without the ability to carry over unused tax credits to subsequent years that are allowed in terms of section 6*quat* of the Income Tax Act (South Africa, 1962) relief (Department of Finance, 2003). Both the DTA (South Africa, 2003b) and section 6*quat* of the Income Tax Act (South Africa, 1962) effectively ring-fence the tax paid in Greece, resulting in the effective rate in South Africa being equivalent to the higher rate paid in Greece. With the tax system in Greece not allowing the normal section 11(a) of the Income Tax Act (South Africa, 1962) deductions against rental income that are allowed in South Africa (Taliaki, 2007), it effectively increases the marginal rate, which can be very harsh on the South African resident. The tax effect of rental income in Greece is discussed in chapter 4 in more detail. This is best explained by way of an example taken from the case study. Sibling A, resident in South Africa, owned various properties as set out in chapter 2. He earned the following combined income and incurred the following combined expenditure during the 2007 tax year (the rental loss on his holiday home was excluded as it was a suspect trade and ring-fenced):

	€
Rental income	56 164
Deductible expenses	**(32 444)**
Accountancy fees	(812)
Bank charges	(114)

Repairs and maintenance	(22 403)
Municipal tax	(2 625)
Real estate tax	(2 344)
Stamp duty	(2 021)
Depreciation	(2 125)
Net profit	23 720

Sibling A, being *a South African resident,* paid tax of €23 208 (40% + 1,5% of the *gross rental of* €56 164) in Greece. The rate of tax in Greece is based on a sliding scale with the maximum rate ending on 40% plus an additional tax of 1,5%. This is explained in detail in part 4.2 of chapter 4.

In South Africa he had to add R231 981 to his normal South African income. This is calculated as follows: €23 720 x 9,78 = R231 981.

His SA sourced income, after deductions and exemptions, amounted to R525 555. His total tax liability is calculated as follows:

	SA source	**Foreign Rental**	**Total**
Taxable income	R525 555	R231 981	R757 536

Tax payable on R757 536 before rebates at 2007 tax rates amounted to R260 014.

The section 6*quat* of the Income Tax Act (South Africa, 1962) rebate is calculated as follows:

R231 981
R757 536 x R260 014 = R79 624

The additional tax paid in Greece on the inclusion of the €56 164 of rental income amounted to €23 308 (calculated at a 41,5% marginal rate). Converted to rand at the average exchange rate of 9,78 this amounts to R227 952. He will be entitled to deduct the tax paid in Greece but this will be limited to the amount of additional tax payable in South Africa as calculated above. The deductions would then be limited to R79 624 even though he has paid R227 952 in Greece resulting in an effective tax rate of 98% on the net profit in the two counties. He will be able to carry over the unused portion (R148 328) to subsequent years, but it is unlikely that he will get the opportunity to use it within the required seven years before it is lost (Department of Finance, 2003).

Finally, it appears that there is uncertainty as to whether a resident taxpayer would be able to deduct any taxes paid in Greece that are not allowed as a credit in terms of section 6*quat* of the Income Tax Act (South Africa, 1962), or the DTA (South Africa, 2003b), as an expense in terms of 11(a) read with section 23(g) against the rental income earned in Greece (Dachs, 2006:138). While section 6*quat* of the Income Tax Act (South Africa, 1962) provides clear guidelines for obtaining foreign tax credits, the law is less clear on whether South African residents can deduct foreign taxes if no credit is available (or if a deduction is preferred) (Silke & Stretch, 2007). The new subsections (1C) and (1D) of section 6*quat* of the Income Tax Act (South Africa, 1962) that have

recently been introduced into the Income Tax Act only appear to allow a deduction of foreign taxes paid against South African sourced income.

3.4 TAXATION IMPLICATIONS OF HAVING A TAX INTEREST IN FIXED PROPERTY (DEEMING PROVISIONS)

3.4.1 General discussions

It is submitted that South African residents will have a tax interest in fixed property in Greece in the following circumstances:

- They have made a gratuitous or interest-free loan to a non-resident who has used the funds to acquire fixed property in Greece.
- They have made a donation to a non-resident who has used the donation to acquire fixed property in Greece.
- They have donated fixed property situated in Greece to a non-resident.

If fixed property situated in Greece is owned by a non-resident company or an individual and a South African resident has a tax interest therein as described above, regard must be had to the provisions contained in section 7(8) of the Income Tax Act (South Africa, 1962), paragraph 72 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) and section 31 of the Income Tax Act (South Africa, 1962). These are all discussed in detail below. As the decision handed down in CSARS v Brummeria Renaissance (Pty) Ltd and Others (69 SATC 205) turned on very specific circumstances applicable to that

case, it appears as if the findings of this case do not apply to normal interest-free loans as discussed in this section

3.4.2 Section 7(8) implications

When the residence-based tax system was introduced, the legislature, concerned about the avoidance of tax on foreign earnings, enacted section 7(8) of the Income Tax Act (South Africa, 1962) aimed specifically at preventing this form of tax avoidance (Mitchell, 2004:138)

Section 7(8) of the Income Tax Act (South Africa, 1962) reads as follows:

> *(a) Where by reason of or in consequence of any donation, settlement or other disposition (other than a donation, settlement or other disposition to an entity which is not a resident and which is similar to a public benefit organisation contemplated in section 30) made by any resident, any amount is received by or accrued to any person who is not a resident (other than a controlled foreign company in relation to such resident), which would have constituted income had that person been a resident, there shall be included in the income of that resident so much of that amount as is attributable to that donation, settlement or other disposition.*
>
> *(b) So much of any expenditure, allowance or loss incurred by the person contemplated in paragraph (a) as does not exceed the amount included in the income of the resident in terms of that paragraph and which would be allowable*

> *as a deduction under this Act in the determination of the taxable income derived from that amount had that person been a resident, is deemed to be an expenditure, allowance or loss incurred by that resident for purposes of the determination of the taxable income of that resident from that amount.*

Therefore, if rental income has accrued as a result of a donation, settlement or other disposition from a South African resident, the provisions of section 7(8) of the Income Tax Act (South Africa, 1962) apply (Huxham & Haupt, 2007:319).

The expressions “donation, settlement or other disposition” and “by reason of” used in section 7(8) of the Income Tax Act (South Africa, 1962) have been subjected to extensive examination by our courts. In CIR v Berold (1962 (3) SA 748 (A), 24 SATC 729), the taxpayer had sold assets to a company and no interest was charged on the outstanding purchase price. The court found that the failure to charge interest amounted to a continuous donation. In Joss v SIR (1980 (1) SA 674 (T), 41 SATC 206), the court adopted a similar approach and in Ovenstone v SIR (1980 (2) SA 721 (A), 42 SATC 55) the court concluded that the phrase “any donation, settlement or other disposition” excludes any disposal of fixed property that is a wholly commercial or business one and is made for due consideration. However, it covers any disposal of fixed property made wholly gratuitously out of liberality or generosity. It also covers any disposal of fixed property made under a settlement or other disposition for some consideration but in which there is an appreciable element of gratuitousness and liberality or generosity.

An interest-free loan is therefore considered an “other disposition” as referred to above and would result in section 7(8) of the Income Tax Act (South Africa, 1962) becoming relevant.

Section 7(8) of the Income Tax Act (South Africa, 1962) is an anti-avoidance provision as it deems the income earned by the non-resident to be received by the resident lender for normal tax purposes. The effect of the deeming provisions is that the income derived by the non-resident will be taxable in the hands of the resident lender while the resident lender is alive. It will only cease to operate when the lender passes away or when the non-resident repays the loan or the loan is subjected to a market-related interest charge (Mitchell, 2005a).

However, the findings in SARS v Woulidge (2000 (1) SA 600 (C), 62 SATC 1) must be considered. In SARS v Woulidge (2000 (1) SA 600 (C), 62 SATC 1) the court found that where a disposition in the form of an interest-free loan leads to the application of section 7(8) of the Income Tax Act (South Africa, 1962), the *in duplum* rule, which prohibits the charging of interest when the arrear interest already outstanding, under an agreement of loan, equals the sum of the outstanding capital, is of application to the interpretation of these provisions. According to Clegg and Stretch (2007), the judgment in the case is somewhat obscure and the facts are not clearly set out. However, the thrust of the judgment is that, because the income attributable to the creditor as a result of the investment of the funds loaned is based upon a notional interest foregone, the *in*

duplum rule must apply so as to limit the attribution of that income to an amount equal to the capital outstanding on a cumulative basis (Clegg & Stretch, 2007).

It should be noted that when there is no “donation, settlement or other disposition”, the provisions of section 7(8) of the Income Tax Act (South Africa, 1962) do not apply.

There must be a certain nexus between the amount and the donation, settlement or other disposition. It should be noted that, whereas the other anti-avoidance provisions in section 7 of the Income Tax Act (South Africa, 1962) use either the phrase “by reason of” or “in consequence of”, section 7(8) of the Income Tax Act (South Africa, 1962) *uses both.* The combination of both phrases indicates that a liberal interpretation of the nexus required by section 7(8) of the Income Tax Act (South Africa, 1962) is called for. It would seem that the legislature intended the ambit of section 7(8) of the Income Tax Act (South Africa, 1962) to be even wider in this regard than the other anti-avoidance provisions in section 7 (Mitchell, 2005a:17–19).

A very important point made by Huxham and Haupt (2007:583) is that, unlike the other section 7 provisions, section 7(8) of the Income Tax Act (South Africa, 1962) does not deem the amount accruing to the non-resident to be the income of the donor. Instead, it requires the amount to be included in the income of the South African donor. This means that, for tax purposes, it still accrues to the person to whom it goes. If the income is from a South African source, and there is no tax exemption, the non-resident will also

be subject to tax on the same amount. This is commonly referred to as *economic double tax for which there is generally no relief.*

In addition, Mitchell (2005a:17) is of the opinion that, for the provisions of section 7(8) of the Income Tax Act (South Africa, 1962) to apply, the donation must be made by a person who is resident in South Africa at the time of the donation. It follows that if a person makes a donation prior to becoming a resident of South Africa, any amount earned from the donated asset will not be caught by the deeming provisions after he becomes a resident. Huxham and Haupt (2007:583) agree with this view.

This signals some significant tax planning opportunities. If we refer back to the case study example in 3.3.3.3 above, dealing with a popular estate planning technique in Greece of parents donating assets to children, it would make sense for any donations to be made by a parent while he is not considered resident in South Africa. There are also donations tax and estate duty benefits if these donations are made before the parent becomes resident in South Africa for the first time. This is discussed in more detail in part 5.3 of chapter 5.

South African taxpayers who have a tax interest in fixed property as discussed above that leads to the application of section 7(8) of the Income Tax Act (South Africa, 1962), also need to be aware of the contents of section 7(10) of the Income Tax Act (South Africa, 1962).

3.4.3 Section 7(10) of the Income Tax Act disclosures

As was discovered from the case study and the respondents interviewed, a lesser known disclosure requirement is contained in section 7(10) of the Income Tax Act (South Africa, 1962).

Section 7(10) of the Income Tax Act (South Africa, 1962) reads as follows:

> *Any resident who, at any time during any year of assessment makes any donation, settlement or other disposition as contemplated in this section, shall disclose such fact to the Commissioner in writing when submitting his return of income for such year and at the same time furnish such information as may be required by the Commissioner for the purposes of this section.*

Accordingly, resident taxpayers who make any donation, settlement or other disposition contemplated in section 7(8) of the Income Tax Act (South Africa, 1962) are required, in terms of section 7(10) of the Income Tax Act (South Africa, 1962) to disclose that fact in writing to the Commissioner when submitting their return for the year in which the donation, settlement or other disposition is made.

According to Mitchell (2005a:17) the disclosure of a donation, settlement or other disposition made prior to the commencement of section 7(10) of the Income Tax Act (South Africa, 1962) (on 1 January 2001, and applying to years of assessment commencing on or after that date) is not required. Non-compliance with the disclosure requirement in section 7(10) of the Income Tax Act (South Africa, 1962) can lead to

criminal sanctions, the raising of additional assessments, and the loss of the three-year protection limit on the re-opening of assessments as provided for in section 79 of the Income Tax Act (South Africa, 1962) (Mitchell, 2005a:17).

The mother of the siblings (in the case study) made a donation of €2 000 and advanced a gratuitous loan of €100 000 to a family member resident in Greece and disclosed that fact to SARS as required in terms of section 7(10) of the Income Tax Act (South Africa, 1962). The family member in Greece then used these funds to purchase a fixed property in Greece and was not be prepared to provide details of the property or what income was earned and refuses to inform the resident donor of the relevant facts. Section 7(8) of the Income Tax Act (South Africa, 1962) appears to be stultified as it is legally impossible for the mother to “guestimate” what amount of income is attributable to the donation and gratuitous loan and that should be taxed in her hands in South Africa (Meyerowitz, 2005:8–11). However, it does appear as if the onus of proving that an amount has accrued falls on SARS (CIR v Butcher Bros (Pty) Ltd., 13 SATC21,1945 AD 301).

Another deeming provision of the Income Tax Act that could apply when section 7(8) of the Income Tax Act (South Africa, 1962) falls short and that is often overlooked by resident taxpayers having a tax interest in property in Greece is section 31 that deals with transfer pricing.

3.4.4 Section 31 – Transfer pricing implications

When a South African resident makes a loan that is interest free or at an inadequate rate to a non-resident in Greece, the consequences of section 31 of the Income Tax Act (South Africa, 1962) need to be examined. Section 31 of the Income Tax Act (South Africa, 1962) regulates what is referred to as “transfer pricing” and confers on the Commissioner the discretion to adjust the consideration received for goods or services made available by a resident to a non-resident or for the consideration paid by a resident to a non-resident for goods and services imported into the country (Croome, 2004:16).

Practice Note No. 7 was issued by SARS (Department of Finance, 1999) to provide taxpayers with guidelines on the procedures to be followed in determining arms-length prices, taking into account the South African business environment.

The practice note deals extensively with the definition of “connected person” and deals with the issue of interest-free loans to “connected” non-residents.

