
SOUTH AFRICAN REVENUE SERVICE

**THE ABC OF CAPITAL GAINS
TAX FOR COMPANIES**

Another helpful guide brought to you by the
South African Revenue Service



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.

Should you require additional information concerning any aspect relating to CGT, you may –

- contact your local SARS office,
- if calling locally, contact the SARS National Call Centre on 0860 12 12 18;
- if calling from abroad, contact the SARS National Call Centre on +27 11 602 2093
- visit the SARS website at www.sars.gov.za,
- contact your own tax advisor or tax practitioner,
- consult the SARS *Comprehensive Guide to Capital Gains Tax* or the *Tax Guide for Share Owners*, both of which are available on the SARS website, or
- e-mail your enquiry to cgt@sars.gov.za.

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1. INTRODUCTION

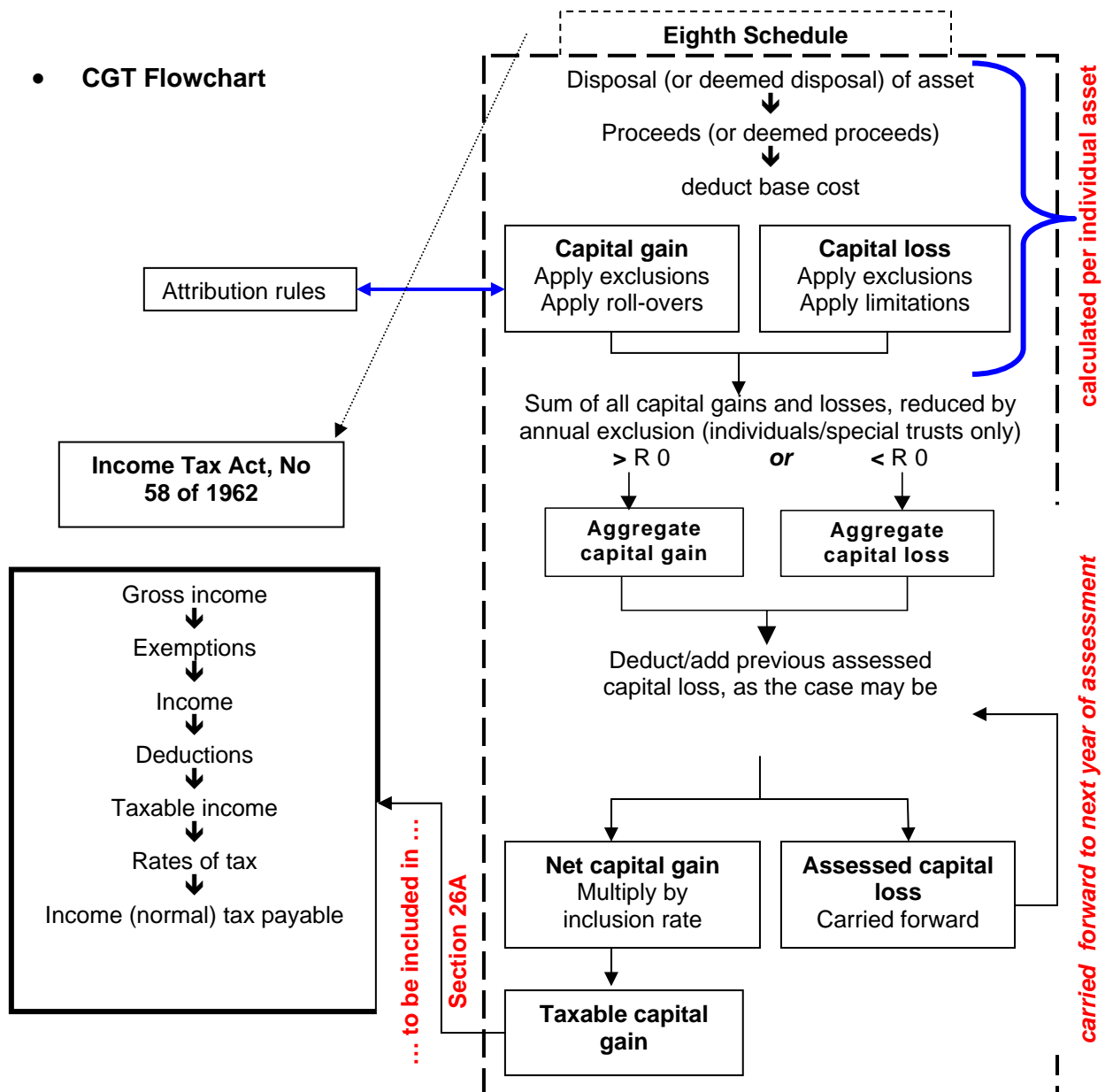
Capital Gains Tax (CGT) was introduced in South Africa with effect from 1 October 2001 and applies to the disposal of an asset on or after that date. Internationally, the idea of such a tax is not uncommon, with many of South Africa's trading partners having implemented CGT decades ago.

