



Tax and Legal News

Shares as consideration for rental

Landlords typically receive consideration for renting space to tenants. The tax consequences of standard rental agreements where the consideration is in the form of 'cash' is well understood by landlords and tenants, and the income tax and Value-Added Tax (VAT) treatment of these agreements is clear.

If the tenant is in the unfortunate position of not being able to settle the rent due, it may negotiate settlement in another form, such as issuing shares to the landlord, for example. One would expect that the shares in this instance would be of equal value to the consideration that would have been paid as rent.

Settling an obligation by issuing a share to the landlord has the potential to create significant complexity and uncertainty for the parties concerned.

How do landlords treat a consideration which is not in cash?

Income tax

We include below some appropriate extracts from case law:

- *"The tax ... 'is to be assessed in money on all receipts or accruals having a money value."*^[1]
- *... a farmer who sells his produce in return for shares in a co-operative company will ... have included in his gross income the value of the shares.*^[2]
- *The value to be placed upon the asset other than cash received or accruing as income is the amount that could be obtained for it on the open market if it were to be sold under some reasonable method of sale.*^[3]

^[1] Ochberg v CIR 1931 AD 215; CIR v Hersov 1952 (1) SA 485 (A); 18 SATC 20

^[2] ITC 475 (1940) 11 SATC 274

^[3] Lace Proprietary Mines Ltd v CIR 1938 AD 267, 9 SATC 349

Under a rental agreement, where the landlord receives shares from the tenant in consideration for use of the premises, there would still be an income tax liability in respect of the market value of the shares received. Practically, the landlord will either have to sell the shares in order to settle the consequent tax liability or alternatively it will have to fund the tax from its own cash reserves.

VAT

For VAT purposes the landlord has made premises available to its tenant and would have issued an invoice for the use thereof. The landlord would also have an obligation to pay output VAT on the rental due from the tenant.

Where shares are issued by the tenant, the landlord would similarly have to fund the output VAT payment from its own cash resources or alternatively sell the shares that have been issued.

Capital Gains Tax

As the landlord receives shares as consideration for use of premises, tax could be triggered on the disposal of the shares. CGT could be triggered on the sale of the shares in instances where the landlord does not trade in shares - which is likely to be the case for most landlords whose primary business is the renting of space. The shares which the landlord receives under these circumstances would in all likelihood be reflected as an investment on its balance sheet as opposed to trading stock.

What are the likely tax consequences where the landlord values the shares at nil?

Under a standard rental agreement where the tenant is not able to settle its rental obligation, the landlord is generally entitled to claim a bad debt allowance where the debt due is written off. Can the landlord potentially be prejudiced where it no longer reflects a debtor, but instead has a share that is subsequently valued at nil?

Would the South African Revenue Service grant a refund or a credit for the VAT where the landlord is forced to write off the shares issued?

Are there any adverse tax consequences for the tenants?

These are just some questions which landlords should consider if they are faced with the above situation.

Conclusion

In today's challenging economic environment where consumer spending has been curtailed and businesses are negatively affected, tenants could be forced to enter into arrangements as described above with their landlords.

We strongly recommend that both landlords and tenants carefully consider the potential tax consequences of arrangements that may be entered into in order to address cash flow difficulties encountered in these challenging economic times.

If you have any queries, require assistance or need more information, please contact us:

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Regards
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FOOTNOTES

^[1] Ochberg v CIR 1931 AD 215; CIR v Hersov 1952 (1) SA 485 (A); 18 SATC 20

^[2] ITC 475 (1940) 11 SATC 274

^[3] Lace Proprietary Mines Ltd v CIR 1938 AD 267, 9 SATC 349

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