Land reform without compensation in South Africa: A critical analysis of the taxation policy

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PREFACE

The writing of this thesis is a culmination of a two year journey which started out as a much needed challenge in order to refocus and stimulate the mind. In the end, I gained so much more than what I had initially anticipated and for than I am extremely grateful. It is an impossible journey for one to successfully embark on, without the valuable contribution and sacrifices of others. At the risk of potentially excluding anyone, I want to thank everyone that had a role to play, no matter how big or small, in achieving this milestone. A special word of gratitude has to go to my loving family who had to sacrifice a lot of family time in order for me to focus on this initiative.

ABSTRACT

This thesis, brought about by the shift in the South African land redistribution programme to “expropriate land without compensation”, primarily focusses on the taxation policy considerations given the current legislative framework; whether any changes to the framework should be envisaged and whether there are any tax relief measures that could be considered. Through literature review, as well as lessons learnt from countries where a similar approach was followed, relative to land reform programs, it considers a widespread impact, which includes a government perspective, an expropriated person’s perspective and the beneficiaries’ perspective. The research shows that the disposal or deemed disposal of property without compensation has a wider impact than just social and economic factors, and that wider legislative changes may be required than just the proposed changes to the constitution. Due consideration is given to Capital Gains Tax, Value Added Tax, Donations Tax, Transfer Duty and general Income Tax considerations.

KEY TERMS

Land reform

Constitution

Property

Deemed capital loss

Debt

Tax relief

Capital Gains Tax

Value Added Tax

Rights

Disposal

Deemed disposal

INTRODUCTION

South Africa's land reform programme, going as far back as 1994, is widely regarded as having been a failure to date. It is stated that the major reason for the failure is due to the lack of support from government for farmers once they have become landowners and massive backlogs in the processing of land claims.

The government is, therefore, under pressure to fast-track land reform, and views expropriation without compensation as a mechanism to redress imbalances of the past, reduce inequality, promote land ownership and agricultural sector participation by black people (Mahlaka, 2018).

What is, however, different to the process followed to date, and warrants closer scrutiny and analysis as far as potential impacts are concerned, is the shift to "expropriation without compensation", which was called for at the 54th national conference of the African National Congress (ANC) (Hall, 2018).

Besides the fact that the "disposal or deemed disposal" of properties under the new proposed approach will have certain economic impacts, the impact and potential treatment from a taxation perspective, also warrants further analysis and consideration.

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CHAPTER 1- BACKGROUND TO THE RESEARCH AREA

1.1 Literature review

A motion to expropriate land in South Africa without compensation was passed in Parliament in February 2018, following the 54th national conference of the ANC. Following the decision by Parliament, an ad-hoc Constitutional Review Committee was established to review and make proposals on how section 25 of the Constitution should be amended, in order to allow the state to expropriate land without compensation (Hall, 2018).

Although a lot has been said in the media, and general discussions seem to be focussed more on agricultural land, the requested amendment to section 25 of the Constitution raises specific concerns. According to Section 25(4)(b) of the Constitution (1996), property is not limited to land only. It should further be noted that any changes to section 25 cannot be made in isolation, as section 25 should be read in conjunction with section 36, which provides a general limitation clause stating that all rights in the Bill of Rights will be limited in terms of law and with that, all limitations must be reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom.

Although at this stage, there is uncertainty on which land has been earmarked for purposes of expropriation, it could well mean that expropriation without compensation could extend to more than just agricultural land and also include other forms of properties such as homes, shares, factories etc. (Mahlaka, 2018).

Since the passing of the motion in Parliament, the number of sporadic land occupations by poor, homeless and landless South Africans has increased. The seaside town of Hermanus faced an attempted occupation, as did Midrand and other areas in Johannesburg (Haffajee, 2018).

The sporadic land grabs and the concerns raised by investors have led to an amended resolution by the ANC. It states that "the ANC should, as a matter of policy, pursue expropriation of land without compensation", but then it adds that

"this should be pursued without destabilising the agricultural sector, without endangering food security in our country, and without undermining economic growth and job creation" (Haffajee, 2018).

A task team led by deputy public works minister Jeremy Cronin has drafted an amendment to a forthcoming expropriation law that also sets out which land and property will be expropriated without compensation. The team has identified land and property that can be expropriated without compensation, such as abandoned buildings, unutilised land, commercial property held unproductively and purely for speculative purposes or underutilised property owned by the state, and finally, land farmed by labour tenants with an absentee titleholder (Haffajee, 2018).

In his book “Land Reform in Developing Countries: Property Rights and Property Wrongs”, economist Michael Lipton focusses on the evidence of which land reforms have worked and which have not (Lipton, 2009).

In his article, Mahlaka (2018) raises the concern of what would happen from an economic perspective should mass expropriation of land occur. In his view, mass expropriation without compensation will result in a protracted period of “no new net investments in agriculture”, which means “no growth in the agricultural output as well as no growth in the agribusiness sector”.The reason being, that unaffected commercial farmers or those yet to be affected, are unlikely to make any new investments in the agricultural industry. New Farmers entering this industry are also unlikely to have the funds or means to make significant investments.

In October of 2017, Professor Cyril Mbatha presented a research paper on how to understand, evaluate and influence efficient progress in South Africa’s Land Reform Process. In his presentation, he draws specific comparisons to other former British colonies such as Kenya and Zimbabwe (Mbatha, 2017).

Some taxation implications that will need to be considered include, capital gains tax (CGT), value added taxation (VAT) and the impact on normal income tax, as the going concern status of many organisations may be negatively affected. In his article released in April 2018, Patrick Kabamba refers to the latest landowners financing statistics, which shows that 56% of owners secured loans through banks, 9% through agricultural cooperatives and 30% through the Land Bank (Kabamba, 2018).

The obvious question then is how these loans will be honoured in the absence of any income being generated, when the land in question does get re-possessed without compensation. In the case where these loans are not repaid, it would lead to impairments on the financial statements of financial institutions, i.e. the expected losses will need to be recognised by the lender. Given the general size of banks' debtors books, as far as loans are concerned, the financial position and ultimately even the going concern status of affected institutions/banks will be affected. (Kabamba, 2018).

The process of expropriation is set out in the Expropriation Act 63 of 1975. This Act calls for the Minister to initiate the process by serving notice on the owner, setting out the details of the property to be expropriated. Given the proposal for expropriation without compensation, it stands to reason that this act will also need to be revised as the act is written on the premise of a willing buyer and willing seller (Paton, 2018).

There is a very interesting consideration relative to both Capital Gains Tax (hereafter referred to as CGT) and Value-Added Tax (hereafter referred to as VAT). The Value-Added Tax Act No.89 of 1991 (hereafter referred to as the VAT Act) turns around the notion of a 'supply' and it becomes a question of fact that if you have not 'supplied' something, you could not have incurred a VAT liability (Scholtz, 2010).

“In other jurisdictions – notably Australia – it has been accepted that the notion of a ‘supply’ ordinarily calls for some voluntary act. Where the owner of land who has been offered just and equitable compensation has no choice but to accede, an alienation of land pursuant to such an offer is essentially involuntary.” (Scholtz, 2010).

“In the case of Shell’s Annandale Farm, decided in 1997, the Cape High Court held that because expropriation is ‘compulsory’ rather than ‘voluntary’, an expropriation did not give rise to a ‘supply’ as then defined in our VAT Act. The landowner was accordingly not subject to VAT on the compensation received.” (Scholtz, 2010).

In 1999, the VAT Act was amended to ensure that a ‘supply’ would include ‘compulsory’ transactions and transactions occasioned ‘by operation of law’.
Supply is defined in section 1 as including performance in terms of a sale, rental agreement, instalment credit agreement, and all other forms of supply whether voluntary, compulsory or by operation of law. Therefore, even the expropriation of property is a supply by the owner of the property. It does, however, not include anything done for nothing (i.e. for no consideration as may be the case when expropriation takes place without compensation) (Haupt, 2018). The broadened definition of ‘supply’ would now clearly capture amounts received as compensation for the expropriation of property (Scholtz, 2010).

Section 8(2) of the VAT Act should also be considered in cases where a person ceases to be a vendor and a recoupment of input taxes claimed may come into play. Section 8(7), which deals with going concerns may also be relevant in certain cases (Haupt, 2018).

Paragraphs 65 and 66 of the Eighth Schedule to the Income Tax Act, No. 58 of 1962, as amended (the Act), allows for the capital gain arising on the disposal of certain fixed assets that would otherwise be taxed, to be deferred in certain specific circumstances (SAICA, 2005).

Paragraph 65 deals with those cases where an asset is involuntarily disposed of, for example, where the asset is disposed of by way of operation of law, theft or destruction, and the proceeds of disposal exceed the base cost of the asset. Under paragraph 65, any capital gain that would otherwise have been liable to tax will be disregarded where the taxpayer acquires a replacement asset within the prescribed period of 12 months and brings it into use within 3 years of the disposal of the first asset. The rolled-over capital gain will be taxed when the replacement asset is sold (SAICA, 2005).

