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The Income Tax Act:

The implications of farming in your own name

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Agriculture is a unique sector. It ensures food security in the country and puts food on the table each day. With the sector's contribution to the country food's security in mind, South Africa has put specific legislation, which provides for a special tax dispensation to promote food security, in place.

Section 26 of the *Income Tax Act, 1962 (Act 58 of 1962)* (the *Act*) stipulates that a producer's taxable income is determined as per the *Act's* provisions, subject to the requirements of the *First Schedule*. Therefore, amendments to the *Act* came into effect in March 2016. These amendments incorporated the rules applicable upon a producer's death (as contained in paragraphs 40 and 41 of the *Eighth Schedule: Capital Gains Tax*) into the new Section 9HA and the revised Section 25 of the *Act*.

The application of Section 9HA

In short, Section 9HA deals with tax in respect of the estate's disposal, while Section 25 deals with the deceased estate's tax. Upon the producer's death, the individual's tax is closed and all deductions that may arise up until the date of death, are made against the estate. The executor registers a new tax number; in other words, the estate receives its own tax number, which means that no claims, losses or expenditure of the deceased may be deducted from the estate.

The *Act* and its application particularly relate to producers who farm in their own name, meaning the farm, livestock, vehicles and farm implements are registered in their own name. Following the *Act's First Schedule*, the market value of livestock is reduced to a standard value, while depreciation applies to farm implements and vehicles. Upon death, all the producer's assets are deemed to have been disposed of at market value.

Prior to March 2016, the difference between market and standard value was taxed as capital gains at an effective rate of 18%. Section 9HA stipulates that capital gains tax must be changed to income tax, with a maximum rate of 45% for individuals.

When there are crops on the land, all expenditure is claimed from the individual's estate. However, no current expenditure may be claimed against tax on the estate. Therefore, the crop's full profit will be taxable in the estate. Only expenditure incurred by the estate and in the name of the estate, may be claimed from the income.

Table 1 illustrates the impact the calculation of income tax from March 2016 can have on an estate, compared to that of capital gains tax prior to March 2016. In this example it results in a difference of R3 564 141 – cash required in addition to the estate and tax.

Section 9HA does not apply if the producer's spouse is the sole heir, and the income tax is deferred only until the surviving spouse dies.

Table 1: Calculation of trading stock in estate.

Assets	Number	Book value/ standard value	Market value	Subjected
Dairy cows	220	R8 800	R2 200 000	R2 191 200
Dry cows	130	R5 200	R1 300 000	R1 294 800
Heifers	81	R2 430	R364 000	R607 500
Calves	73	R2 190	R328 500	R326 310
Sheep	65	R390	R195 000	R194 610
Farm implements		R653 896	R9 240 000	R8 586 104
				R13 200 524
	Capital gains at 18% prior to March 2016		R2 376 094,32	
	Income tax at 45% after March 2016		R5 940 235,80	

The solution to the problem

When the *Act* was implemented, experts in the field consulted with the South African Revenue Service (SARS) and the National Treasury regarding the impact of farming activities that are discontinued upon the producer's death and the subsequent threat to food security. The answer comes in the form of a question: Why do farmers still farm in their own name?

This question requires a complex answer that only an expert in this field can provide. The estate and associated taxes comprise not only income tax but also estate duties, such as capital gains tax and value-added tax.

The following benefits apply to those who farm within a company:

- Farming operations may qualify as a small business enterprise, and therefore income tax will be payable at lower rates.
- The company cannot 'die'. If the necessary management agreements and business contracts are in place, farming operations can continue.
- Shareholding in the company will be an asset in the estate and be subject to capital gains tax at a lower rate than that of income tax.

Be sure to assess your situation and seek specialist advice. For more information, visit *www.sanlam.co.za*.