
SOUTH AFRICAN REVENUE SERVICE

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

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South African Revenue Service



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THE ABC OF CAPITAL GAINS TAX FOR INDIVIDUALS

Foreword

This guide provides a simple introduction to capital gains tax (CGT) at its most basic level and probably contains insufficient detail to enable you to accurately determine your liability for CGT under most practical situations. It should accordingly not be used as a legal reference.

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

- contact your local SARS office,
- if calling locally, contact the SARS National Call Centre on 0800 00 7277,
- 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. Understanding the basics

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, such a tax is not uncommon, with many of South Africa's trading partners having implemented CGT decades ago.

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

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 a taxable capital gain must be included in taxable income.

Must a person register separately for CGT?

No, since CGT forms part of the income tax system. You must simply declare your capital gains and capital losses in your annual income tax return. If you had a capital gain or capital loss which exceeded the annual exclusion (2010: R17 500) 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 an income tax return for that year.

2. Important definitions

What is meant by a disposal?

A wide meaning is given to the term "disposal". The following are some examples of events that are 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 include the following:

- The first R1,5 million of gain or loss on disposal of a primary residence (see 4 for a more detailed explanation of what a "primary residence" is and how it is affected by CGT)
- A primary residence when the proceeds on disposal are R2 million or less
- Most personal belongings such as a motor vehicle (including a motor vehicle in respect of which you receive a car allowance), a caravan, artwork, stamp collecting,

furniture and household appliances and other assets used mainly (that is, more than 50%) for a non-trade purpose

- Boats not exceeding ten metres in length and aircraft having an empty mass of 450 kilograms or less
- Lump sum payments from pension, pension preservation, provident, provident preservation and retirement annuity funds (approved retirement funds)
- Proceeds from an endowment policy or life insurance policy (but not if it is a second-hand policy or a foreign policy)
- Compensation for personal injury or illness
- Prizes/winnings from gambling, games or competitions which are authorised by, and conducted under, the laws of South Africa, 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

<u>Gain</u>		<u>Loss</u>	
	<u>R</u>		<u>R</u>
Proceeds	10 000	Proceeds	10 000
Less: Base cost	<u>(5 000)</u>	Less: Base cost	<u>(20 000)</u>
Capital gain	<u>5 000</u>	Capital loss	<u>(10 000)</u>

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 that asset (for example, sales commission – see **Note** below) or to improve the asset (such as the cost of capital improvements to the asset). The base cost of an asset does not include any costs to the extent to which they have been allowed as a deduction against ordinary income, such as a capital allowance on plant or machinery. Some of the main costs that may form part of the base cost of an asset are the following:

- Expenditure to acquire the asset
- Transfer costs, stamp duty, securities transfer tax, transfer duty
- Advertising cost to find a buyer or seller
- Cost of improvements to an asset

- Cost of the valuation of the asset for the purpose of calculating a capital gain or loss on disposal of the asset
- Costs directly related to the acquisition, creation or disposal of an asset, for example, fees paid to a surveyor, auctioneer, accountant, broker, agent, consultant or legal advisor, for services rendered
- Value-added tax (VAT) paid and not claimed or refunded on an asset
- Cost of establishing, maintaining or defending a legal title to or right in an asset
- Cost of moving an asset from one location to another for purposes of acquiring or disposing of it
- Cost of installation of an asset, including the cost of foundations and supporting structures

Note: When 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 when applying the relevant formulae.

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 a value for the asset as at that date (referred to as the “valuation date value”). You may use one of the following methods to determine the valuation date value of the asset as at 1 October 2001 (the “valuation date”):

- a) 20% x (proceeds less allowable expenditure incurred on or after 1 October 2001)
(This method would typically be used when 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 (In order to use this method you must have valued your asset on or before 30 September 2004 except in the case of certain assets whose prices were published in the *Government Gazette*, such as South African-listed shares or participatory interests in collective investment schemes)

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:

$$\text{Original cost} + \frac{(\text{proceeds} - \text{original cost}) \times \text{Number of years held before 1/10/2001}}{\text{Number of years held before 1/10/2001} + \text{number of years held after 1/10/2001}}$$

Example of time-apportionment

An individual acquired a holiday home for R450 000 on 1 August 1996, that is, six years before the valuation date of 1 October 2001. He sold the property on 30 June 2009, that is, eight years after the valuation date for R800 000.