All capital gains and losses made on the disposal of assets are subject to CGT unless specifically excluded.

The CGT provisions are contained in the Eighth Schedule 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.

2. OVERVIEW OF THE CORE PROVISIONS OF CAPITAL GAINS TAX

The **CGT Flowchart** below sets out the core steps in determining a taxable capital gain to be included in taxable income or an assessed capital loss to be carried forward to a subsequent year of assessment.



3. DETERMINING A CAPITAL GAIN OR LOSS

The Eighth Schedule provides for four key definitions (Asset, Disposal, Proceeds and Base Cost) which form the basic building blocks in determining a capital gain or loss.

- **Asset**

An asset is widely defined and includes any property of whatever nature and any interest therein. CGT applies to all assets disposed of on or after 1 October 2001 (valuation date), whether or not the asset was acquired before, on or after that date.

However, only the capital gain accruing from 1 October 2001 will be subject to CGT.

- **Disposal**

The concept of disposal covers any event, act, forbearance or operation of law which results in a creation, variation, transfer or extinction of an asset. It also includes certain events treated as disposals, such as the change in the use of an asset.

- **Proceeds**

Once an asset is disposed of the amount which is received by or which accrues to the seller of the asset constitutes the proceeds from the disposal.

- **Base Cost**

The base cost of an asset is generally the expenditure actually incurred in acquiring the asset together with expenditure directly related to its improvement and direct costs in respect of its acquisition and disposal and certain holding costs. The base cost does not include any amounts allowed as a deduction against ordinary income, such as a capital allowance on plant and machinery. Some of the main costs that may form part of the base cost of an asset are the following:

- **Direct costs of acquisition and disposal**

Expenditure directly related to the cost of acquisition, creation or disposal of an asset:

- Cost of acquisition
- Cost of creating an asset
- Cost of obtaining a valuation for CGT purposes
- Remuneration of a surveyor, valuer, auctioneer, accountant, broker, agent, consultant or legal advisor

- Transfer costs
- Stamp duty, transfer duty or similar duty
- Advertising costs to find a seller or to find a buyer
- Moving costs - but only in acquiring or disposing of an asset
- Installation costs including foundations and supporting structures
- Cost of an option to acquire or dispose of an asset
- VAT paid and not claimed or refunded in respect of an asset
- Costs of establishing, maintaining or defending a legal title or right in the asset

○ **Cost of improvements or enhancements**

The improvement or enhancement must be reflected in the state or nature of the asset at the time of disposal. For example, if a car port was erected against the side of a building at a cost of R20 000, but was later irreparably damaged and as a result removed, R20 000 may not be included in the cost of the building.

○ **Holding costs**

These costs must have been wholly and exclusively incurred for business purposes, and must not have been claimed as a deduction against ordinary income:

- Repairs and maintenance, insurance and protection
- Rates and taxes on immovable property
- Interest on loans used to directly finance the cost of acquiring an asset and any improvements to it
- Interest on amounts used to repay existing loans. However, when the assets being financed comprise listed shares or participatory interests in collective investment schemes, the amount of interest that may be added to the base cost is limited to one-third.

4. **WHAT IS THE BASE COST OF AN ASSET HELD ON 1 OCTOBER 2001?**

In order to exclude the portion of the gain relating to the period before 1 October 2001, the base cost of the asset as at that date must be determined according to any one of the following methods:

- a) $20\% \times (\text{proceeds less allowable expenditure incurred on or after 1 October 2001})$. This method would typically be used when no record of

pre-valuation date expenditure exists and no valuation was obtained at 1 October 2001.

- b) Market value of the asset at 1 October 2001 (the "valuation date").
- c) Time-apportionment base cost method.
- **Market value method on 1 October 2001**

The Act lays down various requirements that apply when the market value method is used.

- **Time limit for performing valuations**

All valuations must have been completed by 30 September 2004. If you failed to perform a valuation by this date you will not be permitted to use the market value method. Valuations must be performed as if done on 1 October 2001. The prices on 1 October 2001 of certain financial instruments such as South African-listed shares and participatory interests in South African collective investment schemes were determined by SARS and published in the *Government Gazette*. You are required to use these prices and you therefore do not need to determine your own values for these assets. The prices are also available on the SARS website.

- **Who may perform valuations?**

The Act does not prescribe who may perform valuations. This is the responsibility of the company and the onus of substantiating a valuation rests with the company. A company was, however, entitled to appoint a professional person to assist with the valuation.