Section 31(1) of the Income Tax Act (South Africa, 1962) defines “services” to include the granting of financial assistance including the granting of a loan by one person to another. If a loan is granted by a South African resident to a non-resident, and no interest is levied on it, the Commissioner can tax the South African resident on an amount of interest that would be determined by having regard to what can be referred to

as an “arm’s-length price” for the loan in question. The Commissioner, in exercising his discretion, would take into account the commercial rates of interest that could have been levied on a loan entered into between parties dealing on an arm’s-length basis (Croome, 2004:16).

Therefore, if an interest-free loan is made available by a South African resident to a non-resident who is a connected person as defined, the provisions contained in section 31 of the Income Tax Act (South Africa, 1962) could deem the South African resident to have received a market-related rate of interest on the loan (Huxham & Haupt, 2007:332). Clegg (2003:15) agrees with this view, as does Croome (2004:15–18). Mitchell (2005a:16-18) goes further to suggest that it could be possible that a resident could find tax being levied in terms of section 7(8) in addition to tax in terms of the application of section 31(2) of the Income Tax Act (South Africa, 1962).

Section 31(2) of the Income Tax Act (South Africa, 1962) therefore states that an arm’s-length interest rate must be charged on an international loan between connected parties and if the rate charged is not arm’s-length the Commissioner may adjust the rate to an arm’s-length rate (Mitchell, 2005a:18). SARS Practice Note No. 2 (Department of Finance, 1996) sets out what the Commissioner considers to be an arm’s-length interest rate between international loans for connected parties. It states that if the loan is denominated in local currency then an arm’s-length rate will be the prime rate in SA plus 2% and if it is a foreign-denominated loan the arm’s-length rate will be the relevant interbank rate plus 2%.

It is important to note that section 31(2) of the Income Tax Act (South Africa, 1962) does not apply to income arising from a donation.

3.4.5 Capital gains implications

3.4.5.1 Attribution rules – paragraph 72

Paragraph 72 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) provides that, in certain circumstances, capital gains arising as a result of a conditional settlement or similar transaction are attributed to the "settlor". These rules are similar to those in section 7(8) of the Income Tax Act (South Africa, 1962) and attribute certain capital gains enjoyed by non-residents to South African residents. Similar to section 7(8) of the Income Tax Act (South Africa, 1962) these rules depend on a resident having a tax interest in a fixed property in Greece resulting from him making a "donation, settlement or other disposition" to a non-resident to which a gain can be attributed.

A "settlement or other disposition" requires some degree of gratuity such as a low-interest or interest-free loan being made by a person to a non-resident. It appears that SARS's practice is to accept that when a low interest loan has been repaid by a non-resident, the attribution rules can no longer be triggered. Where there are various sources of funding, it will be necessary to determine how much of a particular gain is attributable to a particular source of funding, and this could be very difficult (Clegg & Stretch, 2007)

According to Mitchell (2005a:17) it would seem that for the provisions of paragraph 72 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) to apply, the donation must be made by a person who is resident in South Africa at the time of the donation. It follows that, if a person makes a donation prior to becoming a resident of South Africa, any capital gain earned from the donated asset would not be caught by the deeming provisions after they become a resident. SARS DRAFT Comprehensive Guide to Capital Gains Tax (Department of Finance, 2007b:363) supports this view.

From the case study and the respondents interviewed it became apparent that many South African residents have made interest-free loans or donations to their children resident in Greece to help them buy a home to live in with no idea that when that child disposes of the house at a profit, a portion or even the entire gain could be taxable in the hands of the parent in South Africa.

3.4.5.2 Limitations of the attribution rules – paragraph 73

When an amount of income and a capital gain have arisen because of a donation or "other disposition", the income and the capital gain could be subject to the deeming rules embodied in section 7 of the Income Tax Act (South Africa, 1962) and the attribution rules embodied in the Eighth Schedule of the Income Tax Act (South Africa, 1962). This could result in the taxation of both amounts in the hands of the South African resident lender. However, paragraph 73 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) limits the total amount of the gain that can be taxed in the

hands of the lender to the amount of the benefit derived from the disposition (Mitchell, 2005a:18; Department of Finance, 2007b).

For example, if the "disposition" is in the form of a low-interest loan, then the maximum amount that may be attributed to the lender in terms of the Eighth Schedule of the Income Tax Act (South Africa, 1962) is limited to the difference in the interest actually charged and the interest that would have been charged at a market-related interest rate. If the loan was for R500 000, and the actual rate of interest was 6% and the market-related interest rate was 9%, then R15 000 (R500 000 x (9% – 6%)) is the maximum amount of the benefit derived from the disposition (low-interest loan).

However, when an asset is funded by means of a donation there is *no limit* on the extent of the attribution of a capital gain and the *entire gain* on disposal of an asset funded by that donation will be attributed to the donor. SARS DRAFT Comprehensive Guide to Capital Gains Tax (Department of Finance, 2007b) and Clegg & Stretch (2007) support this view.

Referring back to the case study discussed in 3.3.3.3 above, dealing with a popular estate planning technique in Greece where many close friends and extended family of the siblings had donated fixed property to their children, it is clear that the attribution rules discussed above will also be applicable and have severe taxation implications for those resident taxpayers. Remember, if the parent makes a donation the entire capital gain on the sale of the fixed property will be attributed to his taxable income in South

Africa. Assuming that the child does not pay capital gains tax in Greece because of an exemption, the resident parent will end up paying tax in South Africa without any tax relief, and on a transaction that may not be subject to capital gains tax in Greece at all.

From the respondents interviewed in the case study, it appears that parents resident in South Africa often donate funds or make interest-free loans to their children resident in Greece to help them buy residential property (or visa versa) owing to the fact that obtaining mortgage bonds in Greece is not something that can be done easily. In fact, in many parts of mainland Greece and on most of the Greek Islands it is still very difficult to obtain a mortgage bond (Tyropolis, 2005).

It might be better for a parent to advance a low-interest loan to his child (or non-resident) to purchase an income-producing fixed property in Greece rather than to make a donation. The findings above show that section 7(8) of the Income Tax Act (South Africa, 1962) will deem an amount of the income to be taxable in the hands of the resident and paragraph 72 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) will attribute a portion of the capital gain to be taxed in the resident's hand *but the capital gain will be limited* in terms of paragraph 73 Eighth Schedule of the Income Tax Act (South Africa, 1962).

An interesting application of the above was covered in the case study when a cousin of the siblings, being a South African resident, loaned €200 000 in 2004 to a family member resident in Greece who used the funds to buy an income-producing fixed

property in Greece. No interest was charged on the loan. The family member could have secured a loan from a bank at 6% fixed for five years. The fixed property was let under a full maintenance lease with the tenant covering all running costs. The fixed property earned a net rental income of €8 854, €9 555, €10 650 and €11 771 from 2004 to 2007 when it was sold for €400 000. The deemed income amount taxable in the cousin's hands each year was calculated as follows and reflected in the second last column.

The maximum capital gain that can be attributed back on disposal would be calculated as follows: €200 000 X 6% = 12 000 per year held.

		Deemed	**Average**	**Rand**
Year	**Net Rental (€)**	**Section 7(8)(€)**	**Exchange Rate**	**Value(R)**
2004	8 854	8 854	8,45	74 816
2005	9 555	9 555	7,87	75 198
2006	10 650	10 650	7,83	83 389
2007	11 771	11 771	9,78	115 120
Total	40 830			

The amount of capital gain attributable to the cousin was calculated as follows-

	(€)
Proceeds euros	400 000
Less base cost	(200 000)
Capital gain	200 000

Paragraph 73 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) limitation of attribution is €200 000 X 6% = €12 000 per year X 4 years = €48 000 less €40 830 (already included in terms of section 7(8) of the Income Tax Act (South Africa, 1962)) resulting in €7 170 having to be included in the hands of the cousin resident in South Africa.

The cousin had to then include R70 123 (€7 170 X R9.78) as a capital gain in his SA income in 2007 in addition to the deemed interest income reflected in the last column. Had the cousin donated the €200 000, the capital gain would not have been limited in terms of paragraph 73 Eighth Schedule of the Income Tax Act (South Africa, 1962) and would thus have been the full €200 000 amounting to a massive R1 956 000. This illustrates the importance of careful planning before embarking on any estate planning in Greece. These transactions seem commonplace and it appears as if affected residents have no idea of these taxation implications.

3.4.6 Double taxation relief – Section 6*quat*

A very important aspect of the deeming provisions discussed above is the fact that the section 6*quat* of the Income Tax Act (South Africa, 1962) rebate, as discussed in detail under “Taxation Implications of directly held fixed property” above, may be claimed by the resident in respect of any foreign tax paid by the non-resident to whom the income actually accrued. The South African resident would simply treat this income, capital gain

and any foreign tax paid by the non-resident as if he owned the fixed property and earned the income and paid the foreign tax.

3.5 DONATIONS TAX IMPLICATIONS

3.5.1 General discussions

Donations tax is a tax on the net transfer of assets and is dealt with in sections 54 to 64 of the Income Tax Act (South Africa, 1962). It imposes a flat rate of donations tax of 20% on South African *residents* who donate their assets in order to avoid normal income tax and/or estate duty. Donations tax is payable on the value of any fixed property disposed of, whether directly or indirectly, and whether in trust or not, under any donation by any donor who is *resident* in the Republic (Clegg & Stretch, 2007; Stretch et al., 2007). Section 59 of the Income Tax Act (South Africa, 1962) stipulates that donations tax is payable by the donor and should the donor fail to pay the tax within the prescribed period, the donor and the donee become jointly and severally liable for the tax (Huxham & Haupt, 2007:528; Clegg & Stretch, 2007).

"Property" is defined in section 55(1) of the Income Tax Act (South Africa, 1962) as any right in or to property, movable or immovable, corporeal or incorporeal, no matter where it is situated. According to Clegg and Stretch (2007), the word "property" includes both personal and real rights, provided such rights constitute rights in or to property, such as a right to an annuity in a property. The liability for donations tax depends upon whether or not the donor is resident in South Africa. Therefore the term "resident" (as discussed

in 3.2) is again key to whether donations tax is applicable on the donation of fixed property in Greece.

As section 6*quat* of the Income Tax Act (South Africa, 1962) does not appear to provide relief for donations tax, and the double taxation agreement between South Africa and Greece does not cover donations tax (Huxham & Haupt, 2007:343), resident taxpayers must be very careful when donating foreign assets as they could find themselves being subject to donations tax in both Greece and South Africa. In addition to the tax, interest in terms of section 89(2) of the Income Tax Act (South Africa, 1962) and additional tax (penalties), in terms of section 76 of the Income Tax Act (South Africa, 1962), of up to 200% could be applicable (Huxham & Haupt, 2007:533).

3.5.2 Section 56(1) exemptions

There are certain exemptions to donations tax as set out in section 56(1) of the Income Tax Act (South Africa, 1962). While, in terms of section 56(1)(b) of the Income Tax Act (South Africa, 1962), spouses may donate fixed property to each other and avoid donations tax on those donations, of particular importance to this study is the exemption granted by section 56(1)(g) (as amended with effect from 8 November 2005 by Act 31 of 2005) that deals with property situated outside the Republic of South Africa. Section 56(1)(g) of the Income Tax Act (South Africa, 1962) reads as follows:

> *56. Exemptions.—(1) Donations tax shall not be payable in respect of the value of any property which is disposed of under a donation—*

(g) if such property consists of any right in property situated outside the Republic and was acquired by the donor—

(i) before the donor became a resident of the Republic for the first time; or

(ii) by inheritance from a person who at the date of his death was not ordinarily resident in the Republic or by a donation if at the date of the donation the donor was a person (other than a company) not ordinarily resident in the Republic; or

(iii) out of funds derived by him from the disposal of any property referred to in sub-paragraph (i) or (ii) or, if the donor disposed of such last-mentioned property and replaced it successively with other properties (all situated outside the Republic and acquired by the donor out of funds derived by him from the disposal of any of the said properties), out of funds derived by him from the disposal of, or from revenue from any of those properties"

It is important to note that section 56(1)(g) of the Income Tax Act (South Africa, 1962) refers to property "outside the Republic" and as such only fixed property situated outside the Republic falls within this exemption provision. In addition, section 54 of the Income Tax Act (South Africa, 1962) refers to "any donation by a resident" and as such donations tax only applies to taxpayers who are resident in the Republic; the exemption provisions in section 56 of the Income Tax Act (South Africa, 1962) therefore do not affect persons who are not resident (Huxham & Haupt, 2007:529; Stein, 2004a:51). This again emphasises the importance of the definition of resident in section 1 of the Income Tax Act (South Africa, 1962), as discussed in detail in part 3.2 of this study.

With regard to the exemption in section 56(1)(g)(ii) of the Income Tax Act (South Africa, 1962), it is important to note that, in the case of fixed property that the present donor acquired by inheritance, it is a requirement that the deceased person should not have been resident in the Republic at the time of his death. Section 56(1)(g)(iii) of the Income Tax Act (South Africa, 1962) extends not only to fixed property acquired out of the proceeds of fixed property (situated outside the Republic) which itself would have ranked for the donations tax exemption by virtue of having been acquired either—

(i) prior to the present donor first becoming resident in the Republic; or

(ii) by inheritance or by donation from a person who, as at the date of the death or donation to the present donor, was not resident in the Republic; or

(iii) out of the proceeds of property referred to in (i) or (ii) above (or foreign property successive thereto),

but also to property acquired out of the revenues of the prior property, or property successive thereto (Stein, 2004a:53).

Therefore it is vital to distinguish how fixed property owned by South African residents in Greece was acquired. If the fixed property was acquired prior to the South African becoming a resident, or was inherited or donated from a non-resident, donations tax can be avoided if these assets are donated resulting in possible income tax and estate

planning opportunities being achieved, both in South Africa and Greece. However, the implications of the deeming provisions contained in section 7(8) of the Income Tax Act (South Africa, 1962) and the attribution rules applicable to capital gains discussed in part 3.4 must be considered. These tax and estate planning opportunities are discussed in part 5.3 of chapter 5 of this study.

As was clearly evident from the case study and the respondents interviewed, many South African residents would have regularised fixed property in Greece in terms of the Exchange Control and Amendment of Taxation Laws Act (South Africa, 2003a; Korten et al., 2003). In addition, many South African residents would have made declarations in terms of Exchange Control Circular No. D405 (South African Reserve Bank, 2003) which allowed residents, who had received foreign inheritances prior to 17 March 1998 and immigrants who possessed foreign assets and who had not declared these to the Reserve Bank, to regularise their foreign assets without the need to apply for exchange control relief in terms of the amnesty (South Africa, 2003a) and thereby avoid having to pay any amnesty levy (Haupt, 2004; Morris, 2004).