Base cost = R450 000 + [(R800 000 – R450 000) x 6/14] = R600 000

	R
Proceeds	800 000
Less: Base cost (as calculated above)	<u>(600 000)</u>
Capital gain	<u>200 000</u>

Notes:

1. When 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 a year is treated as a full year. The number of years before valuation date is determined by counting in yearly intervals starting on the date of acquisition and ending on 30 September 2001. Thus in the example the number of years before valuation date is determined as follows:

	Number of years
1 August 1996 to 31 July 1997	1
1 August 1997 to 31 July 1998	1
1 August 1998 to 31 July 1999	1
1 August 1999 to 31 July 2000	1
1 August 2000 to 31 July 2001	1
1 August 2001 to 30 September 2001 (two months)	<u>1</u>
	<u>6</u>

Similarly, the number of years after the valuation date is determined by counting the yearly intervals starting on 1 October 2001 and ending on the date of disposal.

3. The “proceeds” used in the above formula are determined using a separate formula when improvements to an asset have been made on or after valuation date.
4. This example only illustrates the basic principle of time apportionment, and in practice the application of the formulae is likely to be more complex. In order to assist taxpayers, SARS has made available a “TAB calculator” on its website which uses an Excel spreadsheet. More advanced examples can be found in the SARS *Comprehensive Guide to Capital Gains Tax*.

What is the annual exclusion?

For each year of assessment an annual amount, known as the “annual exclusion” of the sum of your capital gains and losses is excluded for CGT purposes. The annual exclusion increases in the year in which a person dies. If the sum of capital gains and losses results in a net loss, that loss must also be reduced by the annual exclusion. The table below summaries the annual exclusion, applicable in various years of assessment.

<u>Year of assessment</u>	<u>Exclusion</u>	<u>Exclusion in year of death</u>
	<u>R</u>	<u>R</u>
2010	17 500	120 000
2009	16 000	120 000
2008	15 000	120 000
2007	12 500	100 000
2006 and earlier years	10 000	50 000

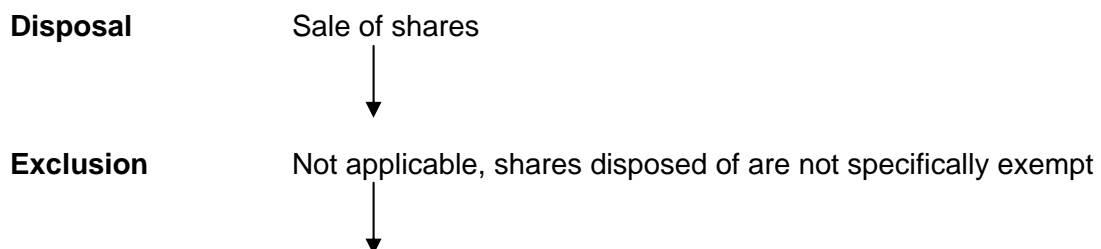
What portion of a capital gain is subject to tax?

A person’s taxable capital gain for a 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 the year of assessment.

Example of CGT

An individual acquired shares for investment purposes six months after the implementation of CGT for R10 000 and disposed of all of them during the 2010 year of assessment for R37 500.



	<u>R</u>	
Capital gain	Proceeds	37 500
	Less: Base cost	<u>(10 000)</u>
	Capital gain	<u>27 500</u>
	↓	
Annual exclusion	The exclusion of R17 500 is applicable to a natural person.	
	↓	
	<u>R</u>	
	Capital gain (as calculated above)	27 500
	Less: Annual exclusion	<u>(17 500)</u>
	<u>Net capital gain</u>	<u>10 000</u>
	Inclusion rate = 25%	
Taxable capital gain	=	25% x R10 000
	=	R2 500
The taxable capital gain of R2 500 must be included in taxable income.		

4. Primary residence

Will the sale of a primary residence be subject to CGT?

Most primary residences will not be subject to CGT because –

- the first R1,5 million of any capital gain or loss on the sale is disregarded for CGT purposes. This means that you need to make a capital gain of more than R1,5 million in order to be subject to CGT. Before 1 March 2006 the primary residence exclusion was R1 million, and
- in addition, if the proceeds on disposal of a primary residence do not exceed R2 million, any resulting capital gain or loss must be disregarded (this rule is subject to certain conditions, for example, no part of the residence must have been used for the purposes of trade).

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 as his or her main residence and must use the home mainly for domestic purposes.