- **Methods to be adopted in valuing certain assets**

In general the Act does not specify the methods to be used in performing valuations, though there are some exceptions, as summarised in the table on the next page:

Market Value on 1 October 2001

Type of asset	Valuation method
General rule	Market value = price based on willing buyer, willing seller acting at arm's length in an open market
South African-listed securities	Volume weighted average price for the five business days preceding 1.10.2001 ¹
Foreign listed securities	The ruling price (usually the last sell price) on the last business day before 1.10.2001
Participation rights and "property shares" in South African collective investment schemes	Average "sell to management company" price for the last five trading days before 1.10.2001 ²
Participation rights in foreign collective investment schemes	Same as for SA collective investment schemes, except based on last trading day before 1.10.2001
Controlling interest	Control premium determined on listed company disposal and applied to listed price at 1.10.2001
South African second-hand endowment policies	Greater of ° Surrender value ° Insurer's market value (assume policy runs to maturity)
Farm land	Land Bank value or market value based on general rule. Note: As from 1 February 2006 the market value must be the fair market value as per par (b) of the definition of "fair market value" in sect 1 of the Estate Duty Act, namely, the price that could be obtained between a willing buyer and willing seller dealing at arm's length in an open market, less 30%.

¹ Prices supplied in *Government Gazette* 23037 dated 25 January 2002 and on SARS website under Tax Types/CGT.

² Same as footnote 1

- **Submission requirements**

The prescribed valuation form (CGT 2L if completed after 30 September 2004 or CGT2 / Annexure if completed before that date) must generally be lodged together with the relevant return of income for the year of assessment in which the asset was disposed of. However, in the case of certain assets, the valuation forms must be lodged with the first return of income submitted after 30 September 2004, irrespective of whether or not the relevant assets have been disposed of. If the return was not thus submitted, SARS may extend the submission period provided that it can be proved that the valuation was done by 30 September 2004. These categories of assets are set out in the table that follows:

Type of asset	Applies	Where market value exceeds
Intangible assets (such as goodwill and trade marks)	Per asset	R1 million
Unlisted shares	All shares held by the shareholder in the company	R10 million
All other assets	Per asset	R10 million

- **Loss and gain limitation rules**

Certain rules, which are beyond the scope of this guide, are in place to limit gains and losses when the market value of the asset on 1 October 2001 has been determined, or has been published in the *Government Gazette* (for example, South African-listed shares). These rules limit capital losses when the market value of an asset has been adopted or determined. Under certain circumstances capital gains are also limited.

- **Time-apportionment method**

This method may be used when a company has a record of the date of acquisition and cost of an asset. The following formula is used to determine the time-apportionment base cost of an asset:

$$B + [(P - B) \times N / (N + T)]$$

In which –

B = Allowable expenditure incurred before 1 October 2001

P = Proceeds on disposal of asset

N = Number of years or part thereof before 1 October 2001

T = Number of years or part thereof on or after 1 October 2001

For the purposes of this formula:

- Improvements or additions made before 1 October 2001 are assumed to have taken place when the asset was acquired.
- A part of a year is treated as a full year.
- The period before 1 October 2001 is limited to 20 years when –
 - improvements have been made to an asset before 1 October 2001; and
 - the asset was acquired before 1 October 1981.
- When no additions or improvements have taken place before valuation date, the 20-year limit does not apply.
- When capital allowances have been claimed on an asset for normal tax purposes –
 - the proceeds must be reduced by the amount of any recoupments; and
 - the expenditure must be reduced by the amount of any capital allowances that have been allowed.
- The following additional formula must be used to determine the value of “P” (proceeds) when improvements to an asset occur on or after 1 October 2001:
 - $P = R \times B / (A + B)$
 - In which –
 - R = Amount received or accrued from disposal of asset
 - B = Allowable expenditure incurred before 1 October 2001
 - A = Allowable expenditure incurred on or after 1 October 2001
 - A special “depreciable assets” formula applies when –
 - capital allowances have been claimed, in respect of an asset, and
 - additions to the asset have occurred on or after 1 October 2001.

The use of the special depreciable assets formula is illustrated in Example 2 later in this guide.

- Selling expenses are treated as a reduction in proceeds for the purpose of determining the time-apportionment base cost. This aspect is not illustrated in the examples to follow.

To assist taxpayers, SARS has made available a “TAB calculator” on its website which uses an Excel spreadsheet. **Note:** The TAB calculator does not apply when the special depreciable assets formulae are applicable. More advanced examples can be found in the SARS *Comprehensive Guide to Capital Gains Tax*.

- **Examples**

Example 1 – Time-apportionment base cost (TAB): All expenditure incurred before valuation date

XYZ (Pty) Limited purchased a machine for R100 000 on 1 October 1998 and sold it for R150 000 on 30 September 2007. At the date of sale capital allowances of R60 000 had been claimed on the machine. Calculate the capital gain.