Therefore, in terms of section 56(1)(g)(ii) of the Income Tax Act (South Africa, 1962), if a South African resident owning fixed property in Greece had inherited the fixed property from a *non-resident* he would be able to donate these assets free of donations tax (Haupt, 2004; Morris, 2004; Adkins). However, the donation would result in capital gains tax being payable immediately on any growth in value after 28 February 2003 and not the value on 1 October 2001 as is normally the case (Haupt, 2004; Huxham &

Haupt, 2007). Section 28 of the Exchange Control Amnesty and Amendment of Taxation Laws Act (South Africa, 2003a) provides that the base cost of foreign assets in respect of which approval for amnesty was granted cannot exceed the sum of the value in foreign currency of that asset on 28 February 2003 and the allowable paragraph 20 expenditure after that date. A further very important point that resident taxpayers will need to note is that they would not be able to donate any foreign asset declared in terms of the D405 (South African Reserve Bank, 2003) to any other South African resident as this could transgress exchange control legislation (Van Staden, 2006:22)

An important aspect of the section 56(1)(g) of the Income Tax Act (South Africa, 1962) exemption (as set out above) is that it covers all replaced assets situated outside the Republic and subsequent growth if the assets were financed from the original inheritance or fixed property owned prior to becoming a resident (Haupt, 2004; Stein, 2004b).

Referring once again to the case study where the uncle of the siblings donated fixed property to his child, child A who was resident in South Africa: child A took advantage of the amnesty and declared the fixed property donated by his father. With this property now regulated and disclosed to the South African authorities, child A has taxation and possible estate duty obligations in both South Africa and Greece. The section 56(1)(g)(ii) and (iii) of the Income Tax Act (South Africa, 1962) exemptions referred to above would allow him to donate these assets free of South African donations tax. However, the donations (gift) tax implications in Greece as set out in chapter 4 must be

carefully considered, as must the possibility of tax on capital gains in South Africa. While the resident would still have a tax interest in the fixed property donated, resulting in the deeming provisions of the Income Tax Act being applicable, there could be future estate duty and income tax savings should he donate these assets to a correctly set up off-shore structure. The same principles applied to the siblings in the case study on the properties that they inherited from their grandfather. These tax savings and tax planning opportunities are discussed in detail in part 5.3 of chapter 5.

When a person is *deemed to be resident for the first time* is very important when relying on the section 56(1)(i) of the Income Tax Act (South Africa, 1962) exemption and its interpretation and possible implications are discussed in detail in part 5.3 of chapter 5. However, unlike the similar deduction allowed for estate duty discussed below, this aspect does not affect fixed property situated outside South Africa that was acquired from *inheritances or a donation from a non-resident* (Stein, 2004b). This is one of the reasons why the siblings in the case study decided to investigate the option of donating some of their fixed properties in Greece. By donating them and enjoying the above exemption from donations tax they could ensure that the possible problem regarding "when one is deemed to be resident for the first time" associated with the estate duty deduction would not become an issue on their death.

3.6 ESTATE DUTY

3.6.1 General discussion

The Estate Duty Act (South Africa, 1955) came into effect on 1 April 1955. In terms of this Act (South Africa, 1955), estate duty is payable in respect of the estate of every natural person who dies and was *ordinarily resident* in the Republic at the date of his death. Generally, the assets which belong to a person ordinarily resident in the Republic at the date of his death fall into his estate, no matter where in the world such assets are situated. If, however, a deceased person was not ordinarily resident in South Africa at the time of his death, only those assets situated in South Africa would fall into his estate in South Africa (Department of Finance, 2005a; Huxham & Haupt, 2007:539; Meyerowitz, 2007).

Therefore, foreign property such as fixed property situated in Greece and owned by a person ordinarily resident in South Africa would be subject to estate duty in South Africa. In terms of section 16(c) of the Estate Duty Act (South Africa, 1955), any death duties paid in the foreign country (Greece) may be deducted from the estate duty payable unless a double taxation agreement provides otherwise. Stein (2004a:89) agrees.

It should be noted that the Estate Duty Act (South Africa, 1955), unlike the Income Tax Act (South Africa, 1962), does not have a definition of “resident” (Clegg & Stretch, 2007; Meyerowitz, 2007). The Estate Duty Act (South Africa, 1955) refers to two types of

person: those who are ordinarily resident in the Republic and those who are not ordinarily resident in the Republic (Huxham & Haupt, 2007:539; Meyerowitz, 2007). Therefore, any natural person who is not ordinarily resident in South Africa, but who became a resident of South Africa in terms of the *physical presence test* (as discussed in 3.2.3 above) for income tax purposes, is still *regarded as a non-resident for estate duty purposes* owing to the fact that such person is not ordinarily resident in South Africa (Department of Finance, 2006c.).

3.6.2 Meaning of "ordinarily resident"

As the Estate Duty Act (South Africa, 1955) does not define the term "ordinarily resident", it has been necessary for the courts to formulate an effective definition of the term (Department of Finance, 2005a; Stretch et al., 2007). The importance of the term "ordinarily resident" in this study is again brought to the fore and has been discussed in detail in part 3.2 of this chapter.

3.6.3 Allowable deductions

In terms of section 4(q) of the Estate Duty Act (South Africa, 1955), all property included in the deceased estate, which accrues to the surviving spouse, can be deducted to the extent that it has been included in the estate (Huxham & Haupt, 2007:548).

However, as was the case with donations tax, it is vital to determine how fixed property in Greece was acquired by the deceased resident, as section 4(e) of the Estate Duty

Act (South Africa, 1955) provides for another deduction in respect of certain foreign assets.

Section 4(e) of the Estate Duty Act (South Africa, 1955) reads as follows:

> *Net value of an estate.—The net value of any estate shall be determined by making the following deductions from the total value of all property included therein in accordance with section 3, that is to say—*
>
> *(e) the amount included in the total value of all property of the deceased as representing the value of any right in or to property situate outside the Republic acquired by the deceased—*
>
> > *(i) before he became ordinarily resident in the Republic for the first time; or*
> >
> > *(ii) after he became ordinarily resident in the Republic for the first time, by—*
>
> *(aa) a donation if at the date of the donation the donor was a person (other than a company) not ordinarily resident in the Republic; or*
>
> *(bb) inheritance from a person who at the date of his death was not ordinarily resident in the Republic; or*
>
> > *(iii) out of the profits and proceeds of any such property proved to the satisfaction of the Commissioner to have been acquired out of such profits or proceeds;"*

According to Stein (2004a:81), the use of the words “any such property” in the last item above means that property acquired out of the profits or the proceeds of other property will be deductible only if the original property itself qualified for the deduction under the preceding items above.

Therefore, if the deceased acquired foreign shares before taking up ordinary residence in South Africa for the first time (this property being deductible), and subsequently sold these shares and used the proceeds to buy fixed property in Greece, the deduction would continue to be available for the fixed property in Greece. But if the property had been sold and the proceeds used to buy an asset in South Africa, the deduction would be lost (Stein, 2004a; Stein, 2004b:96; Meyerowitz, 2007).

According to Stein (2004a:81; 2004b:96) the deduction is not allowed to a person born in South Africa who, having left the country, returns to it and at the date of their death possesses foreign assets acquired while they were living overseas, since they must have acquired the fixed property *before becoming ordinarily resident in South Africa for the first time.*

The section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction is, however, allowed for foreign fixed property acquired by the deceased by donation or inheritance from a non-resident if the property was inherited by the deceased after they became ordinarily resident for the first time.

If a person was born in South Africa and remained ordinarily resident in South Africa for some time before leaving the country later returning to become ordinarily resident again, it may be argued that the deduction should be available for all donations of foreign fixed property made to them at any time or for foreign fixed property inherited by them at any time, on the basis that the donation or inheritance would have occurred after they became ordinarily resident in South Africa for the first time (at birth) (Stein, 2004a; Meyerowitz, 2007).

However, Stein (2004a:81) points out that the counterargument to the above would be that the provision only applies to a person who becomes ordinarily resident in the Republic after having been ordinarily resident elsewhere before becoming ordinarily resident in the Republic.

Therefore, if the counterargument is considered the correct interpretation, there is some uncertainty as to whether the siblings in the case study would enjoy the section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction on the fixed properties inherited in Greece from their non-resident grandparent on their death, as they had never left (and have no plans to leave) South Africa and had always been resident in South Africa.

However, even if the counterargument is considered incorrect, this deduction *would not* apply to their children once they inherit the fixed property, as they would have acquired the fixed property from a resident. Therefore, the case study revealed that members of the family in these situations were investigating the donations tax exemption discussed

in part 3.5.2 above with the view of donating these assets, as the donations tax exemption places no importance on when the fixed property being donated was inherited from the non-resident and eliminates the above risk.

As illustrated above, *whether* a person is a *resident*, and *when* a person is *deemed to be resident for the first time,* are very important when relying on the section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction and its interpretation and possible implications are discussed in more detail in part 5.3 of chapter 5.

3.6.4 Relief from double taxation

3.6.4.1 General discussion

The fact that a deceased person, who was ordinarily resident in South Africa at the time of his death, is liable for estate duty in South Africa on their worldwide assets, including fixed property in Greece, does not prevent Greece from also charging death duty on them and vice versa. Consequently, the same asset may be subject to double death duties. There is no double taxation agreement between South Africa and the Hellenic States (Greece) as relates to estate or death duty (Scholtz, 2005; Meyerowitz, 2007).

Therefore, if no deduction is permitted in terms of section 4(e) of the Estate Duty Act (South Africa, 1955) as discussed above, the only recourse a deceased South African

resident may have to paying estate duty in South Africa is provided for in section 16(c) of the Estate Duty Act (South Africa, 1955).

3.6.4.2 Section 16(c) relief

Section 16 (c) of the Estate Duty Act (South Africa, 1955) makes provision for the deduction of foreign death duties imposed on property situated outside the Republic and included, for estate duty purposes, in the estate of any person ordinarily resident in the Republic on their death.

Section 16 (c) of the Estate Duty Act (South Africa, 1955) reads follows:

> *There shall be deducted from any duty payable under this Act—*
>
> > *(c) without in any way modifying or adding to the rights of any person under an agreement entered into by the Government of the Republic with the Government of any other country or territory relating to the prevention of or relief from double taxation in respect of estate duty, any amount of any death duties proved to the satisfaction of the Commissioner to have been paid to any other State in respect of any property situate outside the Republic and included in the estate of any person who at the date of his death was ordinarily resident in the Republic: Provided that the deduction under this paragraph shall not exceed the duty imposed on such property by this Act.*

According to Stein (2004a:89–90), this deduction may not exceed the estate duty imposed on the property in the Republic, that is, the estate duty attributable to the

inclusion of the foreign property in the estate. The deduction is therefore limited to the lesser of the foreign death duties paid on the fixed property and the South African estate duty attributable to the fixed property. Therefore, if the rate of death duty is higher in Greece, the South African deceased estate will effectively pay death duty at the higher rate in Greece as the credit may not exceed the estate duty imposed in South Africa. With death duty increasing to 40% in Greece on certain assets, as discussed in chapter 4, this could lead to the deceased resident paying 40% (double the SA rate) on certain of his Greek properties. Remember a capital gains liability also arises on death as the deceased is deemed to have disposed of the fixed property at market value at the date of death.

The South African estate duty attributable to the foreign property concerned is, in practice, determined by the application of the following formula, which is accepted by the Commissioner:

$$\frac{\text{Net value of foreign property}}{\text{Total net value of estate}} \times \text{Estate duty payable on dutiable amount of estate}$$

The rebate is not allowed to a person who was not ordinary resident in the Republic on the date of their death, even though they may be liable for both foreign death duties and South African estate duty on the same fixed property (Stein, 2004a:90). Therefore non-residents, who are only liable for estate duty in South Africa on South African assets, will not be allowed a credit in South Africa on any death duty payable in Greece on these South African assets. This again highlights the importance of affected persons understanding the term “ordinarily resident” and how their wanderings between South

Africa and Greece could have a profound effect on their estate duty liability as well as income tax.

3.7 DISCLOSURE OBLIGATIONS AND RAMIFICATIONS OF NON-DISLOSURE.

3.7.1 Failure to report foreign assets – section 78(1A)

In terms of section 78(1A) of the Income Tax Act (South Africa, 1962) the Commissioner must, where the Commissioner has reason to believe that a resident has not declared or accounted for funds held in foreign currency or assets owned outside the Republic, or where the income or capital gain from any funds in foreign currency assets outside the Republic could be attributed to that resident in terms of section 7 or Part X of the Eighth Schedule of the Income Tax Act (South Africa, 1962), estimate the amount in foreign currency of such funds or the market value of such assets. For individuals, the amendments contained in section 78(1A) of the Income Tax Act (South Africa, 1962) apply to returns of income covering the year of assessment ending on 28 February 2003 and all subsequent years (Clegg & Stretch, 2007).

Having estimated the total of the foreign currency assets, the Commissioner must, in terms of section 78(1B) of the Income Tax Act (South Africa, 1962), apply the “official rate of interest” as defined in paragraph 1 of the Seventh Schedule of the Income Tax Act (South Africa, 1962), or a higher rate, to this value to determine the taxable income to be included. This amount, must then, in terms of section 78(1C) of the Income Tax Act (South Africa, 1962) be converted into the currency of the Republic at the ruling

exchange rate at the end of the year and included in taxable income of the resident. Huxham and Haupt (2007: 326) and Clegg & Stretch (2007) agree with this view.

However, the Commissioner must make his assessment only after giving the resident notice to account for those funds or assets that they have failed to disclose within the period stated by him in that notice (Clegg & Stretch, 2007).

According to SARS Interpretation Note No. 23 (Department of Finance, 2004), income estimated in terms of section 78(1B) of the Income Tax Act (South Africa, 1962) is the minimum prescribed estimate if all the requirements have been met. The Commissioner is, however, not bound by this amount and may make a higher estimate in terms of the general provisions of section 78(1) of the Income Tax Act (South Africa, 1962) if he is satisfied that the estimate arrived at in terms of subsections (1A), (1B) and (1C) of the Income Tax Act (South Africa, 1962) is too low.

