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CAPITAL GAINS TAX UPDATE AS IT RELATES TO SALE OF IMMOVABLE PROPERTY

(Updated 29 February 2012)

This tax was introduced on 1 Oct 2001 (therefore the date from which capital gains will be taxed is 1 October 2001), it is triggered on the disposal of an asset and the taxable gain from the disposal is declared in a taxpayer's general income tax return for the year of assessment in which the disposal occurred.

1. Summary of provisions are as follows:

1.1 CGT is payable on the disposal of assets that take place on or after the valuation date being 1 October 2001.

Disposal includes:

- sale of an asset

- donation of an asset

- the loss or destruction of an asset

1.2 In case of South African residents, the tax will apply to the disposal of all assets, including overseas assets.

1.3 The Capital Gain is determined by calculating the difference between the proceeds (the amount that accrues to the seller) and the base costs (costs directly incurred in acquiring or improving) of the disposed asset.

1.4 Certain assets are excluded from CGT and some of the important exclusions are:

1.4.1 An annual exclusion of R30 000, applies in respect of natural persons to the sum of all gains and losses. Where a person dies during the year of assessment, that person's annual exclusion for the year increases to R300 000.

1.4.2 A primary residence (R2 000 000 of the gain or loss) (see paragraph 4 below for more detail on this exclusion)

1.4.3 Most personal belongings (used for purposes other than trade) such as motor vehicles (unless it is used for business purposes even if just partly), furniture, paintings, collectables (but not gold and platinum coins), clothing etc.

1.4.4 Proceeds from an endowment policy or life insurance policy (unless it is a second hand policy)

1.4.5 Compensation for personal injury or illness

1.4.6 Prizes/winnings from a South African competition e.g. National Lottery

1.5 The resulting capital gain/loss (if not specifically excluded) is aggregated with all other gains or losses in the current tax year, and if it is;

1.5.1 an assessed capital loss (base costs exceeds the proceeds), it is carried forward to the following year OR

1.5.2 a net capital gain (proceeds exceeds the base costs), it is multiplied by the inclusion rate (see below) to determine the value to be inserted in a taxpayer's tax return

1.6 In the event of a net capital gain, the inclusion rates are determined as follows:

1.6.1 Natural persons and Special Trusts are taxed on 40% of the net capital gain
1.6.2 Companies, Close Corporations and Trusts (note exception re Special Trust) are taxed on 80% of the net capital gain

1.7 This taxable capital gain is included in the taxable income and taxed at the normal tax rates applicable.
1.7.1 Natural persons are taxed at a sliding scale with the highest marginal rate of 41%, and
1.7.2 Companies and Close Corporations are generally taxed at 28%, and
1.7.3 Trusts are taxed at 41%

This results in effective Capital Gains Tax rates as follows:
- Natural 16.4%
- Companies and Close Corporations 22.4%
- Trusts 32.8%

2. <u>Calculating the Base Costs of an asset</u>

2.1 When calculating the base costs of an asset it generally refers to the expenditure actually incurred in acquiring as asset together with expenditure directly related to the acquisition or disposal of an asset or to improve an asset

2.2 Examples would be:

2.2.1 Expenditure to acquire an asset (could be the purchase price you paid for the property if you acquired it on 1 October 2001 or thereafter or the valuation date value)

2.2.2 Advertising costs to find a seller or buyer

2.2.3 Costs on improvements to an asset still there (like putting in a pool/ built in wall units that are fixed to property)

2.2.4 Costs of the valuation of the asset for the purpose of calculating a capital gain or loss in respect of the asset

2.2.5 Costs directly related to the acquisition, creation or disposal of that asset e.g. transfer fees, transfer duty, donations tax, stamp duty, fees paid to a surveyor, auctioneer, accountant, broker, agent, costs of moving, consultant or legal advisor for services rendered.

2.2.6 VAT paid and not claimed or refunded on asset.

2.2.7 Costs of establishing, maintaining or defending a legal title or right in that asset

2.2.8 Costs of moving an asset from one location to another (on acquisition)

2.2.9 Costs of installation of that asset, including the costs of foundations and supporting structures.

2.3 Specifically excluded from base costs are:

2.3.1 Borrowing costs including interest and raising fees (think of mortgage bond interest etc.)

2.3.2 Expenditure on repairs, maintenance and insurance

3. <u>Methods of calculation of value of assets disposed of</u>

3.1 It follows that in regards to assets acquired prior to the valuation date and still held on to after the valuation date, CGT will only impact on the gain/loss arising after valuation date (1 Oct 2001)

3.2 Therefore the base costs will be = valuation date value + post valuation date expenditure

3.3 Valuation Date Value (1 October 2001) can be determined on 3 main bases:

3.3.1 Market Value at 1 October 2001 – It is up to the taxpayer to ensure the integrity of the valuation. SARS may adjust the valuation if they consider it necessary.

The valuation standard will be what a willing and able buyer will pay for the asset as at 1 Oct 2001

3.3.2 Time Apportionment – The following formula is applied

$$Y = B + \frac{[(P - B) \times N]}{T + N}$$

Where the letters hold the following meaning

Y = amount to be determined (base costs)

B = expenditure before 1 Oct 2001

P = proceeds

N = no of years prior to 1 Oct 2001

T = no of years after 1 Oct 2001

Example:

Asset cost 100

Acquired for 4 years prior to CGT

Sold for 150 one year after CGT

$$\text{Base Costs (Y)} = 100 + \frac{[(150 - 100) \times 4]}{4+1}$$

$$= 140$$

Therefore 150 (as sale price) – 140 (base costs)

= 10 gain

3.3.3 20% of proceeds upon realisation can be deemed to be the base costs (if no records were kept)

4 <u>Specifics regarding Primary Residence exclusion</u>

4.1 Natural person and special trust are only liable for CGT on capital gains in excess of R2 000 000 on the disposal of a primary residence. (Therefore Companies, Close Corporations and Trust do not qualify for this exclusion)

4.2 Only one residence may be a primary residence for any period (If property is used partly for trade the exclusion will be apportioned to the residence portion only)

4.3 Where more than one person holds an interest in a primary residence at the same time (e.g. spouses married in community of property) the amount to be disregarded must be apportioned in relation to the interest held.

4.4 The exemption is limited to land that does not exceed 2 Hectares, and is used mainly for residential purposes and in the event of two adjoining pieces of land only if it is disposed of at the same time to the same person

4.5 Exemption only applies for the period that the residence was occupied by the person disposing thereof (pro rata if not for the full period)

4.6 Where property was not lived in for a maximum of two years, for reasons such as death of a person or sale or building of a new residence, the exclusion will still apply for a period not exceeding two years. (see paragraph 48, page 327 of Introduction to CGT published by SARS)

4.7 Where the residence was let the exclusion will still apply, provided (see paragraph 50, page 330 of Introduction to CGT published by SARS) :

4.7.1 The rental period was not more than 5 years and,
4.7.2 The qualifying person resided there for one year before and after the rental period and,
4.7.3 No other residence was treated as a primary residence and,
4.7.4 The person was temporarily absent from SA or was employed or carried on business further than 250 km from the residence.

5. Additional Advice

View www.sars.co.za for further information pertaining to Capital Gains Tax

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