Paragraph 66, which is not applicable to land but all other kinds of assets, caters for those situations where a taxpayer disposes of an asset subject to allowances available in sections 11(e), 12B, 12C, 12E, 14 or 14bis, and acquires a new asset within a period of 12 months that is brought into use within 3 years after the disposal of the first asset. In such a case, the capital gain is disregarded at the time of disposal and the capital gain that would otherwise have been taxed in year one is spread over the life of the replacement asset (SAICA, 2005).

The further aspect to consider relates to the income tax that becomes payable on the recoupment of allowances previously granted on such an asset (buildings) when disposed of by the taxpayer.

The legislature saw fit to introduce section 8(4)(e) into the principal Act by way of section 18(1)(a) of Act No. 45 of 2003, applying in respect of the disposal of any asset on or after 22 December 2003. That subsection provides as follows:

"Notwithstanding paragraph (a), but subject to paragraphs (eB), (eC), (eD) and (eE), there shall not be included in the income of that person any amount recovered or recouped as a result of a disposal of any asset (with specific relevance to buildings), where that person has elected that paragraph 65 or 66 of the Eighth Schedule applies in respect of the disposal of that asset." It is, therefore, possible in certain cases, to postpone the normal tax that would otherwise have become payable on the disposal of depreciable assets (SAICA, 2005).

“The CGT consequences of an expropriation depend on what you do with the proceeds. If you invest an amount at least equivalent to the compensatory amount in replacement assets, and do so under contracts concluded within 12 months of the expropriation, you will not be subject to CGT on the expropriation of the property. If your confidence in investing in farming land has been shaken by expropriation, you don’t need to buy another farm as a replacement asset. The only requirement is that the replacement assets must be of such a kind that you will be subject to CGT in South Africa when you sell them.” (Scholtz, 2010).

The requirement that the replacement assets must attract a CGT liability when you sell them brings about a new challenge. Should you sell the replacement assets, the ‘foregone capital gain’ on the expropriated land will be added to the capital gains ordinarily arising on the sale of the replacement assets. (Scholtz, 2010). The question to answer now is: what happens in the case that the property is expropriated without compensation, i.e. at a capital loss?

In the current South African context one must also give due consideration to Black Economic Empowerment (BEE), which at its core aims at empowering and transferring wealth to the previously disadvantaged. Often these deals were and are structured through the sale of shares and or the sale of businesses. Common corporate restructuring provisions used in BEE deals, are section 42 “asset for share transactions” and section 43 “share for share transactions” (Dekker, 2007).

Furthermore, prior to the 2005 legislative amendments, share-based payments gave rise to adverse tax implications, as the issuing of shares by a company in settlement of the purchase price of assets acquired did not qualify as an expense actually incurred, and as such, the base cost of the asset acquired was seen to be acquired at a base cost of “0”. Section 24B resolved this matter in that the base cost of the shares is now seen to be at the market value of the assets so acquired (Dekker, 2007).

In this study, it is therefore imperative to also consider BEE deals which may be affected, where land that forms part of previously structured BEE deals, is reformed.

It is also noted that tax law does not contain provisions explicitly aimed at BEE transactions, but a number of provisions do allow for certain exceptions aimed at BEE transactions, without specifically stating or limiting the application thereof to BEE transactions and structures. An example of such a consideration would be where the disposition/transfer of property happens at a value less than market value and may give rise to possible Donations Tax Liabilities (Wallrich, 2016).

1.2 Motivation of topic actuality

Land reform in itself is not a new concept, as various countries across the world have implemented land reform measures with varying levels of success (Lipton, 2009).

What is, however, unique and creating a lot of uncertainty is that the latest motion accepted in Parliament calls for land reform without compensation. This is not only a relevant topic in the current South African context, but also poses significant risk at various levels.

The current state of affairs leaves us as citizens with more questions than answers, but included in these questions is the question on potential taxation implications and relief.

The aim of this research is to look at what the typical tax considerations would or could be from a South African perspective, i.e. is there any envisaged tax relief to be provided to those affected? What lessons are there to be learnt when we start looking at similar approaches followed in other developing countries in the world, both from a taxation and an economic growth perspective?

The countries that will be used as a comparative study will be Zimbabwe and Kenya. Both these countries are former British colonies from the African

continent and were subject to similar land reform challenges as currently experienced in South Africa. Of particular interest relative to Zimbabwe, is that expropriation of land occurred without compensation and there are real lessons to learn from that experience. The Kenya comparative is also of unique relevance as the World Bank specifically referenced the Kenya model as the ideal model to be followed from a South African perspective. The lessons learnt from these countries may be instrumental in understanding state-led (as opposed to market-led) land reform, especially in the case of Zimbabwe, where it is argued that up to 1997 land reform efforts were successful in that up to about 30% of land was transferred without loss in production. It is furthermore argued that at the time when the government started fast-tracking land reform, the failures started to set in (Beinart, 2018)

1.3 Problem statement and research question

1.3.1 Problem statement

The motion accepted in Parliament to expropriate land without compensation raises many questions, unanswered at present. These questions include, but are not limited to, what the potential tax implications would be and whether any relief measures will come into play, other than those already provided for with specific reference to the Income Tax Act (incl. CGT, Donations Tax and Transfer Duty) and the VAT Act.

1.3.2 Research question

Are the current Taxation policies and frameworks adequate to cater for the expropriation of property without compensation, with specific consideration to the Government, beneficiary and the expropriated person’s perspective?

1.4 Research objectives

1.4.1 Main objective

The main objective of the study is to analyse the potential taxation policies to be considered if land is expropriated without compensation in South Africa.

1.4.2 Secondary objectives

1.4.2.1 Analysis of land expropriation without compensation from a:

1.4.2.1.1 Government perspective – Chapter 2
1.4.2.1.2 Expropriated person's perspective – Chapter 3
1.4.2.1.3 Beneficiary's perspective – Chapter 4

1.4.2.2 To perform a comparative study of taxation policies in countries where similar approaches were followed relative to land expropriation/reform.

1.5 Research design / method

1.5.1 Literature review

According to Mouton J (2015:87), one of our first aims should be to find out what has been done in the specific field. This process starts off with looking at what other scholars have done relative to the same or similar research problem. As such, it is not merely an accumulation of literature text, but rather a body of accumulated scholarship.

Sources to be accessed will include, but are not limited to:

- Books, conference and reference materials,
- Relative legislation
- Journal articles
- Newspapers, magazines, reports (including online sources)
- Theses and dissertations

Qualitative research will be conducted in order to gain a deeper understanding of the problem statement, while at the same time taking cognisance of the

general concerns with the issues of validity in qualitative research (Cho, J & Trent, A. 2006).

1.5.2 Critical analysis methodology

A spectrum of different possible interpretations to any topic emerges from the evolving debates in that subject area because academics are continuously extending, qualifying and challenging the ideas of others. Critical analysis involves the exploration of many views across that debate by comparing and contrasting the range of different views on your assignment topic (Bradford University.2017.1)

This will be a key focus/approach in this study.

1.5.3 Paradigmatic assumptions and perspectives

A paradigm choice is largely a reflection of how the researcher views the world (ontology) and believes that knowledge is created (epistemology). Qualitative research requires inductive reasoning to be employed rather than logic, and often calls for more creative and indirect means of collecting data or evidence (McKerchar, 2008).

This will be a key consideration in the process.

CHAPTER 2 - A GOVERNMENT PERSPECTIVE

2.1 The history of land reform in South Africa

In the current South African context, land reform is but one measure in which the National Government is trying to address past racial exclusions and inequalities stemming from as far back as 1913. The Department of Land Affairs (DLA) is tasked to execute this mandate, which effectively aims at redistributing land to those previously denied equitable access as a result of segregation and apartheid, and also to secure the tenure rights of those excluded from acquiring title to land in the past. (Hall & Williams, 2015)

Since 1994, when the African National Congress (ANC) came into power, there have been various attempts at liberalising the agricultural markets specifically, which many would view as dismal failures. The 'Integrated Programme of Land Redistribution and Agricultural Development' (IPLRAD) in itself, went through a number of drafts with a primary focus on 'emerging farmers' that wished to produce for subsistence and to farm commercially on a small, medium or large scale. It also aimed at redistributing thirty percent (30%) of farmland to black people over a 20-year period, and effectively establish and support black commercial farmers. In subsequent drafts, the time scale was brought down to 15 years, focussing on medium to high quality land. (Hall & Williams, 2015)

Up to 2014, all land claims had not been settled and less than 10% of the redistribution targets initially set by government had been met. What has not been taken into account was land that was purchased via private transactions. It has also been reported that more than 90% of land transferred as part of the land reform programme is not being used productively, which is alarming in that in its current form would not address the concerns of poverty and unemployment, nor does it give any comfort relative to food security (Kloppers & Pienaar, 2014).

2.2 A review of the historical legislative framework

To understand the current land reform programme embedded in the South African Constitution, one needs to differentiate between the three pillars on which it is formulated, being restitution, land redistribution and tenure security (Kloppers & Pienaar, 2014).

The concept of restitution (first pillar) is referenced in section 25(7) of the Constitution and specifically states that “A person or community dispossessed of property after 19 June 1913 as a result of past racially discriminatory laws or practises is entitled, to the extent provided by an Act of Parliament, either to restitution of that property or to equitable redress.”