In addition, the non-declaration of income amounts to a default in terms of section 76 of the Income Tax Act (South Africa, 1962) and the Commissioner is, therefore, obliged to impose additional tax, which may be remitted in full or in part depending on the facts and circumstances of the case. In cases where the taxpayer has not cooperated and the Commissioner is forced to make an estimate in terms of section 78 of the Income Tax Act (South Africa, 1962), the taxpayer may face additional taxes of up to twice the tax chargeable in respect of the income estimated (Department of Finance, 2004). In addition to the additional tax chargeable, interest on the underpayment of provisional

tax will also be levied in terms of section 89*quat*(2) of the Income Tax Act (South Africa, 1962).

In the conclusion to Interpretation Note No. 23 (Department of Finance, 2004), SARS confirms that the measures contained in section 78(1A), (1B) and (1C) of the Income Tax Act (South Africa, 1962) can produce punitive results, but adds that such consequences can be easily avoided if residents keep proper records of their off-shore income and assets, make full disclosure in their returns of income and respond in a timely fashion to any enquiries from the Commissioner.

This section is of the utmost importance to those residents who have made declarations of their fixed property in Greece in terms of the Exchange Control and Amendment of Taxation Laws Act (South Africa, 2003a). Should they not disclose their income or forget to disclose their income on these assets, SARS will apply section 78 of the Income Tax Act (South Africa, 1962) and possible penalties in terms of section 76 of the Income Tax Act (South Africa, 1962) and the Fourth Schedule of the Income Tax Act (South Africa, 1962). To add to this, one must remember that the “official rate” referred to in the Seventh Schedule is generally based on the prime lending rate in South Africa and it is very likely to be much higher than the actual rental yield being achieved on fixed property in Greece and earned in euro.

Resident taxpayers must remember that SARS will have all the details of their fixed properties disclosed in terms of the amnesty (South Africa, 2003a) or in terms of a D405

(South African Reserve Bank, 2003) declaration making the application of section 78 of the Income Tax Act (South Africa, 1962) very easy should a taxpayer omit to disclose details of his fixed property in Greece in his tax return

3.8 SMALL BUSINESS TAX AMNESTY

In the February 2006 Budget, the Minister of Finance announced that the government would be offering a tax amnesty to small businesses to afford them the opportunity to regularise their tax affairs. This amnesty was provided in terms of the Small Business Tax Amnesty and Amendment of Taxation Laws Amendment Act, 2006 (South Africa, 2006b) and the Second Small Business Tax Amnesty and Amendment of Taxation Laws Amendment Act, 2006 (South Africa, 2006c).

The amnesty was introduced on 1 August 2006 and initially ran until 31 May 2007, but was subsequently extended to the end of June 2007. The amnesty was applicable to any individual who met with the following requirements:

- the individual must have carried on a business
- the gross income during the 2006 tax year did not exceed R10 million

This was a very broad amnesty and it is submitted that it would apply to an individual who carried on the business of letting fixed property in Greece. As certain members of the family in the case study and many respondents interviewed had not disclosed certain aspects of their rental income to SARS, this amnesty provided a second

opportunity to regularise their taxation affairs with SARS. Accordingly, applications were made and, once approved, the applicants were granted relief from the payment of

- income tax on the profits of the small business in all years of assessment preceding the 2006 year of assessment
- employees tax in terms of the Fourth Schedule of the Income Tax Act (South Africa, 1962) during any tax period ending on or before 28 February 2006
- VAT during any tax period ending on or before 28 February 2006
- withholding tax in respect of amounts paid to non-residents during any tax period ending on or before 28 February 2006
- UIF during any tax period ending on or before 28 February 2006
- skills development levies during any tax period ending on or before 28 February 2006

A levy based on the 2006 taxable profits of the small business was payable based on a sliding scale starting at 0 to 5% (South Africa, 2006b). While most of the above taxes were irrelevant for foreign rental income the amnesty covered income tax on rentals and capital gains earned on Greek properties that had not been declared during the qualifying period. This amnesty was another great opportunity for affected residents to regularise their income tax position concerning rentals and capital gains not previously declared.

3.9 CHAPTER SUMMARY

This chapter has focused on the taxation and estate duty aspects affecting the ownership of fixed property in Greece by a South African resident. This was done by reviewing all the relevant sections of the Income Tax Act (South Africa, 1962) and Estate Duty Act (South Africa, 1955), as well the various interpretation and practice notes and the various guides issued by SARS. The Double Taxation Agreement between South Africa and the Hellenic States was also reviewed. In addition, leading textbooks, journals, publications and articles on this topic were reviewed, and discussions and interviews were conducted with accomplished authors and leading experts on related topics. This chapter has identified the important taxation areas in South Africa that affect the resident and areas posing possible complications, as well as sections providing possible relief for the double taxation of income tax, donations tax and estate duty. The chapter concludes with flow chart summaries of all the relevant aspects set out in a simple and precise format with links to the relevant paragraphs in the body of the document for more detail (figs 3 and 4 below).

The next chapter will give some insight into the taxation and estate/death duty implications of owning fixed property in Greece. The problems associated with the non-recognition of trusts and the benefits of using a Greek resident company to own fixed property are also discussed.

Figure 3 - Income Tax Implications in South Africa

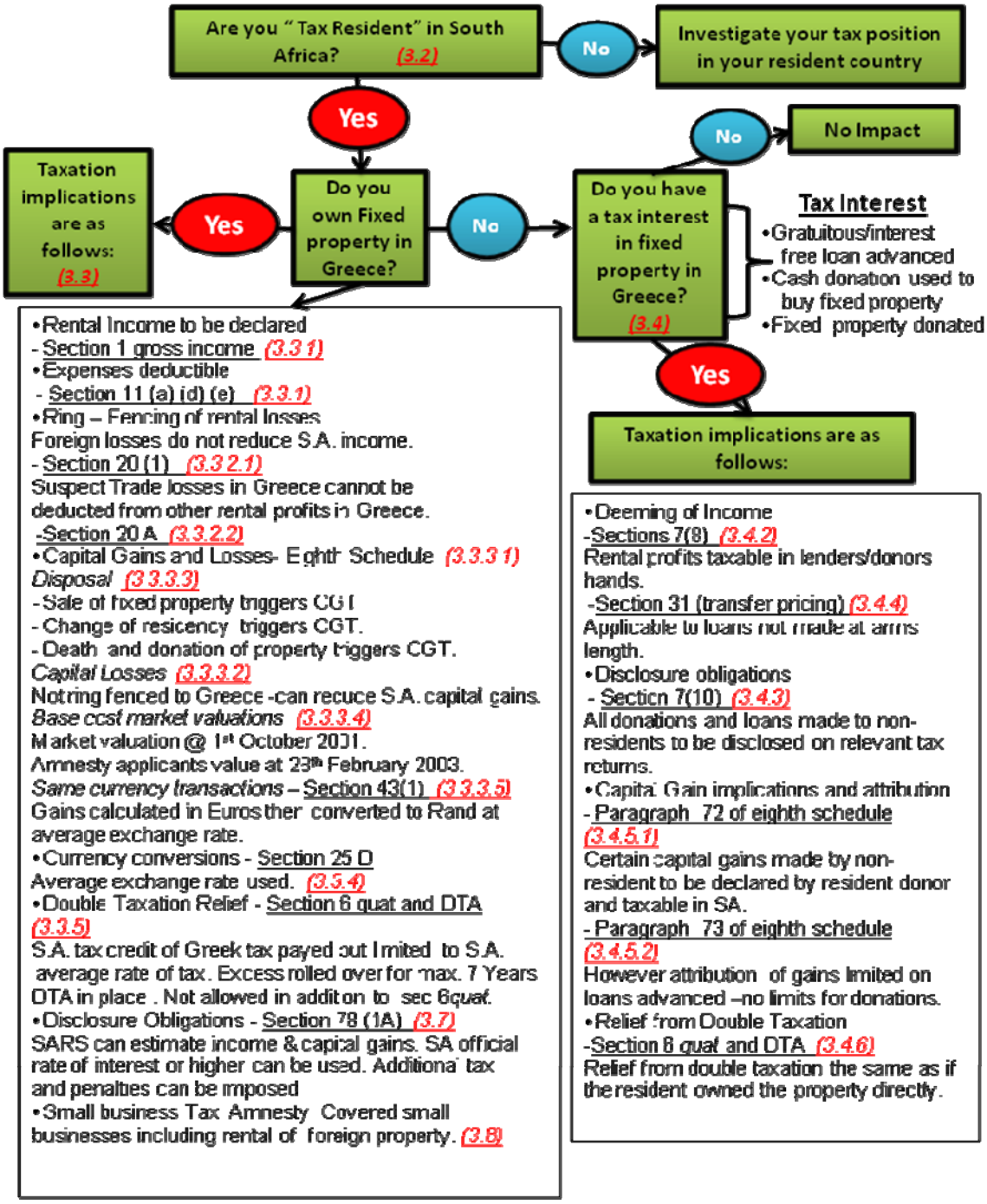
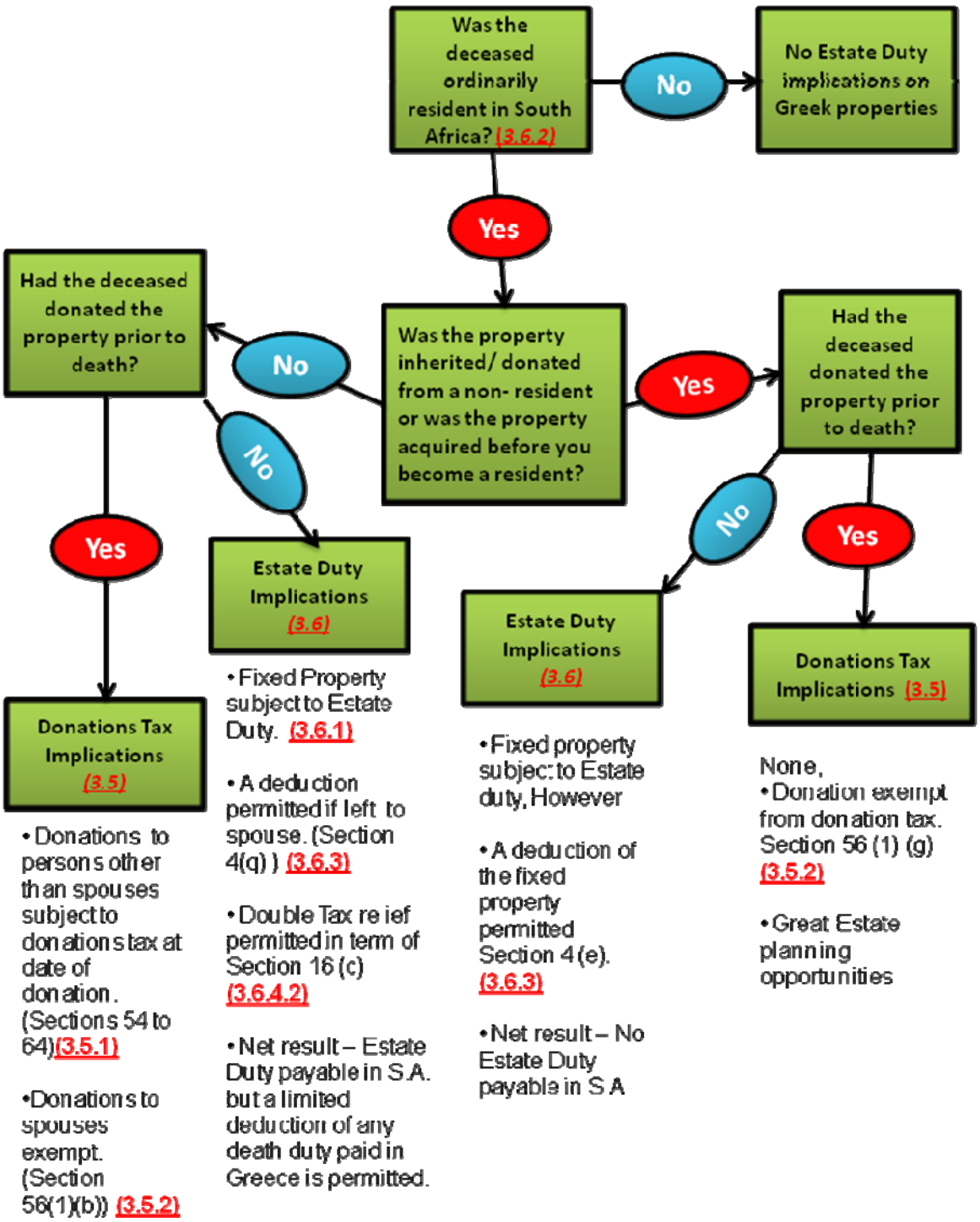


Figure 4 - Donations Tax and Estate Duty Implications in South Africa



CHAPTER 4

TAXATION AND DEATH DUTY IMPLICATIONS IN GREECE

4.1 INTRODUCTION

This chapter will briefly discuss the various forms of taxation that affect the ownership and the transfer of fixed property by a South African resident in Greece. Inheritance (estate duty) and gift (donations) tax will also be addressed, as will the different tax treatment when properties are owned by non-residents as opposed to resident Greek taxpayers. This chapter ends with flowchart summaries of all the relevant aspects set out in a simple, precise format in figures 9 and 10.

As holding fixed property in companies appears to have certain taxation advantages, the taxation of resident companies in Greece is discussed briefly. In addition, as it may be beneficial to transfer fixed property into Greek resident companies, the procedure and costs associated with the transfer of fixed property from an individual to a company are also addressed.

4.2 TAXATION

4.2.1 Individual taxation

According to Taliaki (2007) and Internaxx (2007), individuals (Greek and non-Greek) owning real estate (fixed property) in Greece or receiving income from fixed property situated in Greece, need to obtain a Greek tax registration number and file a Greek income tax return. Non-residents are only taxed on their income from a Greek source at the same progressive tax rates applicable to residents (Taliaki, 2007; Worldwide-Tax, 2007). However, non-residents are not entitled to any of the deductions and allowances that may be claimed by residents (Taliaki, 2007). Therefore, the siblings in the case study, being South African residents, were required to declare the *gross rental income* earned from all fixed property situated in Greece for tax purposes in Greece, without any deductions allowed for normal operating expenses. This is significantly different to South Africa where expenses are deductible against rental income as discussed in detail in part 3.3.1 of chapter 3.

