



## **IBN INFORMS**

### **Commercial Property Holdings**

by

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**What is the best legal structure to hold commercial property in?**

Commercial property investors often ask the question: What is the best way to structure ones commercial property holdings?. While each investor obviously has their own circumstances, there is one way that has found favor with many of the astute and experienced property investors - the Company Trust Combo.

The generally preferred structure works like this: Your discretionary family trust owns the shares in a private company that, in turns, owns the commercial property.

What are the benefits compared to simply holding the property in your own name or in a trust?

The entity owning the property, the company, pays income tax at a rate of 28%. This compares very favorably with the 40% income tax rate of trusts and individuals (at the highest marginal rate).

If the company declares revenue profits (eg rental) as dividends, there is also secondary tax on companies (STC). STC pushes the effective income tax rate of the company up to about 37% but even this is still better than the 40% rate of trusts and individuals.

As to Capital gains tax (CGT), the company pays CGT at a maximum rate of 14,5% which is better than trusts (20%) and not too far off the individual rate (10%). Nowadays, companies also pay STC on capital profits. So, if the company declares the capital profits its effective CGT rate goes up to about 24%. For commercial property, companies should be registered for VAT as most commercial properties would deem turnovers above the required threshold.

But it is clear that, from a tax perspective, a company that reinvests its profits (and therefore pays no STC) is in a very good position.

Under the Company Trust Combo, the trust that owns the shares in the company earns tax-free dividends.

Further, as the trust owns the shares in the company, when you die your estate pays no estate duty or CGT.

If you lent some money to the company to pay for the property, the only asset in your estate is the loan account. You could use the loan account to draw funds from the company if you need it. Also, you could reduce the loan account over time by donating funds to the trust to repay the loan account.

The Company Trust Combo also gives you other benefits such as protecting the property from your creditors. But compared to simply owning the property in a trust, there are other benefits:

- Where a person makes an interest-free or low-interest loan to a trust, the under-charging of interest is sometimes seen as a donation under tax laws. In this case some the income of the trust may attributed to the lender and taxed in the hands of the lender. But under the Company Trust Combo the loan is made to a company, not a trust, and the attribution principle should not apply.
- If a trust owns the property directly it is difficult to bring in other investors. Invariably, it means selling a part of the property or changing the trust deed. However, where the trust owns the shares in a property company, the trust could simply sell shares in the company to the other investor.

A disadvantage of the Company Trust Combo is that it adds an additional layer of administration and expenses (e.g. audit fees).

Further the Company Trust Combo may not be suitable for holding residential property that you live in. It may be better to hold such property in your own name to save transfer duty when buying and to qualify for the R 1.5 million CGT primary residence rebate when selling.

Finally, to make sure that you don't make a meal of structuring the holding of your commercial property, get professional advice before you sign your acquisition offer.

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If you have any questions, please do not hesitate to contact the author under:

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