The ABC

of Capital Gains Tax for Individuals

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The ABC of Capital Gains Tax for Individuals

FOREWORD

This guide deals with some of the basic principles of Capital Gains Tax (CGT) in order to contribute to a broader understanding of the tax. It should, therefore, not be used as a legal reference.

Please note that the deadline for preparation of CGT valuations as at 1 October 2001 expired on 30 September 2004.

Should you require additional information concerning any aspect relating to Capital Gains Tax (CGT), you may:

- Contact any South African Revenue Service (SARS) office
- Visit SARS online at http:/www.sars.gov.za
- Contact your own advisor

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1. UNDERSTANDING THE BASICS

Introduction

In his Budget Speech of 23 February 2000 the Minister of Finance, Mr Trevor Manuel, announced the introduction of Capital Gains Tax (CGT) in South Africa. Internationally, such a tax is not uncommon, with many of our trading partners having implemented CGT decades ago.

Before the implementation of CGT, you were taxed on the ordinary income you earned from owning assets, but were not generally taxed on profits arising from the disposal of those assets. The effect of CGT is that all capital gains and losses made on the disposal of assets are subject to CGT unless excluded by specific provisions.

In order to give effect to the proposals relating to CGT, an Eighth Schedule was added to the Income Tax Act, 1962 (the Act). This Schedule determines a taxable capital gain or assessed capital loss and section 26A of the Act provides that the taxable capital gain must be included in taxable income. The date from which capital gains are taxed is 1 October 2001.

Should this guide not answer your specific questions, you should contact your local SARS office or make use of the e-mail facility cgt@sars.gov.za.

Do I have to register for CGT?

No, CGT will only be triggered on the disposal of an asset. The taxable capital gain will then form part of your taxable income and must be included in your Income Tax Return for the year of assessment in which the disposal occurred. If you had a capital gain or capital loss exceeding R10 000 and you are not registered for income tax purposes, it will be necessary to register as a taxpayer at your local SARS office for the year of assessment in which you disposed of the asset and to complete a tax return for that year.

2. IMPORTANT DEFINITIONS

What is meant by a disposal?

A wide meaning has been given to the concept of disposal. The following are some examples of events that will be regarded as disposals:

- The sale of an asset

- Donation of an asset
- The loss or destruction of an asset

What assets are excluded from CGT?

Certain assets (such as personal-use assets) are excluded from CGT. Some of the important exclusions to note are:

- A primary residence (the first R1 million of gain or loss).(See part 4 of this guide for a more detailed explanation of what a "primary residence" is and how it is affected by CGT.)
- Most personal belongings such as motor vehicles and caravans, which are not used for the carrying on of a trade, furniture, etc
- Currencies, but not coins made from gold or platinum such as Kruger Rands
- Boats not exceeding ten metres in length and aircraft the empty mass of which does not exceed 450 kilograms
- Lump sum payments from pension, provident and retirement annuity funds (approved retirement funds)
- Proceeds from an endowment policy or life insurance policy (unless it is a second hand policy)
- Compensation for personal injury or illness
- Prizes/winnings from South African approved competitions, for example, the National Lottery

What is meant by a capital gain or loss?

A person's capital gain in respect of an asset disposed of is the amount by which the proceeds exceed the base cost of that asset. A capital loss is equal to the amount by which the base cost of the asset exceeds the proceeds.

Example of a capital gain or loss

Loss		**Gain**	
Proceeds	R10 000	Proceeds	R10 000
Base Cost	R20 000	Base Cost	R 5 000
Capital Loss	(R10 000)	Capital Gain	R 5 000

What is the base cost?

The base cost of an asset is generally the expenditure actually incurred in acquiring an asset (what you paid for it) together with expenditure directly related to the acquisition or disposal of an asset (e.g., sales commission – see **Note** below) or to improve the asset (such as the cost of capital improvements to the asset). The base cost does not include amounts which have been allowed as a deduction for income tax purposes. Some of the main costs that may form part of the base cost of an asset are:

- Expenditure to acquire the asset
- Transfer costs, stamp duty, transfer duty
- Advertising cost to find a seller or a buyer
- Cost of improvements to an asset
- Cost of the valuation of the asset for the purpose of calculating a capital gain or loss in respect of the asset
- Cost directly related to the acquisition, creation or disposal of that asset, e.g. fees paid to a surveyor, auctioneer, accountant, broker, agent, consultant or legal advisor, for services rendered
- VAT paid and not claimed or refunded on asset
- Cost of establishing, maintaining or defending a legal title or right in the asset
- Cost of moving the asset from one location to another (on acquisition)
- Cost of installation of the asset, including the cost of foundations and supporting structures

Note: Where the time-apportionment method is used to determine the base cost of an asset as at 1 October 2001, selling expenses must be deducted from proceeds.