All taxes levied on an individual's income in Greece are progressive. As of 2006 (1 January 2006 to 31 December 2006), a self-employed individual is taxed at the rates set out in the table below (Taliaki, 2007; Worldwide-Tax, 2007).

Figure 5 – Tax table Greece

Tax (%)	Tax base (€)
0	1 - 9 500
15	9 501 - 13 000
30	13 001 - 23 000
40	23 001 and over

The tax year runs from 1 January to the end of December for individuals and tax returns are due the following April/May.

4.2.2 Corporate taxation

A Greek resident company can be a beneficial vehicle for owning fixed property in Greece and as they are discussed in the suggestions for applications of this research in part 5.3, their tax implications in Greece are discussed only briefly in this section.

Greek companies are taxed on their income in Greece and from abroad. Foreign companies in Greece are taxed only on income that is generated in Greece. The profits of a company for the 2006 tax year were taxed at a rate of 29% as long as they were not listed companies (Tripidakis, 2006; Worldwide-Tax, 2007; Internaxx, 2007). From 2007, the tax rate reduced to 25%. Unlike non-resident individuals or companies, normal operating expenses are deductible from rental income by a company resident in

Greece (Taliaki, 2007). Therefore, a Greek resident company will pay significantly less tax on rental profits in Greece as, firstly, tax is calculated on the net profit and not the gross proceeds, and secondly, the tax rate of a company is much lower than the maximum marginal rate of a natural person even after the additional tax has been included as discussed below.

4.2.3 Additional tax on income from fixed property

Income from fixed property (i.e. rentals) is subject to an additional tax calculated on gross income. This tax is calculated at the following rates (Price Waterhouse Coopers, 2006; Tripidakis, 2006; Taliaki, 2007):

- 3% for legal entities
- 1,5% for individuals. This additional tax is imposed not only on the income from houses that are rented, but also on the "presumed" income by self-occupied homes, primary or secondary if they exceed the exempt value. This rate increases to 3% for residences exceeding 300 square metres.

4.2.4 Further taxation on real estate

In addition to normal taxation and the additional tax set out above, fixed property situated in Greece is subject to several additional forms of tax. A key issue relevant to real estate taxation in Greece is the concept of “objective value”, which is a deemed value determined according to a formula prescribed by the tax authorities and that is regularly revised. This value does not coincide with book or market value, and varies according to area (Price Waterhouse Coopers, 2006; Tripidakis, 2006; Taliaki, 2007).

However, the objective value is usually less than the market value (Tripidakis, 2006; Taliaki, 2007). The case study revealed that the objective value on properties owned by the family were in all cases less that than the family member considered to be the fair market value of the property.

4.2.4.1 Real estate tax

In Greece, owners of real estate are subject to real estate tax on their fixed property. This tax is applicable to individuals and companies and is calculated on the objective value as defined above (Tripidakis, 2006; Price Waterhouse Coopers, 2006; Taliaki, 2007).

Real estate that is valued at less than the limit specified by law is exempt from real estate tax. The real estate tax rate varies between 0,3–0,8% on amounts above the relevant exemptions set out below (Price Waterhouse Coopers, 2006; Taliaki, 2007):

For individuals:

- The first €243 600 (€487 200 for married couples) of the value of the fixed property is not subject to tax.
- On fixed property values above €243 600, the amount is subject to tax according to a scale ranging from 0,3–0,8%.

For legal entities:

- The first €243 600 of the value of the fixed property is not subject to tax.
- On fixed property values above €243 600, the amount is subject to tax at 0,7%.

However, if a bank mortgage is taken on the fixed property the tax-free amount increases to the amount of the mortgage (Taliaki, 2007).

4.2.4.2 Municipal real estate duty

Real estate owners are also subject to municipal real estate duty, currently calculated at between 0,25 and 0,35 on the objective value of the fixed property (Price Waterhouse Coopers, 2006; Tripidakis, 2006; Taliaki, 2007).

4.2.4.3 Stamp duty

Rentals are subject to 3,6% stamp duty and the landlord is liable for payment but usually recovers it from the tenant (Price Waterhouse Coopers, 2006; Taliaki, 2007).

The taxation implications of owing fixed property in Greece have been discussed in part 4.2 above and to best illustrate this we refer back to the case study example discussed in part 3.3.5.3 of fixed properties owned by sibling A. The properties earned a gross rental of €56 164 and incurred operational expenses totalling €32 444 per year resulting in a net rental profit of €23 720. The operational expenses (listed in 3.3.5.3) included the various taxes referred to above as follow:

Municipal taxes	€2 625
Real estate taxes	€2 344
Stamp duty	€2 021

The sibling, being *a South African resident individual,* paid tax of €23 208 (40% + 1,5% of the *gross rental*) in Greece, while a *Greek resident* individual or company will pay tax

only on the *net profits*. The net profit for a resident individual would be €23 720 while the company will have slightly less profit because of the higher rate of real estate tax payable by companies. The rate at which the tax is levied on the net profits depends on whether the resident is a natural person or a company. A company would pay at a flat rate of 32% (calculated at 29% + 3%) and an individual on the sliding scale set out above with the maximum rate ending on 40% plus the 1,5% additional tax.

Bearing in mind that the section 6*quat* credit in terms of the Income Tax Act (South Africa, 1962) in South Africa is ring-fenced and allowed on a pro rata basis, the overpayment of tax in Greece would in all likelihood not be recouped in South Africa within the seven-year limitation period as explained in part 3.3.5.3 of chapter 3 of this study. Therefore, if a company owns fixed property, the taxation liability in Greece could be more aligned to the effective rate payable in South Africa with the resultant taxation savings for the South African resident.

4.3 INHERITANCE (ESTATE DUTY) AND GIFT (DONATIONS) TAX

Tax Law 2961/2001 “Code of Provisions Regarding Taxation of Inheritances, Gifts, Dowries and Profits from Lottery” deals with inheritance (estate duty) and gift (donations) taxation in Greece (Tripidakis, 2006; Taliaki, 2007).

4.3.1 Inheritance (estate duty) tax

According to Tripidakis (2006), when an inheritance consists of real estate, the heir must formally “accept” the estate through a deed drafted and executed before a public notary. This deed must then be registered with the local land registry (where the fixed property is located) in the name of the heir (Tripidakis, 2006). The heirs (under intestacy or by virtue of a will) must file an inheritance tax statement within six months if they live in Greece, or 12 months if they live abroad. The time limit for this statement begins at the date of death or, should there be a will, as of the date of the will's publication (Tripidakis, 2006; Taliaki, 2007).

Inheritance tax is imposed on the value of certain assets bequeathed by an individual and the tax rate depends on the type of asset bequeathed (Tripidakis, 2006; Taliaki, 2007). Inheritance tax on real estate and shares in companies owning real estate are discussed below.

4.3.1.1 Inheritance and gift tax on fixed property

In order to determine inheritance tax on fixed property, heirs are divided into categories depending on the relationship that connects them with the deceased. For each category a different progressive tax scale applies starting with a tax-free amount (which is €95 000) for the first category and increasing to 40% (Tripidakis, 2006; Taliaki, 2007); generally, the closer the relationship to the deceased, the lower the tax obligation. The heirs (beneficiaries), depending on their relationship with the deceased, are grouped into the following three categories (Tripidakis, 2006; Taliaki, 2007). For each of these

categories a different progressive tax scale applies (effective from 1 March 2007) as follows (Taliaki, 2007):

Category A – is applicable to inheritance that devolves to

- the wife of the deceased
- descendants of the first grade (children from a legal marriage, children born without marriage of their parents when inheriting from their mother on the condition that they have been recognised voluntarily or judicially when inheriting from their father, legalised by a posterior marriage of their parents)
- consanguine descendents of second grade
- consanguine ancestors of first grade (parents)

Figure 6 – Category A

Scale (€)	Percentage of the scale (%)	Tax of the scale (€)	Value of the property (€)	Tax that should be paid (€)
First 95 000	-	-	95 000	-
Next 25 000	5	1 250	120 000	1 250
Next 145 000	10	14 500	265 000	15 750
Above 265 000	20			

Category B – is applicable to inheritance that devolves to

- descendants of the third and following degrees
- ancestors of the second and following degrees
- voluntarily or judicially recognised children with regard to ancestors of their father
- descendants of the recognised children with regard to the father who has recognised them and his ancestors,
- siblings
- consanguine relatives of the third degree collaterally related
- stepfathers and stepmothers
- children of a previous marriage of the husband/wife
- children of a marriage relationship (son-in-law, daughter-in-law)
- ancestors from a marriage relationship (father-in-law, mother-in-law)

Figure 7 – Category B

Scale (€)	Percentage of the scale (%)	Tax of the scale (€)	Value of the property (€)	Tax that should be paid (€)
First 20 000	-	-	20 000	-
Next 55 000	10	5 500	75 000	5 500
Next 195 000	20	39 000	270 000	44 500
Above 270 000	30			

Category C – is applicable for inheritance that devolves to

- any other consanguine relative
- or relative from marriage
- or person who is not a relative of the deceased

Figure 8 – Category C

Scale (€)	Percentage of the scale (%)	Tax of the scale (€)	Value of the property (€)	Tax that should be paid (€)
First 6 000	-	-	6 000	-
Next 66 000	20	13 200	72 000	13 200
Next 195 000	30	58 500	267 000	71 700
Above 267 000	40			

4.3.1.2 Inheritance tax on shares

Taliaki (2007) sites tax legislation (I.3091/02 article 11 par.1b) and confirms that shares in a company bequeathed or donated by an individual will result in inheritance tax being payable at a rate that is determined depending on who inherits the shares. Two family categories are defined as follows:

- First category beneficiary – category A as described above (This category includes parents, spouses and children of the deceased.)
- Second category beneficiary – category B as described above (This category includes grandchildren, brothers, sisters, nephews, nieces and step-parents.)

A first category beneficiary would attract only 1,2% inheritance tax on the value of the shares while a second category beneficiary would attract inheritance tax at 2,4%. If you compare these rates to the inheritance tax payable on fixed property held directly (20%), as discussed in 4.3.1.1, there appears to be estate planning opportunities for South African residents to use companies to own fixed property in Greece. These estate planning opportunities together with the tax advantages of owning fixed property in a company in Greece are discussed in more detail in chapter 5.3 of this study.

4.3.2 Parental gifts (donations) tax

Gifts (donations) tax varies according to the category of beneficiary as set out above and is calculated in the same manner (Taliaki, 2007). However, a parent may donate a house to a child (for his/her use) up to a value of €90 000 free of gifts tax (Taliaki, 2007). In addition, donations by parents to children, up to a total amount of €120 000 for each parent over his or her lifetime, attract gifts tax at only half (½) of the usual gifts tax rate (Taliaki, 2007; Tripidakis, 2006). This amount is increased to €130 000 if one of the parents pass away. Any previous parental gifts/donations that have been made are taken into account when determining these concessions (i.e. they are added together and the concession is reduced accordingly) (Tripidakis, 2006; Taliaki, 2007).

According to Tsakiraki (2007), donating assets to children during the parent's lifetime can reduce inheritance tax. These taxes can be paid in one payment resulting in a 5% discount or in several instalments provided each instalment exceeds €300 (Tsakiraki, 2007; Taliaki, 2007). These concessions are the reason why the various family

members in the case study either received or made donations to/from children/parents as part of the estate planning technique discussed in detail in chapter 3 that can end up creating taxation problems for South African residents.

According to Taliaki (2007), gifts tax in Greece can be summed up as follows:

A gifts tax liability will arise in Greece if

- a donation of any property, movable or immovable, is made that is situated in Greece
- a donation of any movable property situated outside of Greece is donated by a Greek citizen
- a donation of any movable property situated outside of Greece by a non-Greek citizen to a Greek or non-Greek citizen who has his permanent residence in Greece

Therefore, it appears as if there is no gift tax on assets situated outside Greece and donated between parties provided both parties are not resident or Greek citizens. This can be very useful when it comes to estate planning if a South African resident is exempt from donations tax in terms of section 51(1) of the Income Tax Act in South Africa (South Africa, 1962) on fixed property situated in Greece. The South African resident could then sell the fixed property they own in Greece to a Greek company and donate the resulting loan account. This donation could be to a discretionary trust, a spouse or a sibling. This donation appears to be free of donations tax in both South Africa and Greece. In addition, death duties in Greece may then be reduced, as the death duty would be payable on the value of the share and at the lower rate as set out

in 4.5.1.2 above (1,2% if left to a child as opposed to between 5 and 20%). In addition the resident would not be liable for estate duty in South Africa as the asset would no longer belong to them. These planning opportunities are discussed in more detail in part 5.3 of this study.

4.4 SALE OR TRANSFER OF FIXED PROPERTY

The sale or transfer of fixed property from a natural person to a company can be very expensive. The cost of transferring fixed property by a natural person to a legal entity such as a limited liability company in Greece would depend on how the fixed property is transferred. The relevant taxes vary depending on whether the transfer takes the form of a sale, a donation or a bequest (inheritance). In addition to the capital gains liability that may arise in South Africa, the following taxes and transfer costs in Greece should be considered.

4.4.1 Capital gains on the sale of fixed property

Capital gains tax (CGT) has only recently (2006) been introduced to affect transfer of fixed property from natural persons in Greece; prior to this CGT only affected transfers from companies. CGT for individuals only affects properties purchased after 1 January 2006 and capital gains are taxed at a rate starting at 20% and reducing to nil depending on the length of time the property has been held by the seller. The seller pays this tax and if CGT is payable on the sale of a property then real estate transfer tax and municipal transfer tax discussed in 4.4.2 and 4.4.3 below are not levied (Worldwide-Tax, 2007; Taliaki, 2007).

