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Part 12 of 15

Section 42 Asset-for-Share Transactions

A Powerful Estate Planning Tool for
Property Owners and Business Families

*Sometimes the most powerful move
is not buying an asset…
…it's changing how you own it.*

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Section 42 Asset-for-Share Transactions – A Powerful Estate Planning Tool for Property Owners and Business Families

Throughout this Estate Planning series, we have explored how property ownership, family companies, and trusts can play an important role in preserving wealth and facilitating succession planning.

A question often arises when discussing these structures:

"If I already own assets personally, how do I transfer them into a company without triggering significant taxes?"

Under normal circumstances, transferring assets into a company may result in:

- Capital Gains Tax
- Transfer Duty
- VAT implications
- Income Tax consequences

For many individuals, these taxes make restructuring prohibitively expensive.

Fortunately, South African tax legislation provides relief in certain circumstances through a mechanism known as a **Section 42 Asset-for-Share Transaction**.

When applied correctly, Section 42 can allow assets to be transferred into a company without immediately triggering certain tax consequences.

This makes it one of the most powerful restructuring tools available for long-term estate and succession planning.

What Is a Section 42 Transaction?

Section 42 of the Income Tax Act allows a person to transfer an asset to a company in exchange for shares in that company.

In simple terms:

Instead of selling the asset to the company for cash, the individual transfers the asset and receives shares in the company as consideration.

Example

Mr Smith owns an investment property worth:

R5,000,000

He transfers the property to a company.

Instead of receiving cash, he receives shares in the company worth R5,000,000.

The company now owns the property.

Mr Smith owns the shares.

This may sound like a simple transaction, but the tax consequences can be very different from a normal sale.

Why Section 42 Exists

The purpose of Section 42 is to facilitate legitimate business and restructuring transactions.

Government recognised that people should not necessarily be taxed simply because they change the ownership structure through which an asset is held.

The legislation therefore allows qualifying transactions to occur on a tax rollover basis.

This means certain taxes may be deferred rather than immediately triggered.

Understanding Tax Rollover Relief

One of the most important concepts in Section 42 is the idea of:

Tax Deferral

Many people incorrectly believe that Section 42 eliminates tax.

It does not.

Instead, it generally postpones certain taxes until a future event occurs.

The tax liability effectively moves with the asset into the company structure.

This distinction is extremely important.

Section 42 is not a tax avoidance mechanism. It is a restructuring mechanism.

Capital Gains Tax Relief

Under normal circumstances, transferring a property worth R5 million that originally cost R1 million would trigger a capital gain of:

R4,000,000

This could result in a substantial Capital Gains Tax liability.

Where Section 42 applies, the transfer may occur without triggering an immediate Capital Gains Tax event.

The company effectively inherits the tax history of the asset.

The gain is therefore deferred rather than immediately taxed.

Transfer Duty Relief

Transfer Duty is another significant cost when transferring immovable property.

Under certain circumstances, qualifying Section 42 transactions may also qualify for Transfer Duty relief.

This can create substantial savings where property portfolios are involved.

However, specific requirements must be met and professional advice is essential.

Why Estate Planners Use Section 42

Section 42 is often used where an individual wishes to move assets into a company structure as part of a broader estate planning strategy.

Common objectives include:

- Succession planning
- Asset consolidation
- Family wealth preservation
- Future restructuring
- Preparing for trust ownership

The transaction provides a mechanism to move assets into a company without creating an immediate tax burden.

A Practical Example

Consider the following scenario:

Current Position

Mr and Mrs Smith personally own:

- Three investment properties
- A share portfolio
- Various other investments

Combined value:

R15,000,000

Their estate planning adviser recommends creating a family company structure.

The objective is to:

- Simplify succession planning
- Centralise asset management
- Prepare for future family wealth transfer

Without Section 42:

- Capital Gains Tax may arise.
- Transfer Duty may become payable.
- Restructuring costs could be substantial.

With a properly structured Section 42 transaction:

- Assets may be transferred into the company.
- Shares are issued in exchange.
- Certain tax consequences may be deferred.

This makes the restructuring commercially viable.

The Relationship Between Section 42 and Family Companies

As discussed in Part 9, a family company can provide significant estate planning advantages.

However, the challenge is often moving existing assets into the company.

Section 42 frequently provides the mechanism that allows this restructuring to occur.

In many estate planning scenarios:

Step 1

Create the Family Company.

Step 2

Transfer qualifying assets into the company using Section 42.

Step 3

Use the company as the long-term asset holding vehicle.

This creates a platform for future succession planning.

The Relationship Between Section 42 and Family Trusts

In more sophisticated estate plans, the shares issued by the company may ultimately be held by a Family Trust.

The resulting structure may look like this:

Family Trust

Owns the shares in

Family Company

Which owns:

- Properties
- Investments
- Business assets

This structure can facilitate long-term family wealth preservation while maintaining continuity across generations.

Important Considerations

Section 42 transactions are highly technical.

Numerous requirements must be satisfied.

Examples include:

- Qualifying assets
- Share consideration requirements
- Company ownership requirements
- Anti-avoidance provisions
- Future disposal implications

A transaction that is incorrectly implemented may result in the relief being denied.

For this reason, professional tax advice is essential.

When Might Section 42 Be Worth Considering?

A Section 42 transaction may be worth exploring where:

- Significant property assets are owned personally.
- A family company structure is being considered.
- Succession planning is becoming important.
- Estate Duty exposure is increasing.
- Family wealth preservation is a long-term objective.

Every case must be evaluated individually.

What is appropriate for one family may not be appropriate for another.

Looking Beyond Tax

One of the biggest mistakes people make is focusing solely on the tax benefits.

The real value of Section 42 often lies in what it allows you to achieve afterwards.

The transaction is not the destination.

It is the vehicle that allows a family to move from:

Personal Ownership

to

Structured Family Ownership

through a company and, where appropriate, a trust.

This is often where the long-term estate planning benefits arise.

The Bigger Picture

The most successful estate plans focus on future generations rather than immediate tax savings.

Section 42 can be a powerful tool because it facilitates the movement of assets into structures designed for:

- Wealth preservation
- Succession planning
- Continuity
- Family governance

When used appropriately, it can form an important component of a broader family wealth strategy.

Final Thoughts

Section 42 Asset-for-Share Transactions provide one of the most effective mechanisms for restructuring assets into a company without immediately triggering certain tax consequences.

While the legislation is technical and requires careful implementation, it can create significant estate planning opportunities for families seeking to preserve and transfer wealth efficiently.

The objective is not simply to move assets.

The objective is to create a structure capable of protecting, growing, and transferring wealth across generations.

In the next article, we will examine another often-overlooked asset that can have a significant impact on Estate Duty and succession planning:

Part 13: Loan Accounts – The Hidden Asset in Your Estate

Professional Note

Part 13 is likely to be one of the most valuable articles in the series because many business owners and trust founders have substantial credit loan accounts sitting in their estates without fully appreciating that these loan accounts are assets for Estate Duty purposes. This creates the perfect opportunity to discuss:

- Trust loan accounts
- Section 7C
- Donation strategies
- Annual donation exemptions
- Gradual estate reduction planning

which are all highly relevant to your client base of business owners and investors.

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