The second pillar, land reform, or often referred to as the land reform programme, is similarly referenced in section 25(5) and effectively enables citizens to gain access to land on an equitable basis (Kloppers & Pienaar, 2014).

The third pillar, tenure security, is specifically referenced in section 25(6) and states that “A person or community whose tenure of land is legally insecure as a result of past racially discriminatory laws or practises is entitled, to the extent provided by the Act of Parliament, either to tenure, which is legally secure or to comparable redress.”

From a legislative perspective, the Natives Land Act 27 of 1913 laid the foundation for apartheid and territorial segregation in that it formally placed limitations on black land ownership. The aim of this act was to “bring about territorial segregation based on race, where natives were prohibited from occupying or acquiring land.”(Kloppers & Pienaar, 2014)

The ensuing Native Trust and Land Act 18 of 1936, provided for the establishment of the South African Native Trust at that time, which effectively administered trust land. This Act was seen to further the objective of racial segregation, in that it abolished individual land ownership by black people and introduced trust tenure (Kloppers & Pienaar, 2014).

The Group Areas Act 41 of 1950 was used by the National Government at that time to remove Black, Coloured and Indian people from designated White areas. It effectively functioned through the control of ownership of immovable property, occupation and right to use land and premises on the basis of race (Kloppers & Pienaar, 2014).

Complementing the Group Areas Act of 1950 was the Group Areas Act 36 of 1966. “The aim of this Act was to consolidate the law related to the establishment of group areas and to regulate the control of the acquisition of immoveable property and occupation of land” (Kloppers & Pienaar, 2014).

It is estimated that between the period of 1960 and 1983, approximately 3.5 million people were forcibly removed as result of these Acts. In 1991, after the disbanding of the ANC, The Abolition of Racially Based Land Measures Act 108 of 1991 was promulgated to end apartheid and repeal or amend certain land laws based on race or membership of a specific population group (Kloppers & Pienaar, 2014).

The White Paper on Land Policy, released in 1997, had the specific aim of establishing a land policy that is “just, builds on reconciliation and stability, contributes to economic growth and bolsters household welfare (Kloppers & Pienaar, 2014).

The three pillars addressed in the white paper were the same three pillars referenced in the Reconstruction and Development Plan (RDP), being restitution, redistribution and tenure reform. Of critical importance, the new government committed itself to a land reform programme where, with specific reference to redistribution, it would not intervene in the land market. As a result, government committed to adhere to the principle of “willing buyer, willing seller”, where government would provide resources to finance market-led redistribution transactions without government itself becoming the owner of the land (Kloppers & Pienaar, 2014).

One must also consider the latest tabling of the Regulation of Agricultural Land Holdings Bill, which many view as a bad idea. In its current form, it is badly written and riddled with contradictory clauses, poorly formulated objectives, grandiose bureaucratic schemes and obscure plans. This Bill includes proposals to restrict foreign ownership of farmland as well as imposing of a land ceiling in farm ownership (Kirsten, 2017).

2.3 The World Bank

The World Bank, being a major financer and advisor, is made up of 189 member states, which include South Africa. The mission of the World Bank Group is to eliminate poverty by 2030 and boost shared prosperity (Calland, 2018).

In 1992, the World Bank – seeking to place a liberated South Africa within the ambit of a capitalist global economy and to subject land reform to neoliberalism – drafted a report on the agricultural sector and, together with an "array of international experts", presented the lessons learnt from an international perspective relative to the land reform and agricultural policy in South Africa. (Hall & Williams, 2015; Ramutsindela, 2017)

The World Bank's proposal put forward at the time was for a radical redistribution of thirty per cent (30%) of medium and high quality land from large-scale, white commercial farmers to 600 000 small-scale, part-time black farm households. This model was converted into a target by the ANC's Reconstruction and Development Plan (RDP) in 1993, but later abandoned as it was seen to be fiscally and administratively unrealistic. Important to note is that the main emphasis of this policy was to alleviate the plight of the rural poor (Hall & Williams, 2015).

In 2000, the ministry produced a new redistribution policy that had its aim of promoting agricultural production and commercial farming by establishing black commercial farmers (Hall & Williams, 2015).

The latest report by the World Bank reached certain conclusions on issues such as land redistribution in South Africa and identified five (5) root causes or constraints that contributed to what it refers to as “the twin challenges” of poverty and inequality, which characterised South Africa’s slow progress in transition. It is stated that the lack of funds was not a major reason for the slow progress. There is a clear argument to be made for the strengthening of the administrative capacity for land reform, including restitution, redistribution and tenure reform (Calland, 2018).

It listed the constraints as being:

- The skewed distribution of land and productive assets,
- Skills,
- Low competition and economic integration,
- Limited or expensive spatial connectivity, and
- Climate shocks

2.4 Broad-Based Black Economic Empowerment (BBBEE) and Agri-BEE through Land Redistribution for Agricultural Development (LRAD)

Broad-Based Black Economic Empowerment Act (BBBEE), promulgated in January 2004, is known to be a strategic and systematic intervention focussed on addressing economic inequalities in South Africa.

There is also a clear link between BBBEE and the LRAD in that the aspirations of BEE, more specifically the sub-component referred to as Agri-BEE, underpin the LRAD plan for the upliftment of black commercial farmers. Also of interest, is that the thirty percent (30%) target referenced in the Land Reform Policy (LRP) is also referenced in the preamble of the BEE policy document (Lepheane, 2007).

Section 4 of Government’s Agri-BEE Framework, published in July 2004, specifically sets out the following commitments:

"The Established Industry undertakes to:-

- *Contribute to the realisation of country's objective of ensuring that (30%) of agricultural land is owned by Black South Africans by the year 2014;*
- *Contribute to an additional target to make available (20%) of own existing high potential and unique agricultural land for lease by Black South Africans by year 2014;*
- *Make available (15%) of existing high potential and unique agricultural land for acquisition or lease by 2010;*
- *Support legislative and development initiatives intended to secure tenure rights to agricultural land in all areas;*
- *Make available (10%) of own agricultural land to farm workers for their own animal and plant production activities."*

"Government undertakes to:-

- *Contribute through its existing programmes to increasing access and acquisition of agricultural land by Black South Africans;*
- *Proactively acquiring suitable agricultural land that comes on the market for land redistribution;*
- *Use agricultural land that reverts to the state through foreclosure of indebted farmers for redistribution;*
- *Promote the development of a thriving, viable land rental/lease system."*

"Black South African landowners and users undertake to:-

- *Ensure productive and sustainable use of high potential and unique agricultural land."*

As previously stated, up to 2014, all land claims had not been settled and less than 10% of the redistribution targets initially set by government had been met. What has not been taken into account is land that was purchased via private transactions. What is also not clear on the released statistics is to what extent

private BEE deals, aligned to the targets set out above in the Agri-BEE Framework, have been considered and achieved? In a recent report released by the Centre for Development and Enterprise, it is stated that “land reform (both through the state and the market) has made more progress than experts and policy makers care to admit, that expropriation without compensation is a catastrophically bad idea, and that trust between government and private sector is essential for the success and sustainability of effective land reform” (Sihlobo & Kapuya, 2018).

From data collected and fair estimates (State Land Audits and Research conducted by the University of Pretoria), it is argued that out of a possible 82.759 million hectares of land, about 21% of land (17.439 million) has been transferred from white ownership since 1994 (inclusive of private transactions driven by normal market conditions). This is significantly more and closer to the 30% target in comparison to the 8% quoted by politicians. It is also noted that the figure quoted above includes about 5 000 farms purchased by government and not yet allocated – contrary to the objectives as set out in the White Paper (Kirsten, 2018)(Sihlobo & Kapuya, 2018).

The current government policies also imply that most farms generate decent returns that can be distributed among many beneficiaries, yet statistics show that only about 4% of all farms in South Africa generate a turnover of more than R5 million per annum. Besides this fact, most farms are in debt and only generate an average of 6% return on equity during good seasons. In 2016, farm debt reported to be the highest it’s ever been due to draughts etc., reaching R145 billion. It is estimated to have increased to R160 billion in 2018. Commercial Banks held the majority of the debt at 62%, the Land Bank with 27%, 7% held by agricultural cooperatives and the rest held by private individuals and financial institutions. (Sihlobo & Kapuya, 2018)

2.5 A Zimbabwe comparative

"What the Zimbabwe experience tells us is that expropriation without compensation is a catastrophically bad idea" (Sihlobo & Kapuya, 2018).

Since expropriation of land without compensation 18 years ago, the entire Zimbabwean population has paid for this mistake. There have been eight consecutive years of economic decline that have led to job losses, de-industrialisation and a loss of agricultural export revenues. In 2009, an economist, Eddie Cross, estimated these losses at US$20 billion (Sihlobo & Kapuya, 2018).

The increasing unemployment rate of over 90% and tepid growth over the last couple of years has now forced Zimbabwe to go back and rectify the mistakes they made 18 years ago. Zimbabwe has recently established a Compensation Committee under its Land Acquisition Act to allow for dispossessed white former commercial farmers to be compensated for land seized 18 years ago. These costs are estimated at US$11 billion. It does raise the question of why South Africa would take a position of expropriation without compensation that Zimbabwe is now departing from, as it clearly did not work (Sihlobo & Kapuya, 2018).