4.4.2 Real estate transfer tax

A real estate transfer tax is payable in Greece on the sale of real estate. The tax rate varies between 7–11% depending on the value and location of the fixed property. The tax rate on fixed property of up to €15 000 is 7% and 9% for any transfer above €15 000. These rates are increased by 2% when the fixed property is situated in an area covered by a public fire protection service (which is usually the case). If the property sold is subject to CGT, this tax is not levied. Therefore, if the seller acquired the property being sold before 1 January 2006, then this tax is levied; however, if he acquired it after 1 January 2006 then the sale would be subject to CGT and this tax would then not be levied. This tax is paid by the purchaser (Price Waterhouse Coopers, 2006; Tripidakis, 2006; Taliaki, 2007).

4.4.3 Municipal transfer tax

In addition to the real estate transfer tax mentioned above, a local authority surcharge equal to 3% (i.e. municipality tax) is also imposed. As is the case above, if the property sold is subject to CGT, this tax is not levied. Therefore, if the seller had acquired the property being sold before 1 January 2006 then this tax would be levied, however, if he acquired it after 1 January 2006 then the sale would be subject to CGT and this tax would not be levied. This tax is also paid by the purchaser (Price Waterhouse Coopers, 2006; Taliaki, 2007).

4.4.4 Transfer costs

According to Taliaki (2007) these costs can be broken down as follows:

- notary public fees (approx. 1,6% of the value)
- attorney's compulsory fees (calculated according to the Bar Association – imposed for attorneys fees in Greece starting at 1% and reducing to 0,4% depending on the value)
- land registry (approx. 4,5% of the value)

In addition to the above, the way the company is financed to purchase the fixed property will also have a bearing on costs. If the company does not intend to take a loan (mortgage), the share capital of the company has to be at least equal to the value of the fixed property which is being transferred. On the formation of the company this share capital attracts a capital duty of 1% as well as the attorney's compulsory fees (calculated according to the Bar Association imposed for attorney's fees in Greece starting at 1% and reducing to 0,4% depending on the value) for the contract relating to the incorporation of the company. Therefore, if the fixed property is transferred at €400 000 there would be an additional cost of €4 000 if the company does not secure bank finance (Taliaki, 2007).

The bank loan scenario is considered to be more advantageous, as it will provide various tax advantages such as the deduction of the interest on the loan (mortgage) and a considerable reduction in real estate tax as discussed in part 4.2.4.1, as the mortgage amount is deducted from the fixed property value when calculating the real estate tax. This is in addition to the saving in the capital duty (1%) mentioned above and the attorney's compulsory fees (Tripidakis, 2006; Taliaki, 2007).

4.5 REVALUATION OF FIXED PROPERTY

Land and buildings must be revalued every four years in accordance with the requirements specified by the Ministry of Finance for accounting and tax purposes. The most recent revaluation year was 2004. However, this provision does not apply to companies using IFRS as their statutory reporting system (Price Waterhouse Coopers, 2006).

4.6 DOUBLE TAXATION AGREEMENT

As discussed in detail in chapter 3, Greece has entered into a double taxation agreement with South Africa (South Africa, 2003b). However, this agreement only covers income tax (including capital gains). No double taxation agreement exists between the two countries covering estate/death duties (Scholtz, 2005). According to Worldwide-Tax (2007), the Double Taxation Prevention Treaty takes precedence over the Greek Income Tax Ordinance. In other words, if certain income is taxable under the Greek Income Tax Ordinance but there is an exemption (reduced tax) under any taxation treaty, the income is taxed, but only according to the provisions of the taxation treaty.

4.7 CHAPTER SUMMARY

This chapter has focused on identifying the taxation and estate duty implications in Greece affecting the ownership of fixed property by a South African resident. It has identified areas posing possible problems and complications, as well as identified possible solutions to these problems and possible relief for double taxation of income tax, donations tax and estate duty.

The chapter concludes with flowchart summaries of all the relevant aspects set out in a simple, precise format with links back to the relevant paragraphs in the body of the document for more detail (figs 9 & 10 below).

The next chapter presents the results and research findings of the central problem of this study. It analyses the findings and provides general discussions and planning opportunities and suggestions for applying this research.

Figure 9 - The Taxation Implications in Greece

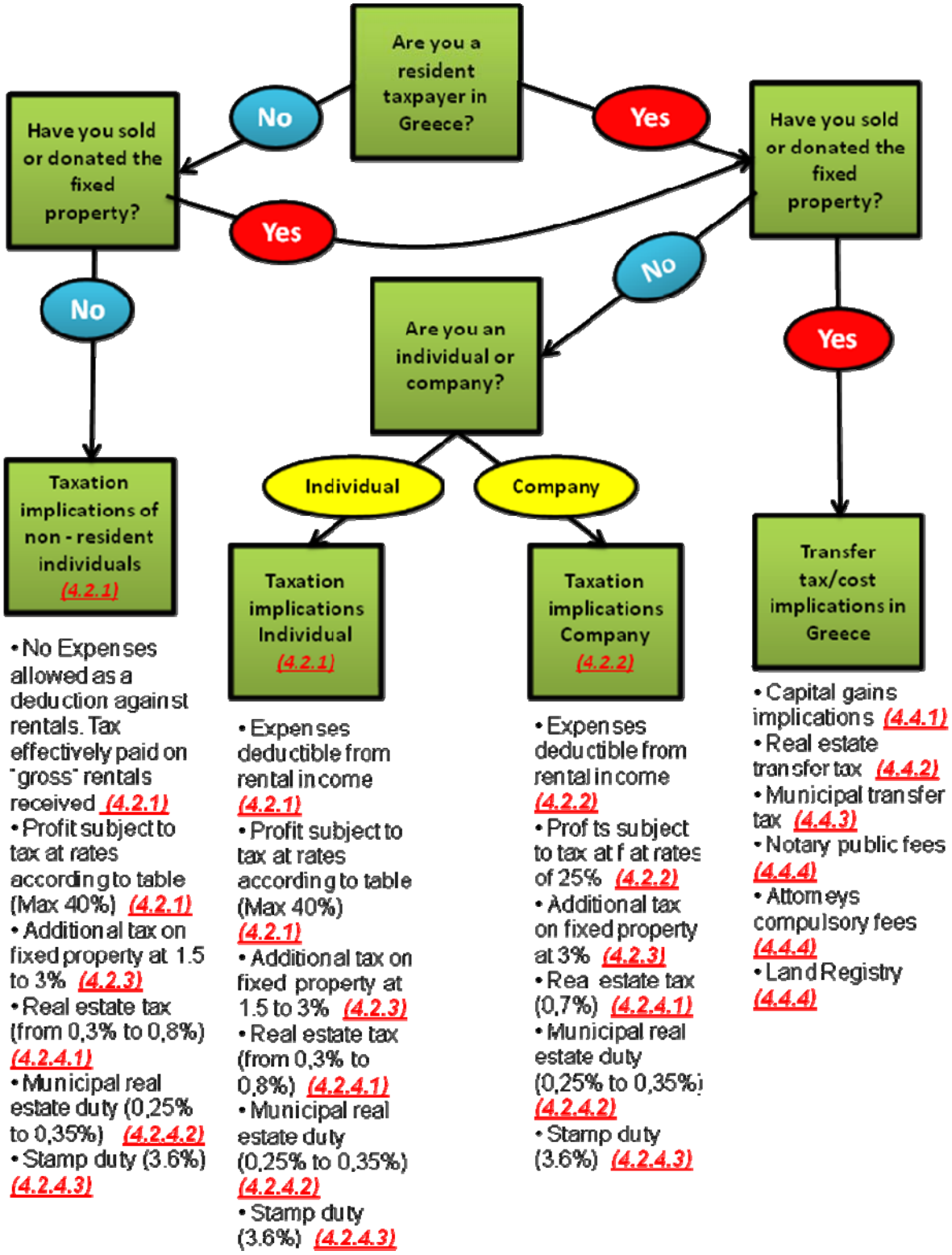
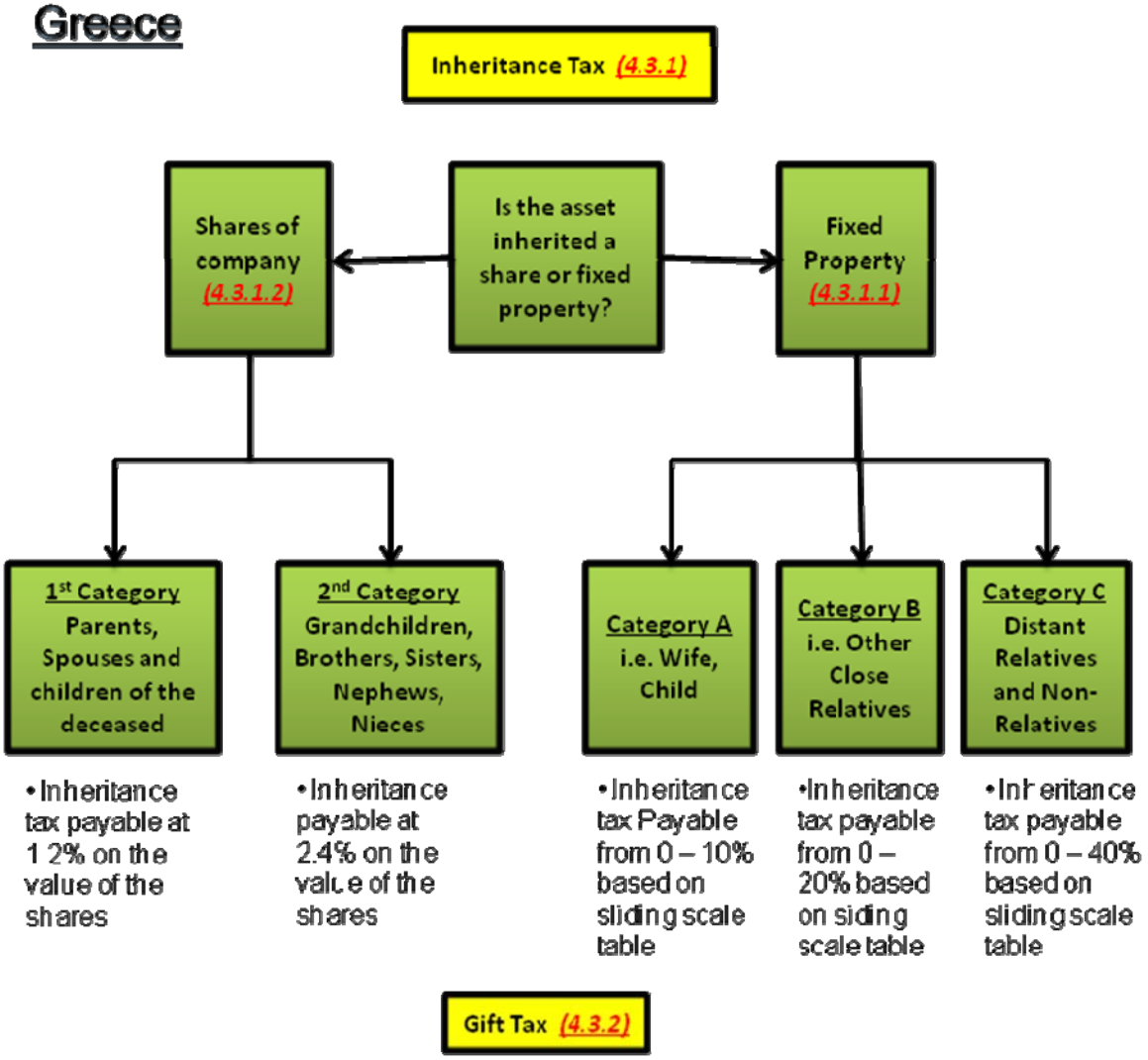


Figure 10 - Inheritance and Gift Tax Implications in Greece



Gift tax is calculated in the same manner as inheritance tax above, however:

- Parents may donate a residential house to a child for his own use to a value of €90 000 free of gift tax.
- There are reduced rates of 50% applicable to gifts to children on amounts up to €120 000.
- There is a 5% discount on gift tax paid during a parents life time.

CHAPTER 5

RESEARCH FINDINGS, DISCUSSIONS AND APPLICATION OF THEORY

5.1 INTRODUCTION

Chapter 3 identified and discussed the implications of the various sections of the Income Tax Act (South Africa, 1962) and the Estate Duty Act (South Africa, 1955) in South Africa that affect the owning of fixed property in Greece. Chapter 4, on the other hand, identified the various forms of taxation applicable in Greece. This chapter sets out the findings of the central problem of this study and a summary of the findings of the various subproblems identified. It also provides a detailed discussion on various aspects of these findings. Planning opportunities, solutions to problems identified and recommendations for the application of this research to avoid double taxation, and at the same time reduce income tax and estate duty in both countries, are presented. General estate planning considerations such as perpetual succession, asset protection and family wealth preservation are also covered in this chapter.

5.2 FINDINGS OF THIS STUDY

The central aim of this study was to determine the South African taxation and estate duty implications and subsequent problems of a South African resident owning or having a tax interest in fixed property in Greece. This study has found that there are three crucial factors that affect this problem. They are the cornerstone of this study and are the initial determining factors that must be considered when identifying the taxation and estate duty implications of owning or having a tax interest in fixed property in Greece. They also have a significant impact on the future planning opportunities that may exist. The following important factors therefore constitute the cornerstone of this study:

- The problem starts and finishes with the definition of “resident” as defined in section 1 of the Income Tax Act (South Africa, 1962) and it is imperative to firstly determine whether a taxpayer is in fact resident for taxation and estate duty in South Africa.
- Once it has been determined that a person is resident for taxation purposes, one needs to ascertain whether the taxpayer owns fixed property directly or has a tax interest in fixed property situated in Greece.
- Finally, it is essential to determine how the fixed property or interest in the fixed property was acquired.

This research has also established that it is not possible to achieve the central aim (main problem) of this study without identifying the taxation and death duty implications

in Greece. This study identifies the advantages of using a Greek company to own fixed property in Greece as it reduces the taxation liability in Greece, as well as the overall taxation and estate duty obligation between the two countries. The use of a company also lays the foundation for estate planning opportunities in both South Africa and Greece.

Importance of "tax residence"

As referred to above, the problem of this study effectively starts and ends with the definition of "residence" as defined in section 1 of the Income Tax Act (South Africa, 1962). This is so because for there to be any taxation obligations in South Africa a taxpayer must be resident as defined in the Income Tax Act (South Africa, 1962). In addition, estate duty only applies to fixed property in Greece if the owner is ordinarily resident in South Africa at the time of death.