3. CALCULATING THE BASE COST

What is the base cost of assets held before 1 October 2001?

In order to exclude the portion of the gain relating to the period before 1 October 2001 you need to determine the value of the asset at that date. You may use one of the following methods to determine the base cost of the asset as at 1 October 2001:

a) 20% x (proceeds less allowable expenditure incurred on or after 1 October 2001) (where no records have been kept and no valuation was obtained at 1 October 2001)

OR

b) Market value of the asset as at 1 October 2001, which is called the valuation date. (In order to use this method you had to have your asset valued before 30 September 2004.)

OR

c) Time-apportionment base cost method. This is a method of calculating the value of the asset based on how long you have owned it before and after 1 October 2001. The calculation is done as follows:

$$\text{Original cost} + \left[(\text{proceeds} - \text{original cost}) \times \frac{\text{Number of years held before 1 October 2001}}{\text{Number of years held before 1 October 2001 plus number of years held after 1 October 2001}}\right]$$

Example of time-apportionment

An individual acquired a holiday home for R450 000 four years before the valuation date of 1 October 2001. He had the property for a total period of 7 years before he sold the property for R800 000. He had the property valued at valuation date and the market value of the property at that time was R500 000.

Base cost =

$$\text{Original cost} + \left[(\text{proceeds} - \text{original cost}) \times \frac{\text{Number of years held before 1 October 2001}}{\text{Number of years held before and after 1 Oct 2001}}\right]$$

$$= R450\ 000 + [R800\ 000 - R450\ 000) \text{ X } \frac{4}{7}]$$

= R650 000

Proceeds	R800 000
Less: Base cost (above)	R650 000
Capital gain	R150 000

Notes:

1. Where no records have been kept and no valuation was obtained on or before 30 September 2004, method a) above must be used.
2. A part of the year is treated as a full year.
3. Where improvements to the asset have been effected after valuation date, the "proceeds" used in the above formula is determined in accordance with a separate formula.

What is annual exclusion?

In respect of each year of assessment the first R10 000 of capital gains is not taxable for CGT purposes. (This is increased to R50 000 when a person dies during the year of assessment.) Likewise, the first R10 000 of capital losses is not taken into account for CGT purposes.

What portion of your capital gain is subject to tax?

A person's taxable capital gain for the year of assessment is as follows:

(a) In the case of an individual or a special trust, 25% of the net capital gain for the year of assessment.
(b) In the case of a company, close corporation or a trust, 50% of the net capital gain for that year of assessment.

Example of CGT

An individual acquired shares (or participation rights in a collective investment scheme) for investment purposes six months after the implementation of CGT for R10 000 and disposed of all these shares two years later for R30 000.

Disposal — Sale of shares

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Exclusion — Not applicable, shares (or participation rights) disposed of are not specifically exempt

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Gain	Proceeds	R30 000
	Less: Base cost	R10 000
	Capital Gain	R20 000

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Annual exclusion: The exclusion of R10 000 is applicable to a natural person.

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Capital gain	R20 000
Less: Annual exclusion	R10 000
Net capital gain	R10 000
Inclusion rate	25% x R10 000 = R2 500
Taxable capital gain	R2 500

The taxable capital gain of R2 500 must be included in taxable income.

4. PRIMARY RESIDENCE

Will the sale of my primary residence be subject to capital gains tax?

Most primary residences will not be subject to CGT as the first R1 million capital gain or loss on the sale is excluded for CGT purposes. This means that you need to make a capital gain of more than R1 million after 1 October 2001 in order to be subject to CGT.

What is a "primary residence"?

There are two basic requirements which must be met before a home may be considered a primary residence -

- it must be owned by a natural person (not a trust, company or close corporation); and
- the owner or spouse of the owner must ordinarily reside in the home and must use the home for domestic or private residential purposes.

When will the sale of my primary residence be subject to CGT?

You will be taxed on a capital gain if one of the following applies:

- If the capital gain or loss on the sale of the primary residence exceeds R1 million, the portion that exceeds R1 million will be subject to CGT. Similarly, If you had a capital loss in excess of R1 million, only the portion exceeding R1 million will be allowed as a capital loss.
- Where the property is larger than two hectares, the gain on the area that exceeds two hectares will be subject to CGT.
- No exclusion from CGT will be allowed, in respect of a period on or after valuation date (1 October 2001), when the person was not ordinarily resident in the primary residence.
- Any part of the primary residence which is used for the purposes of trade, for example, if you use your study as an office for business purposes, is not covered by the primary residence exclusion.

Example of primary residence

An individual's primary residence is valued at R1 200 000 on 1 October 2001.
The residence is sold on 1 December 2002 for R1 400 000.