As previously stated, Zimbabwe went through the same process of fast-tracking land reform by displacing commercial white farmers and replacing them with blacks, with dismal results. The country plunged into an economic and social crisis with effects that will still be felt for years to come. It is sited that this happened as result of land being provided to those that lacked the knowledge, resources and desire to utilise the land and as such, they failed to produce enough food for the nation. Others, who also benefitted from the land reform programme, only did so for speculative purposes and are holding on to vast tracts of idle land (Kuyedzwa, 2018).

Furthermore, the government could not properly provide the infrastructure needed to assist new farmers who had to acquire land that required a great deal of preparation before it could be productive (Wales, 2002).

According to Kuyedzwa, 2018, there are 5 key lessons to learn from the Zimbabwe experience:

- If land is to be taken, it should be given to those who have the knowledge, the resources and the desire to use it to its full purpose.
- Farmers should receive title to the land. In Zimbabwe, land was effectively taken out of the market and said to belong to the state. This meant that farmers were hamstrung and could not invest in meaningful infrastructure. Land without title means it can't be used for collateral.
- Property rights motivate the desire to succeed and once you remove this, there is little if any motivation to financially invest in a particular property.
- Land has complex links with the economy, and commercial farming in particular is an industry with complex links into every other industry. Before a farm is expropriated, the entire value chain needs to be considered as to ensure that upstream and downstream industries are not negatively impacted. As an example, Zimbabwe currently gets more than half of its milk requirements from South Africa. In 2017, Zimbabwe produced 65 million litres of milk on average, as opposed to the required 120 million litres. This is the same country that used to produce 300 million litres before land expropriation without compensation was applied.
- Bad moves wreak havoc further down the value chain as industries collapse, jobs are lost and critical skills and competencies supporting these industries are also lost.

In Zimbabwe, the dominant model used to implement land reform (90% of total reform) was where settler families were allocated residential stands, about five hectares of land for arable purposes and access to communal grazing land. Land was effectively acquired by the state and apportioned into plots, which in turn were redistributed to beneficiaries. Tenure was acquired by the

beneficiaries in the form of permits to either use the land for settlement, cultivation or grazing (Deininger, Hoogeveen and Kinsey, 2002).

Lastly, the International Monitory Fund (IMF) and the World Bank have warned Zimbabwe that command agriculture is negatively impacting domestic debt, which is growing rapidly. It subsequently suspended its aid to Zimbabwe. This in itself spills over and affects many other industries in Zimbabwe. “South Africa, embarking on its land reform, would do well to ensure that similar mistakes as made by Zimbabwe are avoided, and focus is placed on making agriculture work, rather than creating a new class of landowners intricately tied to the State who hold power over both the production of food and the rural votes.” (Pilossof, 2018)(Wales, 2002)

2.6 A Kenya comparative

The World Bank put forward Kenya’s land reform model, with reference to the 1954 Swynnerton Report in Kenya, as the ideal land reform model to be used for South Africa. The World Bank’s report argued that settlers should be selected based on their prior farming skills and their ability to pay for part of the land cost. The World Bank was heavily in favour of creating a free land market. From a South African perspective, the proposal was later altered to allow for communities and not only individuals to acquire land (Hall & Williams, 2015)(Rutten & Zoomers, 1997).

In Kenya, there was a bias towards large-scale commercial farmers. The assumption was that favouring progressive farmers would be a prudent policy. It was believed that the safest way of investing rural development funds was to allocate them to those who have the necessary farming experience and/or training. These would be the people who would most likely achieve increased levels of production and income. In post-independent Kenya, during the Kenya Million Acre settlement scheme, it was found that non-progressive farmers performed better than progressive farmers and actually created more

employment as they were comparatively more labour intensive due to their size. progressive farmers. (Lepheane, 2007)

High potential agriculture in Kenya is limited to about 20% of its total territory. It has a distorted land ownership structure, which is attributed in part to the legacy of the colonial period and insufficient progress during the post-colonial period. A negative consequence of land reform in this country is that land has become increasingly concentrated in the hands of a few, happy, newly elite African farmers, most of them being businessmen, politicians and civil servants. This is noted as the probable explanation for the high political constraints for real land reform in Kenya (Rutten & Zoomers, 1997).

Kenya has been unable to establish a suitable land reform programme since independence, largely due to ethnic clashes and the fact that political leadership in Kenya was the direct beneficiary of land reform policies. It is further stated that the uncontrolled privatisation of public land in Kenya only resulted in economic and agricultural decay. The Kenya experience does not provide evidence of an increase in agricultural production but in fact created more social and economic inequalities. Government failed to provide credit as was initially proposed. (Wales, 2002)

A number of lessons can be learnt from the Kenyan experience with specific reference to group tenure. Interventions should build on local land tenure practices. Group titles can be instrumental in assisting large groups of less well-off people. (Rutten & Zoomers, 1997)

2.7 What constitutes property?

It should be highlighted that the property clause was one of the more contentious issues during negotiations. What emerged from the negotiations was a property clause that protects property rights but also promotes land reform at the same time (du Plessis, 2009).

The meaning of the word “property” is unfortunately not very clear by looking at the constitutional text. Section 25(4)(b) of the constitution does, however, clarify that property is not restricted to land. In the *Lebowa case*, the court showed willingness to consider the meaning of property in cases where it is not clear that the interest infringed constitutes property. This would suggest that property is not only restricted to the private law definition and that non-traditional property might be regarded as property in the constitutional context (du Plessis, 2009).

Currie and De Waal share this view as in their opinion in the constitutional context property does not only refer to limited, traditional, private law concepts of property but at the same time does not just include any relationship or interest having an exchange value either (du Plessis, 2009).

One must also consider the limitations of the right to property. In this instance one must consider the difference between deprivation and expropriation of property. In the case of deprivation of property, the state is not obliged to compensate as the state is allowed to regulate property for public good without incurring liability. In the case of deprivation of property, restrictions are placed on the use of the property and the “ownership” of the property does not necessarily transfer to government. (du Plessis, 2009).

“Because the ‘property clause’ is so often discussed in relation to land reform and the agricultural sector, it is often mistakenly assumed that a move on property rights will be limited to farming and agricultural landholdings.” According to the Institute of Race Relations (IRR), it is also specifically stated that the expropriation of shares in companies may, for example, also be included to achieve empowerment goals etc. (Money Marketing, 2018).

2.8 Compensation and the willing buyer willing seller principle

The motion to review section 25 of the constitution seems to disregard the fact that real progress has been made relative to land redistribution and restitution (Sihlobo & Kapuya, 2018).

As there is clearly no practical evidence that land expropriation without compensation will combat poverty and create jobs, there are strong arguments made as to why it is a bad idea. If the expropriation policy intends to only focus on the element of land, then it would be reasonable to accept that the landowner will be compensated for the other basic investments that he has, relative to the land, such as the investments in fixed improvements: buildings, contours for conservation purposes, dams and other irrigation works, fences, roads, drinking places for animals, wine cellars, packing sheds, silos, etc. and then also operating capital such as machinery, crops on the land, etc. The challenge here is that the pure land component represents little more than 10% of the entire investment in the farm and as such it will create significant disruption to the fiscus (Kirsten, 2017).

There is already evidence of farmers not planting new crops as result of uncertainty in government policy and also because they are struggling to obtain appropriate loan funding due to the fact that in most cases, the land is used as collateral for these loans (Essop & Prince, 2018).

Agricultural Economist, Prof Kirsten, argues that with a programme of mass expropriation without compensation, there will be a protracted period where there is no new investment made in agriculture, which means no new growth in the agricultural output as well as no growth in the agribusiness sector. He also argues that one of the biggest risks one faces with expropriation without compensation is the impact it has on general prices in the economy, given that all prices are derived as a result of countless and sometimes unknown interactions between economic agents of which land is but one agent.

In agriculture, the underlying value of the land supports the entire food and farming industry. From a financial sector perspective, expropriating the land without compensation reduces the Asset value on the Balance sheets to “0”, which will lead to numerous losses and ultimately liquidations (Kirsten, 2017).

Hunt (1984) highlights that the redistribution of land inevitably raises the question of compensation. Compensation signals government commitment to owner property rights. It is stated that compensation is vital if non-revolutionary land reform is to be politically feasible.

So what about the requirements set out in the Expropriation Act 63 of 1975? According to the Act as it currently stands, compensation is a requirement for a valid expropriation, but it is noted that compensation does not have to be full compensation. The compensation amount will be determined in terms of ***section 12*** of the Act. It is also highlighted that compensation need not only be in monetary terms but may be in the form of an allocation of another piece of land. Irrespective of the requirements, should the constitution be changed to allow for expropriation without compensation, it stands to reason that a revision of the Expropriation Act will also be required.

CHAPTER 3 - THE EXPROPRIATED PERSON'S PERSPECTIVE

3.1 Income Tax considerations

In the previous chapter, it was highlighted that property may have a much wider connotation than just pure land. It is also evident that at least from an initial perspective, the focus seems to be on agricultural property. It is, therefore, also prudent to afford significant focus in this and the ensuing chapter on the impact from an agricultural/farming perspective.