Accordingly, any person living in South Africa who owns or has a tax interest in fixed property in Greece must ensure that they and their advisors have a precise, clear understanding of the term "resident".

Importance of determining directly owned fixed property or having a tax interest in fixed property

This study has found that an affected South African resident either owns fixed property directly in their name or has a tax interest in fixed property. The taxation implications are

intrinsically determined by these two factors. The complex deeming provisions and attribution rules are applicable when an individual is considered to have a tax interest in fixed property in Greece and could be easily overlooked by affected residents.

The importance of determining how the fixed property in Greece was acquired

Each and every fixed property in Greece that is owned by a South African resident in their own name must be thoroughly analysed in order to determine how each fixed property was actually acquired, as this significantly impacts on the estate duty and donations tax implications. This study has found that this can be divided into four categories:

A Fixed property received as an inheritance or donation from a non-resident

B Fixed property owned by a resident before that person became a resident of the Republic for the first time

C Proceeds from A and B above

D All other means (such as from one's own savings, or inheritance or donations received from resident South Africans)

By identifying how the fixed property was acquired, one is then able to determine how estate duty and donations tax will impact on the fixed property ownership in South Africa.

Chapter 3 of this study has shown that assets acquired under ategory A, B or C could enjoy a deduction from estate duty in South Africa in terms of section 4(e) of the Estate Duty Act (South Africa, 1955) and donations of these assets could be exempt from donations tax in terms of section 56(1)(g) of the Income Tax Act (South Africa, 1962). However, any asset acquired in terms of Category D, in other words any fixed property that an individual may have acquired from their own funds while resident in South Africa or from an inheritance or donation received from a resident, would still be subject to estate duty in South Africa. Chapter 4 of this study shows that these properties would also be subject to the various forms of death duties in Greece. Any death duties paid in Greece will be allowed as a credit against the estate duty liability in South Africa in terms of the section 16(c) of the Estate Duty Act (South Africa, 1955).

The following is a summary of the findings of the subproblems of this study:

SOUTH AFRICA

Income tax

- Taxation obligations and legislation in South Africa are extensive, extremely complex, onerous, ever-changing and difficult to understand.
- Taxation is payable on rental income in both South Africa and Greece, with a limited credit allowed in South Africa for taxation paid in Greece resulting in the effective tax rate payable in South Africa being substantially higher than the maximum marginal rate in South Africa.

- Double taxation relief is provided for in terms of section 6*quat* of the Income Tax Act (South Africa, 1962) and the double taxation agreement (South Africa, 2003b) between South Africa and Greece, but there are shortcomings in these relief provisions which can be extremely harsh on resident taxpayers.
- Taxes payable in Greece that are not covered by section 6*quat* of the Income Tax Act (South Africa, 1962) and the double taxation agreement (South Africa, 2003b) may not be deductable against the rental income in South Africa.
- Non-compliance of the taxation obligations of a South Africa resident owning fixed property in Greece can have severe implications and even lead to criminal sanctions.

Donations tax

- Donations tax is payable in both South Africa and Greece on assets donated in Greece.
- As neither section *6quat* of the Income Tax Act (South Africa, 1962) nor the double taxation agreement (South Africa, 2003b) provides for relief from donations tax, it appears as if there is double taxation on donations of assets situated in Greece.
- There are some unanswered questions regarding the term “becoming resident for the first time” with regard to donations tax exemption on donations of Greek fixed property by residents acquired while living abroad.
- There are significant donations tax exemptions depending on how the fixed property was acquired.

Estate duty

- The estate duty obligations and legislation in South Africa are extensive, extremely complex and difficult to understand.
- Estate duty on fixed property in Greece could be payable in both Greece and South Africa, with a limited credit allowed in South Africa for death duty paid in Greece, which may result (as explained in part 3.6.4.2) in the effective rate payable by a deceased estate in South Africa being nearly double the estate duty rate in South Africa.
- While the Estate Duty Act (South Africa, 1955) in South Africa does provide a credit for the estate duty payable in Greece, this is limited and has its own shortcomings and it is not clear what tax paid on death in Greece would be allowed.
- There is no double taxation agreement between the two countries as relates to estate duty.
- There are some unanswered questions regarding the term “becoming resident for the first time” as relates to the deduction from estate duty in South Africa.
- There are some significant estate duty deductions in South Africa depending on how the fixed property was acquired.

General

- Failure by a South African resident to disclose fixed property in Greece could result in extremely harsh treatment by SARS.

- Donations to resident taxpayers of foreign fixed property declared in terms of an amnesty D405 declaration could result in a contravention of exchange control legislation in South Africa.
- Once the various sections of the Income Tax Act (South Africa, 1962) and Estate Duty Act (South Africa, 1955) in South Africa have been identified, set out logically and explained (per Figures 6 and 7), the task of determining the extent of a person's obligations becomes clearer and easier to understand.

GREECE

Taxation

- Taxation legislation in Greece is extensive, complex, onerous and difficult to understand.
- The non-deductibility of expenses against rental income in Greece for non-residents effectively leads to a very high overall marginal rate of tax being paid in both countries.
- The use of a resident Greek company has significant taxation savings in Greece that can also lead to taxation savings in South Africa.

Estate/death duty and donations tax

- Estate duty and donations tax legislation in Greece is complex, onerous and difficult to understand.
- The person to whom an asset is bequeathed determines the rate of death duty payable with significant reductions for close family.

- There are gift tax exemptions for gifts (donations) made during the donor's lifetime.
- The use of a resident Greek company could result in death duty savings in Greece that could also be used for general estate planning and perpetual succession.

General

- As trusts are not recognised in Greece they cannot be used to own fixed property there (Taliaki, 2003).
- Once the various forms of taxation and estate duty in Greece have been identified, set out logically and explained (see figs 9 & 10), the task of determining the extent of a person's obligations becomes clearer and easier to understand.

5.3 DISCUSSIONS AND SUGGESTIONS FOR APPLICATION OF THEORY

A South African resident has an obligation to register for income tax and to declare the gross rental incomes received for tax purposes in Greece and to pay tax in Greece on this income (Worldwide-Tax, 2007; Internaxx, 2007; Taliaki, 2007). In addition, in terms of the Greek tax laws, no expenses are deductible against the gross rentals earned (Taliaki, 2007). In other words, no section 11(a) of the Income Tax Act (South Africa, 1962) deductions, such as interest on loans, municipal rates, insurance, repairs and maintenance, are allowed against the rental income earned, and the South African resident will be taxed on the gross rental proceeds in Greece. Looking at the example in

part 3.3.5.3, it can be seen that the effective rate payable on rental profits can be substantially higher than the maximum marginal tax rate applicable in South Africa. This is brought about by the fact that expenses are not deductible in Greece and relief for the tax paid in Greece, in terms of section 6*quat* of the Income Tax Act (South Africa, 1962), is limited and effectively ring-fenced.

Many Greeks living in South Africa have strong ties with Greece (Adendorff, 2004), keeping homes and investment properties there; they must therefore be very careful when they move between the two countries from time to time. Their state of mind and what and when they consider South Africa or Greece their home can have a major impact on taxation and estate duty obligations. As set out in chapter 3, as soon as a taxpayer no longer falls into the definition of resident in the Income Tax Act (South Africa, 1962), they will be deemed to have disposed of all their fixed property in Greece (residential and investment/commercial) triggering capital gains tax liabilities in South Africa even though they have not actually sold the asset.

This can have severe cash follow implications and could even force the person to sell the fixed property to raise the cash required to pay the relevant taxation in South Africa. The fact that mortgage bonds are not readily available in Greece and that interest on loans is not tax deductable by non-residents against the rental income in Greece compounds this problem as a mortgage would normally be the logical means of raising the required cash (Tyropolis, 2005; Taliaki, 2007). The problem can become exacerbated if there has been non-disclosure of gains owing to a lack of understanding

of the problem, as additional tax, penalties and interest could come into play and even criminal sanctions.

This can work both ways (gaining or losing “tax residence”) as a taxpayer could fall foul of SARS due to the non-disclosure of rental income on properties in Greece once falling into the definition of “resident” in South Africa without knowing of these new found taxation obligations. The taxpayer may not consider themselves to be a South African resident even though they fall into the definition of resident under the Income Tax Act (South Africa, 1962) immediately creating taxation obligations in South Africa.

The term “ordinarily resident” also has a major impact on estate duty in South Africa. We have seen from chapter 3 of this study that estate duty is payable in South Africa on fixed property in Greece if the deceased was ordinarily resident in South Africa at the time of death. However, certain deductions in terms of section 4(e) of the Estate Duty Act (South Africa, 1955) could apply.

These deductions rely on certain important factors concerning when a person became a resident for the first time and the deduction from estate duty may not be applicable or even could have been lost to the deceased during their lifetime unbeknown to them. The wording of the deduction allowed in terms of section 4(e) of the Estate Duty Act (South Africa, 1955) can play havoc on Greeks changing residence between South Africa and Greece.

Residents in Greece planning to immigrate to South Africa should be aware of the fact that they will be liable for estate duty in South Africa on their Greek properties on becoming ordinarily resident in South Africa (South Africa, 1955). In order to rely on the section 4(e)(i) of the Estate Duty Act (South Africa, 1955) deduction they must have acquired all their Greek properties before they become resident in South Africa for the first time. Therefore, if they were born in South Africa or lived here before moving overseas, the deduction will not be allowed (Stein, 2004a:86).

In addition, if a person had acquired fixed property in Greece before they became ordinarily resident in South Africa for the first time, and after becoming ordinarily resident in South Africa, they sell the fixed property (creating capital gains tax in SA) and purchase a fixed property in South Africa, the deduction for estate duty on the new asset in South Africa is lost (Stein, 2004a:81). This is because the new property will no longer fall within the estate duty deduction as it would *not* be property that was acquired *before* they became a resident for the first time as they purchased the property *after* they became a South African resident. However, if they had left the proceeds in Greece and purchased another fixed property in Greece, the deduction would have remained. This could have a negative impact on the South African economy as the tax cost of the future estate duty liability in South Africa could result in such a person deciding to invest in Greece or abroad rather than in South Africa.

A further problem arises when a person is born in South Africa but then moves to Greece and is no longer considered resident in South Africa. They then acquire fixed

property in Greece while not resident in South Africa. The person then returns to live in South Africa and becomes resident. On their death they will not be entitled to the section 4(e)(i) of the Estate Duty Act (South Africa, 1955) deduction on this fixed property in Greece because they acquired the fixed property in Greece *after* they became ordinarily resident in South Africa for the first time (having been born here) (Stein, 2004a:81).

As identified by Stein (2004a:81), resident and when a person is deemed to be resident for the first time are also very important concepts when relying on the section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction. While it is clear that a section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction is allowable on assets inherited or donated from a non-resident, it is the term "after becoming ordinarily resident in the Republic *for the first time"* that is concerning. Is a person considered ordinarily resident in South Africa *for the first time* on birth or does/can a person only become ordinarily resident in South Africa *for the first time* after they have been ordinarily resident in another country first and then return to South Africa? This could have a profound impact on the effect of the deduction permitted in terms of section 4(e)(ii) of the Estate Duty Act (South Africa, 1955). If it can be said that a person can only be considered ordinarily resident in South Africa *for the first time* after they have been ordinarily resident in another country first, residents born in South Africa and who have always remained resident in South Africa may never be entitled to the section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction on inheritances or donations of fixed property in Greece received from non-residents.

If a Greek resident plans to bequeath fixed property in Greece to their South African resident children they must be aware that they will deprive their children of the section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction if they are considered ordinarily resident in South Africa on death. The fact that they were resident in Greece when they signed their will is irrelevant. It is the place where they were ordinarily residence at the date of death that matters (Stein, 2004a).

A person with Greek properties planning to immigrate to South Africa should sell their properties to a company in Greece before immigrating. A loan account would then be created between the seller and the company for the outstanding purchase consideration and the shares in the company can be allocated to the individual. They can then move to South Africa. The Greek company can then sell the Greek properties and invest the cash proceeds in South Africa. The assets of the Greek non-resident company would not be subject to estate duty in South Africa on its assets. In addition, the individual, even though ordinarily resident in South Africa, would not be liable for estate duty in South Africa on either the shares or the loan account as these were foreign assets acquired by the resident before they became resident in South Africa for the first time (Stein, 2004a.).

From the case study and the research sample of Greek families interviewed it was found that the majority had inherited fixed property in Greece from non-resident parents or family and a large number of the people inheriting had been born and were always

resident in South Africa. If it can be said that a person can only be considered ordinarily resident in South Africa *for the first time* after they have been ordinarily resident in another country first; residents born in South Africa and who have always been resident in South Africa may never be entitled to the section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction on inheritances or donations of fixed property in Greece received from non-residents.

Possible solutions

The possible solution discussed below involves the use of a Greek resident company. The owning of the shares in a Greek resident company by an individual who is a South African resident could result in section 9D of the Income Tax Act (South Africa, 1962) being applicable. Section 9D of the Income Tax Act (South Africa, 1962) has not been discussed in this study as explained in part 1.3 of chapter 1 (delineation and limitations) and accordingly should be investigated further as part of another study to determine its impact in South Africa .

A possible solution to this problem would be for the South African resident to donate any foreign fixed property that he may have inherited or received as a donation from a non-resident to a non-resident entity before death. This donation would enjoy the exemption from donations tax granted in terms of section 56(g) (ii) and (iii) of the Income Tax Act (South Africa, 1962) as the donation tax exemption makes no reference to the donor or donee having to be resident in South Africa *for the first time* (Stein, 2004b). In addition, as the assets would no longer belong to the resident person they

would not be included in his estate on death. Even if the section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction is permitted, it may make more sense in any event to donate the asset to the foreign entity to ensure that his children avoid estate duty in South Africa on the fixed property in Greece, as the section 4(e)(ii) Estate Duty Act (South Africa, 1955) deduction would not flow through to his children as they would have inherited the assets from a resident. In addition, by donating the fixed property to a non-resident entity, it would also avoid transgressing exchange controls as the fixed property would not be made available to a South African resident as would be the case if he donated the fixed property to his South African resident children or wife (Van Staden, 2006:23).