Solution:

(a) Remove recoupment from amount received or accrued and capital allowances from cost

	R
Consideration received / accrued	150 000
Less: Recoupment	<u>(60 000)</u>
Proceeds for CGT purposes	<u>90 000</u>
Cost	100 000
Less: Capital allowances	<u>(60 000)</u>
Cost for CGT purposes	<u>40 000</u>

(b) Determine time-apportionment base cost (TAB)

Period 1 October 1998 – 30 September 2001	=	3 years
Period 1 October 2001 – 30 September 2007	=	6 years
Total period 1 October 1998 – 30 September 2007	=	9 years

(c) Determine capital gain or loss

$$\begin{aligned} \text{TAB} &= \text{R}40\,000 + [(\text{R}90\,000 - \text{R}40\,000) \times 3/9] \\ &= \text{R}40\,000 + \text{R}16\,667 \\ &= \text{R}56\,667 \end{aligned}$$

	R
Proceeds	90 000
Less: TAB	<u>(56 667)</u>
Capital gain	<u>33 333</u>

Example 2 – Time-apportionment base cost (TAB): Expenditure incurred after valuation date

Assumes the same fact as in **Example 1** but that the machine was upgraded on 1 July 2007 at a cost of R10 000 and that allowances of R2 000 were claimed on these improvements.

Calculate the capital gain.

Solution:

(a) Remove recoupments from proceeds

	R
Received or accrued	150 000
Less: Recoupment	<u>(62 000)</u>
Proceeds for CGT purposes	<u>88 000</u>

(b) Remove capital allowance from cost

	Before 1.10.2001 R	After 1.10.2001 R	Total R
Cost	100 000 (B ₁)	10 000 (A ₁)	110 000
Less: Capital allowances	<u>(60 000)</u>	<u>(2 000)</u>	<u>(62 000)</u>
Cost for CGT purposes	<u>40 000 (B)</u>	<u>8 000 (A)</u>	<u>48 000</u>

(c) Determine portion of proceeds relating to period before valuation date

$$\begin{aligned}
 P_1 &= R_1 \times B_1 / (A_1 + B_1) \\
 &= R150\,000 \times R100\,000 / R110\,000 \\
 &= R136\,364
 \end{aligned}$$

(d) Determine time-apportionment base cost (TAB)

$$\begin{aligned}
 \text{TAB} &= B + [(P_1 - B_1) \times N / (N + T)] \\
 &= R40\,000 + [(R136\,364 - R100\,000) \times 3 / 9] \\
 &= R40\,000 + R12\,121 \\
 &= R52\,121
 \end{aligned}$$

(e) Determine capital gain or loss

	R
Proceeds	88 000
Less: TAB	(52 121)
Cost after valuation date	<u>(8 000)</u>
Capital gain	<u>27 879</u>

5. AGGREGATE CAPITAL GAIN OR LOSS

This is determined by adding the capital gains and losses on individual assets together for a specific year of assessment.

6. NET CAPITAL GAIN OR ASSESSED CAPITAL LOSS

Deduct any assessed capital loss brought forward from the previous year of assessment, to arrive at the net capital gain or assessed capital loss.

7. INCLUSION RATE AND TAXABLE CAPITAL GAIN

Apply the inclusion rate to arrive at the taxable capital gain. In the case of a company or close corporation 50% of the net capital gain is included in taxable income. See the example below:

Example: Determine the taxable capital gain

XYZ (Pty) Limited has sold the following assets during the 2009 year of assessment:

Asset	Capital gain or loss
	R
Vacant land	50 000
Trade mark	5 000
Truck	(5 000)
Machine	<u>(10 000)</u>
Aggregate capital gain	<u>40 000</u>

XYZ (Pty) Limited does not have an assessed capital loss from the previous year of assessment. **Note:** An assessed capital loss may only be deducted from capital gains and added to capital losses. It may not reduce ordinary income.

Solution:

	R
Aggregate capital gain	40 000
Less: Assessed capital loss brought forward	<u>Nil</u>
Net capital gain	<u>40 000</u>
Taxable capital gain = R40 000 x 50%	<u>20 000</u>

The taxable capital gain will be included in the company's taxable income and taxed at the rate of 28%, that is, R20 000 x 28% = R5 600. The effective rate of tax on the sum of all the gains and losses is R5 600/R40 000 x 100 = 14%.

8. EFFECTIVE RATES OF CGT (1 April 2008 – 31 March 2009)

Type of company	Inclusion rate %	Statutory rate %	Effective rate %
Companies & Close corporations	50	28	14
Small business corporations	50	0 – 10 – 28	0 – 5 – 14
Employment companies	50	33	16,5
Non-resident companies	50	33	16,5
Tax holiday companies	50	0	0