In the context of farming operations, it is important to note that Capital Expenditure are primarily deducted either in full (with certain limitations) under the provisions of paragraph 12 of the First Schedule (capital development expenditure), as special depreciation allowances under section 12B and 12C, or as wear and tear allowances under section 11(e) of the Income Tax Act No.58 of 1962.

The limitations referred to in paragraph 12 relate to deductions limited to the farmers taxable income from farming operations in a particular year (before these deductions) and are generally referred to as unredeemed capital development expenditure. The unclaimed portion is then claimed in the following year of assessment. Paragraph 20A(1) of the Eighth Schedule allows the farmer to elect that the amount carried forward be treated as expenditure incurred for the purpose of calculating capital gains or losses. It is important to note that this election can only be made in instances where a farmer has ceased to carry on farming operations and has disposed of the immovable property on which those operations were carried out.

In essence, the special depreciation allowances referenced above in section 12B allow for the depreciation of machinery, implements, utensils and articles if owned by the farmer and brought into use for the first time. As such, a 50% allowance is allowed in the first year, 30% in the second year and the remaining 20% in the third year of use. Also important to note, is that no apportionment is done in a part of a year and should the asset be disposed of during any

particular part of the year, no apportionment is done and a full deduction will still be allowed. Section 12C allows for a special wear and tear allowance in respect of certain new or used assets, relative to assets used for storage and packing of agricultural products.

Where moveable assets do not fall within the provisions of paragraph 12 or section 12B or 12C**,** normal wear and tear allowances will be claimed under section 11(e).

Section 8(4)(a) is a general recoupment provision that applies to amounts that have previously been deducted under section 11 to 20 of the Income Tax Act. In terms of this section, such recoupments are included in the taxpayer's income, unless the provisions of section 8(4)(e) apply where a recoupment on the disposal of an asset will not be included in income and where the taxpayer has so selected it in terms of paragraphs 65 or 66 of the Eighth Schedule.

In essence, paragraph 65 of the Eighth Schedule allows a taxpayer to defer a capital gain arising on the involuntary disposal of assets. This would be the case where an asset has been disposed of by way of operation of law, theft or destruction and a replacement asset is acquired. Paragraph 66 in similar fashion allows the taxpayer to defer any capital gain on voluntary disposal of assets that were previously subject to capital deduction or allowances in terms of section 11(e), 12B,12C,12E,14 or 14bis and a replacement asset is brought into use within 18 months of disposal. It is also important to note that the recoupment of an asset, set against a replacement asset as above, is treated under section 8(4)(f).

When we consider the potential impact on debt funding relative to land reform without compensation, we must also consider section 19 of the Income Tax Act. The effect of section 19 is that if debt owed by a debtor is reduced, cancelled, conceded or compromised and that debt was used to fund working capital or assets on which allowances were claimed, then the amount by which the debt is reduced firstly reduces the cost of the revenue asset (if still in use) and any excess is then treated as a section 8(4)(a) recoupment.

Capital expenditure deducted in terms of paragraph 12 of the Frist Schedule is, therefore, not included in this general recoupment provision as they are catered for separately in the First Schedule. Paragraph 12(1B) allows for the recoupment of assets written off in full, to the value of proceeds on disposal or the cost of the asset, which is the lesser when sold. Paragraph 12(1C) allows for recoupment and inclusion in the farmer's income, the fair value of a moveable asset disposed of by the farmer as a donation, or for an inadequate consideration or a consideration that cannot readily be valued. The amount included will not exceed the original cost of the asset and will be deemed to have been paid by the other person for the acquisition of the asset.

It is also important to highlight section 11(o), which at the discretion of the taxpayer may be used to claim a further "allowance" on certain depreciable assets and under certain conditions. It is important to note that this section is available only where assets have been alienated, lost or destroyed and not where they have merely been taken out of operation. It also does not apply to assets that have an expected life span of more than 10 years.

3.2 Capital Gains Tax considerations

When we consider potential CGT implications, it is important to understand certain crucial definitions catered for in policy framework. The basic principle is that if an asset is sold for a profit, the profit will be subject to CGT and where a loss is created, the loss is set off against other "capital" profits in a particular year. If there are not sufficient "capital" profits against which to set it off, the rest of the unclaimed losses are carried forward to the following year.

In South Africa, it is also important to note that CGT is not a separate tax from Income Tax, but rather a part thereof, in that capital gains are included in your Income Tax calculation at a predetermined "inclusion rate". Section 26A of the Income Tax Act states that taxable capital gains must be included in the taxable income of a person for a particular year of assessment. The taxable capital gain is calculated and provided for in terms of the Eighth Schedule of the Income Tax

Act. Of particular importance is paragraph 4 of the Eighth Schedule, which stipulates that a capital loss arises when the base cost of an asset disposed of is greater than the *proceeds or deemed proceeds* from disposal.

The term “Asset” is defined in paragraph 1 of the Eighth Schedule and includes all property (moveable or immovable), tangible and intangible assets, rights or interest and even assets such as ‘goodwill’, which derives its value from underlying assets.

It is also important to note that the Eighth Schedule deals with both actual and deemed disposals. “Disposals” are defined in paragraph 1 as “an event, act forbearance, or operation of law, as envisaged in paragraph 11 of the Schedule”.

Paragraph 11 in turn states that disposal includes, amongst others, “any event, act, forbearance or operation of law which results in the creation, variation, transfer, or extinction of an asset”; “the donation of an asset”; “the expropriation, conversion, grant, cession, exchange of an asset”; “any alienation or transfer of ownership of an asset”; “the forfeiture of an asset” and “the termination of an asset”.

Paragraph 12A(3) also has specific relevance as previously discussed in relation to allowance assets, where funding was acquired to purchase the asset, and debts may not be paid under land expropriation without compensation. It states that where a debt was used to fund expenditure in respect of a capital asset or allowance asset, the debt benefit must firstly be used to reduce the paragraph 20 expenditure, i.e. the expenditure that constitutes the base cost of the asset. The amount of the debt benefit that exceeds the base cost is then treated as a recoupment of the capital allowances on that asset and will be treated as described above in terms of section 19 of the Income Tax Act.

It might also be prudent to reference Paragraph 13(1)(a)(iv) from a timing of disposal perspective. This section establishes the timing of disposal as “the

expropriation of an asset, the date on which the person receives the full compensation agreed to or finally determined by a competent tribunal or court”

Paragraph 20A provides for scenarios where a farmer may sell his farm and the balance of his unredeemed capital development expenditure can be treated as part of the base cost of the farm. Important though, is that he cannot create a capital loss out of the unredeemed expenditure.

One should also consider the impact of Paragraph 65 and 66 of the Eighth Schedule, which in general terms provide for roll over relief in that it allows for the recognition of a capital gain to be deferred to a future date.
Paragraph 65 applies, at the discretion of the taxpayer, to all assets excluding financial instruments. In cases where an asset is *expropriated*, lost, stolen, or destroyed and the person receives compensation at least to the value of the base cost, such gains can be deferred if the proceeds are used to purchase a replacement asset. The effect in essence is that the initial gain is deferred until such time as the replacement asset has been disposed of. All of the following conditions must, however, be met:

- The full proceeds will be used to acquire a replacement asset or assets
- The replacement assets are those that are contemplated in section 9(2)(j) or (k)
- The contract for the acquisition of the replacement assets must be concluded within a period of 12 months after the date of disposal of that asset
- The replacement assets must be brought into use within 3 years of the disposal of that asset

Important to note is that the Commissioner may on application by the taxpayer, decide to extend the latter two periods by 6 months if the taxpayer can show that reasonable steps were taken to conclude the same.

Paragraph 66 also provides for rollover relief and effectively applies to all assets (other than land) where the taxpayer is allowed to claim a capital allowance in terms of sections 11(e), 12B, 12C,12D, 12E,14,14bis, or 37B. In these instances, if such an asset has been sold and the proceeds are more than the base cost of those assets, the gain so created can be deferred and made in annual instalments from the first year that the new replacement assets come into use. The same timeframes and conditions apply in this scenario as does in Paragraph 65 to these categories of assets**.** In this case, the taxpayer has the option to defer any capital gain in terms of paragraph 66 and the recoupment of previous allowances in terms of section 8(4)(e).

Of critical importance is the consideration to paragraph 64D of the Eighth Schedule that states, “A person must disregard any capital gain or loss in respect of the disposal by way of a donation of land or right to land by virtue of the measures as contemplated in Chapter 6 of the National Development Plan”.

According to the SARS comprehensive guide to Capital Gains Tax (volume 6), “This exclusion grants relief to persons who donate land under land reform measures. Were it not for this exclusion, the person donating land or a right to land would be deemed to have proceeds equal to the market value of the land or right to land under paragraph 38, which could give rise to a capital gain, which would act as a disincentive to those wishing to take part in the land reform initiative.”

Paragraph 38 deals with the disposal by way of donation, consideration not measurable in money and transactions between connected persons not at an arm’s length price. Paragraph 38(a) specifically states that “the person who disposed of that asset must be treated as having disposed of that asset for an amount received or accrued, equal to the market value of that asset as at the date of that disposal.” In this regard, the definition of “donation” is critical and will be elaborated on below.