Proceeds			R1 400 000
Valuation date value			R1 200 000
Valuation fee			R 5 000
Swimming pool added in November 2001			R 45 000

Proceeds			R1 400 000
Less:	Base Cost -		
	Valuation date value	R1 200 000	
	Valuation fee	R 5 000	
	Improvements	R 45 000	R1 250 000
Capital gain			R 150 000

The gain is less than R1 million and therefore disregarded for CGT purposes. (Should you sell the residence for R2,4 million the gain would be R1,15 million. R150 000 would therefore be subject to CGT.)

Implications if you do not ordinarily reside in your home for one of the following reasons:

- Your old home was in the process of being sold while a new primary residence was acquired or was in the process of being acquired.
- Your home was being built on land acquired for the purpose of being your primary residence.
- The primary residence had been accidentally rendered uninhabitable.
- Upon your death.

If one of the above reasons applies, you will be treated as having been ordinarily resident for a continuous period of up to two years even if you were not living in your home during that two-year period.

What happens if my spouse and I hold our primary residence jointly?

The R1 million primary residence exclusion is divided according to the interest each of you hold in the primary residence. For example, if you and your spouse have an equal interest in your primary residence, you will each qualify for a primary residence exclusion of R500 000.

5. EFFECT OF CGT ON THE CALCULATION OF CERTAIN DEDUCTIONS AND ON THE TAXATION OF CERTAIN AMOUNTS SUBJECT TO A LOWER RATE OF TAX (RATING FORMULA)

The taxable capital gains would affect the calculation of certain deductions and certain amounts subject to the rating formula when calculating taxable income as follows:

- When calculating pension fund contributions in terms of section 11(k) of the Act, the taxable capital gain must be excluded as such gain does not constitute retirement funding income.
- When calculating retirement annuity contributions (RAF), the taxable capital gain must be excluded from the calculation to determine the 15% allowable deduction. The reason for this is that capital gains are part of taxable income and not income as required by section 11(n)(aa)(A) of the Act.
- When calculating the medical expenses deduction in terms of section 18(2) of the Act, the rule that only that portion of medical expenses exceeding 5% of taxable income will be allowed, will also include 5% of the taxable capital gain as it forms part of taxable income.
- When calculating amounts (such as lump sum payments from approved retirement funds), which are subject to tax at a lower rate ("rating formula") in terms of section 5(10) of the Act, taxable capital gains must be excluded from this calculation.

Example of a taxable capital gain

Salary	R 80 000
Bonus	R 50 000 (non-pensionable)
Capital gain	R100 000
Pension fund contributions	R 7 500
RAF contributions	R 10 000
Medical claim	R 12 000

The first step is to work out the taxable capital gain.

R100 000 less R10 000 annual exclusion = R90 000 x 25% inclusion rate = R22 500 = taxable capital gain

The second step is to work out the taxable income.

Pension fund contributions: R80 000 x 7,5% = R6 000, thus R1 500 is excess (capital gain not taken into account)

RAF contributions: Bonus of R50 000 x 15% = R7 500, thus R2 500 is excess and must be carried forward (capital gain not taken into account).

Medical deduction: R80 000 (salary) plus R50 000 (bonus) less R6 000 (pension) less R7 500 (RAF) = R116 500 plus the taxable capital gain of R22 500 = R139 000 x 5% = R6 950
Thus allowable medical deduction is: R12 000 – R6 950 = R5 050 (taxable capital gain taken into account)

Thus taxable income (excluding taxable capital gain) is R116 500 – R5 050 = R111 450 and according to section 26A the taxable capital gain must be included in taxable income. Thus taxable income including taxable capital gains is R111 450 + R22 500 = R133 950. The normal tax rebates and tax scales will be applicable on the taxable income of R133 950.

Example of an assessed capital loss

Salary	R 80 000
Bonus	R 50 000 (non-pensionable)
Capital loss from previous year	R150 000
Pension fund contributions	R 7 500
RAF contributions	R 10 000
Medical claim	R 12 000

Pension fund contributions: R80 000 x 7,5% = R6 000, thus R1 500 is excess (capital loss not taken into account)

RAF contributions: Bonus of R50 000 x 15% = R7 500, thus R2 500 is excess and must be carried forward (capital loss not taken into account)

Medical deduction: R80 000 (salary) plus R50 000 (bonus) less R6 000 (pension) less R7 500 (RAF) = R116 500 x 5% = R5 825.
Thus allowable medical deduction is: R12 000 – R5 825 = R6 175 (capital loss not taken into account)

The taxable income is R116 500 – R6 175 = R110 325. The assessed capital loss will not reduce the taxable income of R110 325 as the loss is ring-fenced and will be carried forward to future years where it can only be set-off against future taxable capital gains.

Please note that the above are just some of the criteria and it is not a comprehensive list. If more information is required please refer to the sources as indicated under the Foreword of this guide.

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