However, the donation would be a disposal in terms of the Eighth Schedule of the Income Tax Act (South Africa, 1962) and capital gains would need to be calculated on the market value of the fixed property at the date of donation and included as part of the taxable income of the resident. In addition, the disclosure requirements set out in section 7(10) of the Income Tax Act (South Africa, 1962) and the income tax obligation in terms of section 7(8) of the Income Tax Act (South Africa, 1962) should not be forgotten. While there could be ongoing taxation implications in South Africa on the net rental income and capital gains in terms of section 7(8) of the Income Tax Act (South Africa, 1962), and the attribution rules set out in the Eighth Schedule of the Income Tax Act (South Africa, 1962), these would be no worse than if the fixed property remained in his name.

However, the income tax position in Greece could become significantly better if a resident Greek company were used, as deductions against the rental income would now be allowed and the lower tax rate applicable to Greek companies would be applicable (Price Waterhouse Coopers, 2006; Taliaki, 2007; Worldwide-Tax, 2007). The higher tax scale (maximum marginal tax rate) for individuals in Greece amounts to 41,5% made up of 40% income tax and 1,5% additional tax. The same rate for a real estate company resident and registered in Greece amounts to 32% made up of 29% income tax and 3% additional tax (Price Waterhouse Coopers, 2006; Taliaki, 2007; Worldwide-Tax, 2007).

The resident Greek company may also deduct interest on loan accounts against its rental income (Taliaki, 2007). However, a withholdings tax is deductable on interest payments depending on whom paid (Taliaki, 2007). The rate would be 10% if paid to a Cypriot company and 15% if paid to a UK or other European Union (EU) resident company (Taliaki, 2007). In addition, death duty could be avoided in Greece if structured via Cyprus where trusts are recognised by law and can be used to own a Cypriot company that would be the sole shareholder of the Greek company (Taliaki, 2007).

In terms of Greek law, it would become necessary for the Greek company to identify its ownership clearly and this is why it is imperative for a company setup in Cyprus to be utilised (Price Waterhouse Coopers, 2006; Taliaki, 2007). Owing to the relationship between Greece and Cyprus and their close ties, the compulsory 3% taxation on companies owning fixed property can be avoided, provided the directorship and

ownership of the Cypriot company is made known to the Greek tax authorities (Taliaki, 2007).

The fixed property could then be sold to the Greek company with the resulting loan account then being donated to a Jersey or Cypriot trust. The Jersey trust would on-loan the money to the Cypriot company which would then advance the loan to the Greek company. This is required in order to ensure that the loan account is between the Greek company and the Cypriot company being two EU countries acceptable to the Greek tax authorities (Taliaki, 2007). Interest can then be paid on that loan account with a lower withholding tax rate of only 10%. The Greek company would deduct the interest paid to the Cypriot company on this loan account but would have to pay over the 10% withholding tax (Taliaki, 2007).

Any net profit remaining after deducting expenses and interest on the loan account would then be retained in the Greek company and would be subject to taxation in Greece at the lower rate. This could even pave the way for taxation savings in South Africa, as section 7(8) of the Income Tax Act (South Africa, 1962) may never come into play as the rental profits of the company would remain in the company and the trust would never receive an income**.** *Section 7(8) of the Income Tax Act (South Africa, 1962) would only deem any income earned being as a result of the donation of the loan account to the trust. However, if the trust never receives a dividend from the Cypriot company, section 7(8) of the Income Tax Act (South Africa, 1962) may never be applicable* (Haupt, 2004). In addition section 31 of the Income Tax Act (South Africa,

1962) concerning transfer pricing may not be applicable as this section does not apply to donations.

The effect of this is that, for the cost of taxation on the capital gains, one could reduce the rate of estate duty in South Africa and Greece as well as reduce taxation on the rental profit in South Africa and significantly reduce taxation on the rental profit in Greece.

Considering that taxation will in any event be payable on the capital gains of the fixed property on death and that the fixed property value is likely to increase continually, this would be well worth considering. This recommended restructure would then eliminate all the complications discussed above concerning owning fixed property in Greece that was inherited from a non-resident. However, to own fixed property in the name of a company in Greece is fairly complicated and the sale of fixed property from the natural person to the company can be very expensive in Greece and these aspects would have to be taken into account. Even if the shares are retained in the individual's name, estate duty could be saved as the rate applicable in Greece is substantially lower if an asset is a share as opposed to directly held fixed property.

The uncertainty that exists as to when a person is considered *resident for the first time* in terms of the deduction for estate duty, as discussed above, can also have an impact on the exemption for donations tax allowed in terms of section 56(1)(g)(i) of the Income Tax Act (South Africa, 1962). Fixed property situated in Greece acquired by a resident

before he became a resident (as defined in section 1 of the Income Tax Act (South Africa, 1962)) for the first time, by any manner, would be entitled to the section 56(1)(g)(i) of the Income Tax Act (South Africa, 1962) exemption. However, Stein (2004b:95) argues that the exemption would not apply to any person who was born in South Africa. Therefore, residents who were born in South Africa and then emigrated to Greece and acquired fixed property in Greece while living abroad would not be able to rely on the section 56(1)(g)(i) of the Income Tax Act (South Africa, 1962) exemption if they ever became resident in South Africa even though the fixed property was acquired while resident in Greece.

Another interesting point is that, according to Mitchell (2005a:17), for the provisions of section 7(8) of the Income Tax Act (South Africa, 1962) or for the provisions of paragraph 72 of the Eighth Schedule of the Income Tax Act (South Africa, 1962) to apply, the donation must be by a person who is resident in South Africa at the time of the donation. It follows that, if a person were to make a donation prior to becoming a resident of South Africa, any income or capital gains earned from the donated asset would not be caught by the deeming provisions after he becomes a resident. Huxham and Haupt (2007:583) agree with this view.

If a Greek resident plans to bequeath fixed property in Greece to children resident in South Africa, they must be aware that they will deprive the children of the section 4(e)(ii) of the Estate Duty Act (South Africa, 1955) deduction if they are considered ordinarily resident in South Africa on death. A solution to this problem would be to donate the

fixed property to the children, or even better to a non-resident structure similar to the one discussed above, before the Greek resident becomes ordinarily resident in South Africa, resulting in significant taxation and estate duty savings for the children and themselves.

Finally, as is evident from the above discussion, companies can play a pivotal role in solving some of the problems identified by this study and accordingly the use of a Greek company to own property in Greece should be thoroughly researched to determine what the taxation implications are in South Africa.

5.4 CHAPTER SUMMARY

This chapter focused on the main findings of this study and presented various interesting aspects and discussion points surrounding the topic. It also discussed planning opportunities and made recommendations for possible solutions to some of the problems identified by the study.

The next chapter will present the conclusions of the study and, based on the findings, will set out various recommendations for affected residents and government agencies. It will also identify areas of future research.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

6.1 INTRODUCTION

The previous chapter presented the results and research findings of this study and provided a general discussion on and planning opportunities and suggestions for the application of this research.

This final chapter sets out the conclusions to this study and provides recommendations for affected South African residents, government agencies (policymakers) and areas for future research.

6.2 CONCLUSIONS TO THIS STUDY

The various sections of the South African Income Tax Act (South Africa, 1962) and Estate Duty Act (South Africa, 1955) identified in this research are extremely important and must be taken into account by South African residents who own fixed property in Greece. The various forms of taxation in Greece are just as important. The flowchart

summaries at the conclusions of chapters 3 and 4 set out the taxation implications for a South African resident owning or having a tax interest in fixed property in Greece in a simple, focused format that helps to identify the applicable legislation and links the reader back to the relevant discussion areas in the body of the document for more detail.

The terms “resident” for the purposes of taxation and “ordinarily resident” for estate duty in South Africa are of critical importance, as is determining the way in which the fixed property in Greece was acquired. In addition, resident taxpayers must be aware of the taxation implications of having a tax interest in fixed property in Greece.

Double taxation on donations and the risk of paying as much as double the estate duty rate in South Africa on Greek fixed property is a very real problem. The limitation of credits in South Africa on income tax paid in Greece on rentals from Greek fixed property leads to an effective tax rate in South Africa that is substantially higher than the maximum marginal rate of taxation.

The limitation of credits in South Africa on estate duty paid in Greece on fixed property there leads to an effective estate duty rate in South Africa that is substantially higher than 20%. Non-disclosure of fixed property held in Greece can have far-reaching implications for South African residents, as SARS has extremely effective sections allowing it to raise the estimated assessments of non-conforming or ignorant taxpayers.

South African resident taxpayers (being non-residents in Greece) are severely taxed on their gross rental proceeds in Greece due to the non-deductibility of expenses. In addition, there are many different forms of taxation in Greece that affect the ownership of fixed property. However, there are taxation and estate duty benefits to owning fixed property in a Greek resident company as opposed to in a person's own name.

There are also exemptions and deductions for donations tax and estate duty that apply to fixed property in Greece that taxpayers are able to use to avoid donations tax and estate duty both in South Africa and Greece. Furthermore, there are planning opportunities to reduce taxation and estate duty in both South Africa and Greece and this study provides suggestions for the application of this research in cases of affected residents.

This research concludes that the taxation and estate duty implications for a South African resident owning fixed property in Greece can be very complex and difficult to understand in both South Africa and Greece. It would be fair to say that the average affected resident would not be aware of the many sections that could have an impact on his taxation and estate duty obligation in both South Africa and Greece.

6.3 RECOMMENDATIONS

6.3.1 Recommendations for affected residents

- Affected taxpayers should have a clear understanding of the impact that the definition of "resident" has on their taxation position in South Africa and take note of the discussion points set out in chapter 5.
- Affected taxpayers must understand the taxation impact of having a tax interest in fixed property in Greece.
- Affected taxpayers must not forget about their disclosure obligations to SARS.
- Affected taxpayers must clearly identify and record how they acquired fixed property in Greece.
- Affected taxpayers should not embark on any estate planning exercise in Greece without investigating the impact it may have on their taxation and estate duty obligations in South Africa and vice versa.
- Affected taxpayers must be aware of the possibility of donations tax on assets donated in Greece being payable in both South Africa and Greece.
- Affected taxpayers should investigate and consider the use of a Greek company for owning their fixed property in Greece.
- Affected taxpayers who have inherited or received fixed property in Greece from non-residents should take note of and investigate the possible planning opportunities discussed in chapter 5.

6.3.2 Recommendations for government agencies (policymakers)

- Treasury should consider amending the double taxation agreement (South Africa, 2003b) between the countries by ensuring that the total taxes payable to the two countries together do not exceed the maximum marginal rate applicable to an individual in the country that he resides.
- Treasury should consider entering into a double taxation agreement with Greece for estate duty to ensure that all the different forms of death taxes are covered and that the total death duties payable to the two countries together does not exceed the maximum marginal rate applicable to the deceased in the country that he resides at the date of death.
- Treasury should consider providing relief for double taxation on donations tax payable by residents in both South Africa and Greece.
- Treasury should consider making amendments to the Estate Duty Act (South Africa, 1955) to allow a deduction in estate duty on assets in South Africa belonging to the deceased that have arisen from inheritances or donations from non-residents or out of funds acquired by the deceased before he became resident in South Africa and that he brought into South Africa. This might encourage residents to bring foreign funds into South Africa and boost our foreign reserves rather than leave them overseas.
- Treasury should clarify the position as to whether a person is considered ordinarily resident in South Africa *for the first time* on birth or does/can a person only become ordinarily resident in South Africa *for the first time* after

he has been ordinarily resident in another country first and then returns to South Africa.

- Treasury should try and simplify the law in South Africa as regards income tax on foreign assets.
- The meaning of "ordinarily resident" is of vital and significant importance and perhaps should be defined in the Estate Duty Act (South Africa, 1955) and the Income Tax Act (South Africa, 1962).
- There should be clarification as to whether taxes paid in Greece that are not allowed as a tax credit in terms of section 6*quat* of the Income Tax Act (South Africa, 1962) or the DTA (South Africa, 2003b) are tax deductable from the rental income in South Africa.

6.3.3 Suggestions for future research

- The taxation implications in South Africa and Greece when a South African resident owns shares in a Greek company (to own fixed property in Greece) as opposed to owning fixed property directly in that person's name
- The taxation and estate duty implications of owning fixed property or other foreign assets in other foreign jurisdictions such as the United Kingdom and the United States of America
- To determine what is meant and covered by the term "death duties" referred to in section 16(c) of the Estate Duty Act (South Africa, 1955)
- To determine whether a person is considered ordinarily resident in South Africa *for the first time* on birth or does/can a person only become ordinarily

resident in South Africa *for the first time* after he has been ordinarily resident in another country first and then returns to South Africa

- To determine the credits that are allowed in terms of section 6*quat* of the South African Income Tax Act (South Africa, 1962) regarding all the different forms of taxation payable in Greece as identified in chapter 4
- To determine what credits that would be allowed in terms of section 6*quat* of the Income Tax Act (South Africa, 1962) against capital deemed taxable in terms of section 25B(2A) of the Income Tax Act (South Africa, 1962), especially the tax paid by the trust in previous years on the capital later distributed and deemed taxable in the hands of a South African resident. How is this worked out taking into account complications such as fluctuating exchange rates and the various forms of taxation that may have been paid by the trust on the capital distribution made years later.
- The problems identified by Mitchell (2005a) regarding section 7(8) of the Income Tax Act (South Africa, 1962) and transfer pricing rules contained in section 31(2) of the Income Tax Act (South Africa, 1962) resulting in double tax. Mitchell (2005a:16–18) suggests that it could be possible that a resident could find tax being levied in terms of section 7(8) of the Income Tax Act (South Africa, 1962) in addition to tax in terms of the application of section 31(2) of the Income Tax Act (South Africa, 1962).
- Fixed property ownership in Greece, where in some areas there is no title deeds register, and the impact this has on the triggering (timing) of taxation

of capital gains in South Africa especially as regard to when a sale becomes binding

- The problem identified by Meyerowitz (2005:8–11) where a donation is made outside South Africa to a non-resident donee, who is free to use the donation for any income-earning purpose and who is not prepared to inform the resident donor as to any of the relevant facts. Section 7(8) of the Income Tax Act (South Africa, 1962) is then stultified and it is legally impossible to "guestimate" what amount of income attributable to the donation is to be taxed in the hands of the resident donor.
- The impact exchange control legislation has on tax and estate planning in South Africa

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