3.3 Value Added Tax considerations

As previously stated, the expropriation of land without compensation brings about various risks. One of these risks is the impact it will have on the "going concern" status of the business itself. It was also illustrated that for a VAT liability to be incurred (relative to registered VAT vendors), a 'supply', as defined in the VAT Act, has to occur.

Prior to 1999, the VAT Act did not include 'compulsory transactions, and transactions occasioned by 'operation of law' in the definition of supply. As such, in the Shell's Annandale Farm case, the Cape High Court held that because expropriation did not give rise to 'supply' as defined in the VAT Act at the time, no VAT liability was incurred. In 1999, the VAT Act was amended and the current definition of "supply" as per section 1 states that a supply "includes performance in terms of a sale, rental agreement, instalment credit agreement *and all other forms of supply, whether voluntary, compulsory or by operation of law*."

Therefore, it now includes any form of transfer of ownership, possession or use. What it does not provide for in its current state is the scenario of anything provided for nothing, i.e., where no consideration or compensation is received. The expropriation of property is therefore a supply by the owner of the property.

It is then also prudent to highlight section 10(3), dealing with the value of a supply. It states that the amount of any consideration referred to shall be the amount of money received or if the consideration is not received in the form of money, the open market value is to be used. Section 10(4***)*** further clarifies that "*where a supply is made by a person for no consideration or for a consideration in money which is less than the open market value of the supply, the consideration in money for the supply shall be deemed to be the open market value of the supply*."

In this regard, it is important to consider the wording and implications of section 8(2) of the Value-Added Tax Act No.89 of 1991, which states that: "*where a*

person ceases to be a vendor, any goods shall be deemed to be supplied by him in the course of his enterprise immediately before he ceased to be a vendor." It goes on further to state in section 8(2)(iii) that*: "this subsection shall not apply to fixed property to the extent that a deduction in terms of* section 16(3) *has not been allowed or will not be allowed in respect of that fixed property or any improvements thereto.*"

Thus, the effect of this provision is that when a person ceases to be a vendor, he is required to pay output tax on all the assets in his enterprise, excluding the assets falling into the categories stipulated above and those where input tax was initially denied in terms of section 17(2). It is also important to note that the VAT payable is calculated on the lesser of the original cost or market value at the time of ceasing to be a vendor as per section 10(5).

It is also worthwhile to consider the definition of "Goods" as defined in section 1, which effectively includes corporeal moveable things, fixed property, any real right in such things of fixed property and electricity. It should also be noted that as per section 8(7), the sale of goodwill as part of a business or part thereof, is also considered to be a deemed supply of goods. This particular section also deals with the scenario where you are selling your business as a going concern and as such, the sale would constitute a supply of goods. This supply may, however, be zero-rated in terms of section 11(1)(e), subject to certain conditions being met. More detail in this regard is also dealt with in *SARS Interpretation Note no 57*.

Given the nature in which farms could be expropriated, *Interpretation Note no 57* relative to farming activities has specific relevance. When you sell a business as a going concern, it has to be the sale of an income-earning activity. Both parties also have to agree to such at the date that the ownership is transferred. Interpretation Note 57 clarifies that the mere sale of a farm property would constitute a supply of a capital asset structure of a business and not a farming enterprise. In order to supply the farming enterprise as a going concern, the seller and the purchaser must agree that the income operating activity, which includes the farm property, its equipment, grazing, crops etc., is transferred.

3.4 BEE Structured deals

Cognisance should be taken that many farming operations are structured and run in various forms of legal entities. Furthermore, many BEE deals have been structured through legal entities to achieve effective transferring of wealth to the previously disadvantaged. Common structuring provisions used in BEE deals are section 42 and section 43 (Dekker, 2007).

It is especially section 42, and the application thereof, that requires further analysis. Section 42 deals with “assets for share” transactions and effectively enables companies to acquire other companies and even individual assets in a tax efficient manner for the seller. Paragraph (a)(i) deals specifically with the seller of the asset and provides for assets, including shares, which are sold to a company in exchange for equity shares in that company, to be free of normal tax, recoupments and capital gains tax in the hands of the seller.

Section 42(2)(a) states that if an asset is a capital asset that is being transferred, the person (seller) is deemed to have disposed of the asset for its base cost if it is equal to or less than the market value of the asset. In this case there is therefore no capital gains that arise. From a sellers perspective the assets disposed of is replaced by the equity shares at the same time and base cost of the assets disposed of.

Section 42(5) states that if these shares acquired via a section 42 transaction are sold within 18 months of the original date of transfer and more than 50% of the market value of the assets transferred are allowance assets, then the proceeds will be treated as income and not capital. Relative to the land expropriation without compensation discussion, it is important to note that this rule does not apply where the disposal is involuntary as contemplated in paragraph 65 of the Eighth Schedule.

It is also worthwhile to consider section 42(7) that states where a company disposes of a capital asset within 18 months of an asset for share transaction, a portion of the resultant capital gain may not be set off against any assessed loss

or capital loss of the company. Based on the applicable inclusion rate, this proportional gain will be recognised immediately as part of the net capital gain for the year.

Section 42(7)(b)(ii) provides for instances where the transferee sells allowance assets within 18 months of acquiring it. In these cases, the amount of the recoupment is deemed to be attributable to a separate trade of the company. The taxable income from this separate trade cannot be set off against any assessed loss or balance of assessed loss of the company.

Relative to section 42 transactions, it is also prudent to note that exemption is given to Securities Transfer Tax – section 8 of the STT Act and Transfer Duty section 9(1)(l) and section 9(15A). From a VAT perspective, if both parties are VAT vendors, the transfer is treated as a non-supply in terms of section 8(25) of the VAT Act.

It is also important to note Section 24BA, where there may be a mismatch in asset for share issues. In essence, if the value of the shares issued are less than the value of the assets received, the excess is deemed to be a capital gain made by the company on the issue of the shares, and where the value of the shares are more than the value of the assets received, the excess will be deemed to be a dividend in specie, subject to dividends tax.

3.5 Donations Tax considerations

Given the definition of ‘donation’ as per section 55 of the Income Tax Act, it is necessary to consider whether donations tax may be triggered in the case of expropriation of land without compensation. As highlighted earlier on, this is critical to understand in the context of Paragraph 38 and Paragraph 64D of the Eighth Schedule. Donation is defined as a *gratuitous* disposal of property or any *gratuitous* waiver or renunciation of a right. Important to note that donations tax is also not a tax on income but rather a tax on the transfer of assets, payable by the donor if and when applicable.

When we then consider the meaning of the word "*gratuitous*" as per the Collins Dictionary of the English Language, we see that something has to be given or received without payment or obligation, without cause and be unjustified. The legal definition states that it is something given or made without receiving any value in return. It can, therefore, be concluded that the disposal of property in terms of an obligation is not a *donation,* even though nothing has been received in return.

This view was confirmed in the Appellate Division case of Welch's Estate v CSARS (2004), where the court considered the meaning of "*donation*". The court held that the definition as stipulated by section 55(1) does not deviate from the common law definition and for a donation to take place; a motive of sheer liberality or disinterested benevolence needs to take place.

Section 56 furthermore sets out certain exemptions from donations tax being paid. Of specific relevance is section 56(1) (h), which states donations by or to any person (including any Government) referred to in section 10(1)(a), (cA), (cE), (cN), (cO), (cQ), (d) or (e). Donations by or to the Government, municipalities and certain public institutions are exempt from donations tax.

Section 56(1)(o) also specifically exempts any donation made, of immovable property, if such property was acquired by any beneficiary entitled to any grant or services in terms of the Land Reform Programme and with approval of the Minister of Land Affairs on the particular project.

Relative to the section 42 transactions highlighted above, it should also be noted that if an asset is sold for a price less than the market value of such an asset, donations tax will arise on the difference between the market value and the selling price. If the value of the asset transferred is more than the value of the shares received, SARS may apply section 58 of the Income Tax Act to the shortfall.

3.6 Zimbabwe comparatives

3.6.1 Capital Gains Tax

CGT is levied on taxable gains from a source within Zimbabwe from the sale or deemed sale of immovable property and any marketable security (specified asset) according to the Zimbabwe Capital Gains Tax Act (Chapter 23:01) of 1981. It further stipulates that CGT is triggered on the disposal or deemed disposal of an asset, which includes but is not limited to any event, act, forbearance or operation of law that results in the creation, variation or transfer of a specified asset, subject to any exclusions and exemptions. The liability for CGT arises irrespective of the date of acquisition of the specified asset. In certain circumstances, elections to defer liability are available.

Relative to assets acquired after 1 February 2009, a taxable gain is calculated by taking the difference between the proceeds received on disposal of the asset and the cost of the asset, plus any additions, inflation allowance, direct selling expenses, bad debts and certain legal costs incurred in CGT appeals to courts.

In comparison to South Africa, Zimbabwe CGT is a separate tax and any amounts included as income or deductions in the calculation for income tax are excluded from CGT. A flat rate of 20% is applicable on the gain.

As for assets acquired before 1 February 2009, the selling price is deemed to be the capital gains and a flat rate of 5% is applicable on this gain. A withholding tax of 15% applies on gains from immovable property. This withholding tax is credited on assessment.