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

A capital gain or loss will not be fully excluded in the following circumstances:

- If the capital gain on the sale of a primary residence exceeds R1,5 million and the proceeds exceed R2 million, the portion of the capital gain that exceeds R1,5 million will be subject to CGT. Similarly, if you have a capital loss in excess of R1,5 million and the proceeds exceed R2 million, only the portion of the loss exceeding R1,5 million will be allowed as a capital loss.
- Should the property be larger than two hectares, the gain on the area that exceeds two hectares will be subject to CGT.
- The primary residence exclusion does not apply to the portion of a capital gain or loss that relates to a period on or after the valuation date (1 October 2001), in which a person or his or her spouse was not ordinarily resident in a primary residence.
- The primary residence exclusion does not apply to the portion of a capital gain or loss that relates to any part of the primary residence that is used for the purposes of trade. This would apply, for example, if you use your study as an office for business purposes.

Example of primary residence

An individual's primary residence is valued at R1 million on 1 October 2001. The residence is sold on 1 December 2009 for R3 million.

		<u>R</u>	
Proceeds		3 000 000	
Valuation date value		1 000 000	
Valuation fee		5 000	
Swimming pool added in November 2005		45 000	
	<u>R</u>	<u>R</u>	
Proceeds		3 000 000	
Less: Base cost			
Valuation date value	(1 000 000)		
Valuation fee	(5 000)		
Improvements	<u>(45 000)</u>	<u>(1 050 000)</u>	
Gain		1 950 000	
Less: Primary residence exclusion		<u>(1 500 000)</u>	
Capital gain		<u>450 000</u>	

Deemed period of ordinary residence

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 if any one of the following circumstances applies:

- 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.

What happens if you and your spouse hold a primary residence jointly?

The R1,5 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 R750 000. You will also each be entitled to the annual exclusion (2010: R17 500; 2009: R16 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 impact of a taxable capital gain on the calculation of certain deductions and the rating formula which applies a lower rate of tax to certain types of income is as follows:

- Under section 11(k) of the Act your pension fund contributions are limited to 7,5% of your income from retirement funding employment. Since a taxable capital gain does not constitute retirement funding income it must not be taken into account when working out your admissible pension fund contributions.
- When calculating retirement annuity fund contributions (RAF), the taxable capital gain must be excluded for the purpose of determining 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.
- Under section 18A(1) of the Act a person is entitled to a deduction for qualifying donations to the extent that they do not exceed 10% of taxable income. Since a taxable capital gain forms part of taxable income it must be included when working out the 10% allowable amount.
- When calculating the medical expenses deduction under section 18(2)(c)(ii) of the Act, the rule that only that portion of medical expenses exceeding 7,5% of taxable income will be allowed, will also include 7,5% of any taxable capital gain as it forms part of taxable income.

- When calculating amounts (such as lump sum payments referred to in section 7A(4A) of the Act), which are subject to tax at a lower rate (“rating formula”) under section 5(10) of the Act, a taxable capital gain must be excluded from this calculation.

Example of a taxable capital gain

	<u>R</u>
Salary	80 000
Bonus	50 000 (non-pensionable)
Capital gain	107 500
Pension fund contributions	7 500
RAF contributions	10 000
Medical claim	12 000
 <u>The first step is to work out the taxable capital gain</u>	
	<u>R</u>
Capital gain	107 500
Less: Annual exclusion	<u>(17 500)</u>
Aggregate capital gain	<u>90 000</u>
Taxable capital gain = 25% x R90 000	
	= <u>R22 500</u>
 <u>The second step is to work out the taxable income (including the taxable capital gain)</u>	
	<u>R</u>
Salary	80 000
Bonus	<u>50 000</u> (non-pensionable)
	130 000
Less: Pension fund contributions = 7,5% x R80 000	(6 000)
RAF contributions = 15% x R50 000	<u>(7 500)</u>
	116 500
Taxable capital gain (as calculated above)	<u>22 500</u>
	139 000
Less: Medical claim	12 000
Less: 7,5% x R139 000	<u>(10 425)</u>
Taxable income	<u>137 425</u>

Example of an assessed capital loss

		<u>R</u>
Salary		80 000
Bonus		50 000 (non-pensionable)
Assessed capital loss from previous year		(150 000)
Pension fund contributions		7 500
RAF contributions		10 000
Medical claim		12 000
		<u>R</u>
Salary		80 000
Bonus		<u>50 000</u> (non-pensionable)
		130 000
Less: Pension fund contributions = 7,5% x R80 000		(6 000)
RAF contributions = 15% x R50 000		<u>(7 500)</u>
		116 500
Less: Medical claim	12 000	
Less: 7,5% x R116 500	<u>(8 738)</u>	<u>(3 262)</u>
Taxable income		<u>113 238</u>
<p>Note: The assessed capital loss of R150 000 brought forward from the previous year of assessment is not allowable as a deduction against ordinary income, but is carried forward to the following year of assessment in which it will be available for set-off against any future capital gains.</p>		