Of particular relevance is part 3 (8)(2)(b) and (c) of the Zimbabwe Capital Gains Tax Act, which states the following:

“(b) where a person disposes of a specified asset otherwise than by way of sale such disposal shall be deemed to be a sale and an amount which, in the opinion of the Commissioner, is equal to the fair market price of such asset at the time of disposal shall be deemed to have accrued to such person at such time;”

"(c) where a specified asset is expropriated, such specified asset shall be deemed to have been sold for an amount equal to the amount paid by way of compensation for the expropriation of such specified asset."

The normal practice is to accept values of properties as declared by clients for Capital Gains Tax purposes. However, in certain circumstances, if in the opinion of the Commissioner, the value declared falls short of and is outside of fair/open market values for similar properties, then the Commissioner may invoke his power under Section 14 of the Zimbabwe Capital Gains Tax Act to either uplift the value or call for a valuation report from a property valuer, who is registered with the Valuers Council of Zimbabwe.

Of interest, as per the global property guide research calculations, is that in comparison to the rest of Africa, Zimbabwe has the highest effective Capital Gains Tax rate, calculated to be at 50% (South Africa sited as 13.65%).

3.6.2 Value Added Tax

As in the case of South Africa, the risk of an enterprise maintaining its going concern status after expropriation of land takes place becomes very relevant when we start looking at potential VAT implications.

Part 3(7)(2) of the Zimbabwe Value Added Tax Act (Chapter 23:17) of 2004 deems certain supplies of goods and services to take place where: "*a person ceases to be a registered operator*". Also relevant in this regard is Part 4(10)(e), which zero rates certain supplies, in this case the sale of a going concern where: "*the supply is to a registered operator of a trade or of a part of a trade which is capable of separate operation, where the supplier and the recipient have agreed in writing that such trade or part, as the case may be, is disposed of as a going concern*."

The value of supply is determined in accordance with Part 3(9)(3), which states that where: *"(a) to the extent that such consideration is a consideration in money, the amount of the money; and (b) to the extent that such consideration is not a consideration in money, the open market value of that consideration*."

Sale of buildings and land, other than farmland, is standard-rated. Farmland, which is used for agricultural and pastoral activities, is not fixed property for VAT purposes.

3.6.3 Income Tax

With reference to the Zimbabwe Income Tax Act (Chapter 23:06) of 1967 and relative to farming operations, a Special Initial Allowance (SIA) is granted in the year of purchase in relation to movables and in the year of construction in respect of immovable, or year in which the asset is first used. In subsequent years, accelerated wear and tear is allowed on original cost. For farm improvements, the SIA is 25%, with a subsequent 5% wear and tear allowance per year. Wear and tear on all movables is generally on a reducing balance basis, while that on immovables is on a straight-line basis (on cost).

It should also be noted that any general tax losses can be carried forward to the next year but may not be carried forward for a period of more than six years.

Deductions and allowances relative to farming operations are generally done in terms of the Fourth Schedule [section 15(2)(c)] of the Zimbabwe Income Tax Act. Part 3(8)(1)(i) specifically deals with the recoupment of previously allowed deductions and allowances in this regard.

Of unique relevance are the provisions, similar to those in the South African Income Tax Act, that allow for recoupments to be deferred in certain cases. Part 3(8)(1)(j)(i) states that: "*such amount shall not be included in the gross income of that person if he satisfies the Commissioner— A. that he has purchased or constructed or will purchase or construct, within a period of eighteen months from the date the asset was damaged or destroyed, a further asset of a like nature in replacement thereof; and B. that such further asset has been or will be brought into use within a period of three years from the date the aforesaid asset was damaged or destroyed".*

3.7 Kenya comparatives

3.7.1 Capital Gains Tax

Capital Gains Tax in Kenya is a tax chargeable on gains accrued on or after 1 January 2015 on the transfer of property situated in Kenya, irrespective of when the property was originally acquired. It is important to note that it is not a new tax that has been introduced, but CGT was suspended in 1985. CGT is levied at a flat rate of 5% of the net gain and cannot be offset against other income taxes. It is a final tax and the Capital Gains are not subject to further taxation.

Property is defined in the Eighth Schedule to the Kenya Income Tax Act and includes land, buildings and marketable securities. Of particular relevance is that the Eighth Schedule defines a transfer to include, "*on the occasion of loss, destruction or extinction of property whether or not compensation is received; or on the abandonment, surrender, cancellation or forfeiture of, or the expiration of rights to property.*"

The transfer value of the property is defined as the amount or value of consideration or compensation for transfer of the property, less incidental costs on the transfer. Any losses may be carried forward to be offset against future capital gains.

Certain exemptions from capital gains tax are stipulated and amongst others, include exemptions for transfer of machinery, including motor vehicles and Agricultural land that is less than 50 acres (Kenya Revenue Authority. 2014).

3.7.2 Value Added Tax

Relative to land expropriation and the potential impact to the going concern status of farming operations especially, consideration is given to the Value Added Tax Act Cap 476 of Kenya as revised in 2012.

Section 14(1) provides specific relevance stating that: "*Notwithstanding the provisions of this Act, the Commissioner may, with the prior approval of the Minister, in any case where he is of the opinion that there is— (a) uncertainty as*

to any question of law or fact; or (b) impossibility, or undue difficulty or expense, of recovery of tax; (c) hardship or equity, refrain from assessing or recovering the tax in question and thereupon liability to the tax shall be deemed to be extinguished or the tax shall be deemed to be abandoned or remitted, as the case may be."

Certain services are exempt for the purposes of the VAT Act and include, as per the Third Schedule Section 6 of the exemption list, "*Agricultural, animal husbandry and horticultural services*". Various other goods and services relative to the Agricultural sector are zero-rated as per the Fifth Schedule. Section 11A also allows for the deduction of tax on exempt goods and states: "*Where a registered person acquires any goods exempt from tax under Part II (i) of the Second Schedule, the price paid for such goods shall, notwithstanding any other provision of this Act, be deemed to be inclusive of tax, which may be deducted in accordance with section 11"*

Other than the requirements noted above, Section 21 of the 6TH Schedule also has particular relevance and states: "*Where any person disposes of a registered business as a going concern to another registered person— (a) both registered persons shall, within thirty days provide the Commissioner with details of the transaction, of the arrangements made for payment of tax due on supplies already made, of the description, quantities and value of assets and stocks of taxable goods on hand at the date of disposal, and of arrangements made for transferring the responsibility for keeping and producing books and records relating to the business before disposal; (b) unless the Commissioner has reason to believe that there would be undue risk to the revenue, and notifies the registered persons accordingly within fourteen days of receipt of the notification required in subparagraph (a), the assets and stocks of taxable goods on hand may be transferred without payment of the tax otherwise due and payable; (c) notwithstanding that the business is being disposed of by the registered person as a going concern that registered person shall remain registered and be responsible for all matters under this Act in relation to the business prior to its disposal, up to the time of its disposal, until such time as the requirements of this Act have been properly complied with."*

3.7.3 Income Tax

Part IV of the Income Tax Act of Kenya of 1974 has specific relevance as far as capital expenditure on agricultural land is concerned. Relative to Farm Works, Section 22(1) states that: *"Subject to this Schedule, where in a year of income the owner or tenant of agricultural land incurs capital expenditure on the construction of farm works there shall be made, in computing his gains or profits for that year of income and the four following years of income, a deduction equal to one-fifth of that expenditure*. *Provided that, where in any year of income commencing on or after the 1st January, 1985, the owner or tenant of agricultural land incurs capital expenditure on the construction of farm works there shall be made, in computing his gains or profits for that year of income and the two following years of income a deduction equal to one-third of that expenditure*".

Section 22(4) furthermore states that "*where a person (the "transferor") would, if he continued to be the owner or tenant, as the case may be, of agricultural land, be entitled to a deduction under this paragraph in respect of capital expenditure and the whole of his interest in the land in question, or in part of that land, is transferred, whether by operation of law or otherwise, to some other person, (the "transferee") - (a) the amount of the deduction, if any, for a year of income in which the transfer takes place, shall be apportioned in such a manner as the Commissioner may determine to be just and reasonable between the transferor and the transferee; and (b) the transferee shall, to the exclusion of the transferor, be entitled, where the interest transferred is in the whole of the land, to the whole of the deduction for any subsequent year of income, and where the interest transferred is in part only of the land, to so much of the deduction as the Commissioner may determine to be just and reasonable.*"

The Kenyan Income Tax Act deals with recoupments on previously claimed wear and tear/capital allowances as "balancing deductions". Part II section 11(1) states that: *"where wear and tear deductions or investment deductions have been made in computing the gains or profits of a person under paragraphs 7,24, 24A or 24B and that person ceases to carry on the business for the purposes of*

which the machinery was used and the machinery ceases to be owned by him, there shall be made in computing his gains or profits for the year of income in which the cessation occurs, a deduction or charge (in this Part referred to as a "balancing deduction" or a "balancing charge").”

CHAPTER 4 - THE BENEFICIARY PERSPECTIVE

In the previous chapters, an analysis was performed by focussing on the government and the expropriated person's perspective, relative to the concept of land reform without compensation. It is, however, important to note that the recipients of the land in their capacity as benefactors are also subjected to certain taxation framework requirements. We therefore aim to highlight the taxation considerations relative to the beneficiaries of the land in this chapter.

4.1 Income Tax considerations

The relevance and importance of the provisions as set out in paragraph 12 of the First Schedule (capital expenditure), relative to the special depreciation allowances as provided for under section 12B, or the wear and tear allowances (on equipment where applicable) provided for under section 11(e) of the Income Tax Act No 58 of 1962, is again highlighted from a beneficiary perspective.

Relative to section 11(e), it is important to note that the wear and tear allowance referenced in the Income Tax Act is not based on cost, but specifically refers to *value* as the criteria for calculating any relevant allowances. Proviso (vii) to section 11(e) specifically states that:

"the cost, which a person would, if he had acquired such machinery, implements, utensils and articles under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of such machinery, implements, utensils and articles was in fact concluded, have incurred in respect of the direct cost of the acquisition of such machinery, implements utensils and articles, including the direct cost of the installation or erection thereof"

It is, therefore, clear that the criteria for determining the wear and tear allowance in terms of section 11(e) should be based on either the value of the asset or on the cash cost of the asset in arm's length transaction (market value).

It is then also important to reference Interpretation note No.47 and Binding Ruling No. 7 of the Income Tax Act as released by SARS, that effectively elaborates on how the value of an asset can be determined for wear and tear purposes, policies on the determination of the amount of the allowance and a schedule of write-off periods relative to certain assets.

It is also important to reference section 11(o), which in effect provides for a further 'scrapping allowance' should the acquired asset be disposed of at a later stage. What is important from a beneficiary perspective is that where the asset was received for no consideration, this section will not apply as opposed to section 11(e), as this section refers specifically to the cost of the item when acquired, and not the value.

Relative to section 12B (relative to farming plant and equipment), it is important to note that the allowance is available on new or second hand assets as long as it has been brought in to use for the first time by the taxpayer. What is important to note, however, is that no allowance is claimable on buildings and the cost of the asset is determined as the lesser of the '*actual cost'* or an arm's length cash cost (market value). As such, if the asset was received for no consideration, section 12B will not be available to the beneficiary.

4.2 Capital Gains Tax considerations

Paragraph 20 of the Eighth Schedule defines the base cost of an asset as being the cost of acquiring the asset, plus all cost of improving or adding to it. In isolation, this would then mean that if the beneficiary received the land free of charge, the base cost for Capital Gains purposes would in essence be "0".

Section 12P and 12P(5) of the 11th Schedule then has further relevance as far as government grants are concerned. Section 12 P effectively exempts certain government grants from tax and section 12P(5) further states that when a tax-free government grant is for the acquisition, creation or improvement of an

asset, or as a reimbursement for expenditure incurred to acquire, create or improve an asset, the base cost of the asset must be reduced to the extent that the amount of the grant is applied for the acquisition, creation or improvement of the asset.

Under normal conditions, where the land is effectively being “donated” to the new beneficiary, paragraph 38 would be relevant in that it states that where an asset is disposed of by way of donation, the donor is deemed to have disposed of the asset for market value and the donee is deemed to have acquired it at the same market value.

Paragraph 64A of the Eighth Schedule is of particular importance relative to land expropriation without compensation. In line with the SARS CGT Interpretation Guide, paragraph 64A specifically relates to awards made in terms of the Restitution of Land Rights Act or in relation to chapter 6 of the National Development plan. “Persons who were dispossessed of their land as a result of racially discriminatory laws or practices may seek compensation in terms of the Restitution of Land Rights Act 22 of 1994. The compensation may be in the form of a restitution of a right to land, an award or compensation. A person who has put in a claim for land restitution effectively disposes of his or her claim for the amount of the award or compensation received. Any capital gain or loss in respect of a disposal of this nature will be disregarded for CGT purposes.” This section would, therefore, propose a direct link between the person seeking restitution and receiving compensation as described above.

4.3 Value Added Tax considerations

The consideration for Value Added Tax purposes only becomes relevant should the beneficiary be registered for VAT. Should the beneficiary be registered for VAT, various definitions as per section 1 of the VAT Act become relevant.

The definition of *supply* becomes relevant as per section 1 of the Value Added Tax Act, which can effectively include any transfer of ownership, possession or use. It does, however, not include anything done for nothing.

Section 8(7) of the VAT Act, deeming the disposal of a business as a going concern, to be a supply of goods, is relevant especially where the transaction between buyer and seller is zero, rated in terms of section 11(1)(e). Again, for this section to apply, amongst other requirements, the “seller” and the “buyer” need to be registered vat vendors. It is also important to note that in line with this section and relative to farming activities, the sale/disposition of the farm property constitutes the supply of a capital asset structure of the farm and not the farming enterprise as such. In order for it to qualify as a going concern, both the seller and the purchaser must agree that an operative income-earning activity in the form of the farm, its equipment, grazing, cropping etc., will be transferred.

The definition of *consideration* is also important, especially when we consider any input tax implications. Consideration is defined in section 1 as:

- Any payment made or to be made
- Including a deposit on a returnable container
- Whether in money or otherwise
- Or any act or forbearance
- In respect of, in response to, or for the inducement of
- The supply of any goods or services

Section 1 furthermore defines Input Tax as VAT charged by a vendor to another vendor on the supply of goods or services to him. In some cases, such as with second hand goods where no VAT was charged, a notional input tax can be claimed. However, what is important is that a consideration had to be paid and in the absence of an actual payment being made, it stands to reason that no input tax can be claimed.

4.4 Transfer Duty considerations

It should be noted that where a sale or disposition of a property is subject to VAT, it is exempt from transfer duty as per section 9(15) of the VAT Act.

It is also highlighted that transfer duty as per the Transfer Duty Act (no 40 of 1949), other than described above, is payable by the purchaser/beneficiary and is an indirect tax paid on the acquisition of fixed property situated In South Africa. Section 5 further stipulates that the transfer duty is payable on the “value” of the property, which in effect is the greater of the consideration payable or the declared value of the property (market value).

The only relative exclusion from transfer duty as per section 9(1)(a) & (b) of the Transfer Duty Act (40 of 1949) in relation to this subject matter, would be in the case where fixed property is acquired by the Government or by Provincial Administration; or by municipality or a water services provider. In such case, no transfer duty is payable.

Zimbabwe and Kenya comparatives relative to the respective taxation frameworks have been discussed in the previous chapter and as they are relevant to both the perspective of the expropriated person and the beneficiary, they are not discussed here in further detail. However, what should be noted is that in both Zimbabwe and Kenya, stamp duty is payable on the transfer of property.

CHAPTER 5 - CONCLUSION

Various concerns relative to land expropriation without compensation have been raised. This study primarily focussed on the taxation policy considerations, and highlighted certain areas in the current tax landscape that may require further analysis and potential changes. The study considered a widespread impact, which included a government perspective, an expropriated person's perspective and the beneficiaries' perspective. The potential impact, and therefore the need to find the right solution, however, spreads much wider in that the economic stability of South Africa is at risk.

As previously stated, the concept of land reform is not a new concept and with the support of the World Bank has been successfully implemented in some countries (Calland, 2018). Land reform without compensation is a fairly new concept, with no real tangible existing examples of successful implementation. In a country such as Zimbabwe, which is probably the closest comparative, the results were in fact dismal and counterproductive.

The South African Government has signalled the "willing buyer, willing seller" system as one of the principle constraints to land redistribution and is, therefore, proposing the more aggressive approach of expropriation without compensation. As such, it will necessitate a change to the constitutionally protected property clause, which was central to the negotiations that lead to the current political dispensation (Kloppers & Pienaar, 2014)

It is also stated that the majority of agricultural land transferred as part of the land reform programme to date, are not being used productively and the envisaged growth in employment has not materialised. The major cause sighted for this is due to the lack of financial and institutional support from government to the beneficiaries of land reform. This is despite government's acknowledgement in a White Paper that without its support and targeted intervention, land reform, as intended, will not be possible (Kloppers & Pienaar, 2014).

There seems to be no factual evidence to support the fact that land reform can successfully be implemented where a policy of expropriation without compensation is applied. This will certainly undermine property rights, job security, food security and investor confidence, and therefore, deter investment in land as it makes it riskier to invest.

In both the Zimbabwe and Kenya comparative, the element of nepotism and corruption, where politicians benefit more from land reform than the intended recipients, is a major concern and may well be a significant risk in the South African context.

Agriculture and the stability of this sector are pivotal for African countries as their economies rely heavily on the production of agricultural goods. (Wales, 2002)

It is clear from the study conducted that more than just a constitutional change will need to be affected, as it is debatable to what extent the current taxation framework adequately provides for the process and intended consequences of land expropriation without compensation.

Certain questions remain unanswered, and require further analysis and attention:

Are there, or should there be any envisaged tax relief measures that would be provided for in the taxation framework relative to affected parties?

What is the true fiscal impact relative to land expropriation without compensation, not only from a cost to government, but also the impact to collectable tax base?

Are the lessons learnt from similar approaches in neighbouring countries going to be translated into viable solutions in order to meet land redistribution objectives?

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