SOUTH AFRICAN REVENUE SERVICE

ABC OF CAPITAL GAINS TAX FOR INDIVIDUALS

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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. It applies to the 2013 year of assessment which covers the period 1 March 2012 to 28 February 2013.

For more information about CGT you may

- visit the SARS website at **www.sars.gov.za**;
- visit your nearest SARS branch;
- contact your own tax advisor or tax practitioner;
- if calling locally, contact the sars Contact Centre on 0800 00 7277;
- if calling from abroad, contact the SARS Contact Centre on +27 11 602 2093 (only between 8am and 4pm South African time); or
- consult the *Comprehensive Guide to Capital Gains Tax* or the *Tax Guide for Share Owners*, both of which are available on the SARS website.

Comments on this guide may be sent to **policycomments@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 (referred to as the "valuation date") 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 Eighth Schedule to the Income Tax Act, 1962 (the Act) contains the CGT provisions which determine a taxable capital gain or assessed capital loss. Section 26A of the Act provides that a taxable capital gain must be included in your 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 the sum of your capital gains and capital losses exceeded the annual exclusion (2013: R30 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 assets 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:

- Most personal belongings such as a motor vehicle (including a motor vehicle for which you receive a car allowance), a caravan, artwork, stamp collection, 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 which are personal-use assets
- 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 capital loss?

A person's capital gain on 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 capital loss

Gain		**Loss**	
	R		R
Proceeds	10 000	Proceeds	10 000
Less: Base cost	(5 000)	*Less*: Base cost	(20 000)
Capital gain	5 000	Capital loss	(10 000)

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 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 obtaining a valuation of an asset for the purpose of calculating a capital gain or loss upon its disposal
- 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 or loss 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:

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.

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.

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:

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

Example of time-apportionment

X, 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. X sold the property on 30 June 2012, that is, eleven years after the valuation date for R800 000.

Base cost = R450 000 + [(R800 000 – R450 000) x 6/17] = R573 529

	R
Proceeds	800 000
Less: Base cost (as calculated above)	(573 529)
Capital gain	226 471

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)	1
	6

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 (referred to 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. A net loss that results after adding together the capital gains and losses for the year of assessment must also be reduced by the annual exclusion.

Year of assessment	**Exclusion**	**Exclusion in year of death**
	R	R
2013	30 000	300 000
2012	20 000	200 000
2011	17 500	120 000
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?

An individual's taxable capital gain for the 2013 year of assessment is 33,3% of the net capital gain (for earlier years: 25%).

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 2013 year of assessment for R50 000.

Disposal Sale of shares

↓

Exclusion Not applicable, shares disposed of are not specifically exempt

↓

		R
Capital gain	Proceeds	50 000
	Less: Base cost	(10 000)
	Capital gain	40 000

↓

Annual exclusion The exclusion of R30 000 applies to a natural person.

↓

	R
Capital gain (as calculated above)	40 000
Less: Annual exclusion	(30 000)
Net capital gain	10 000

Inclusion rate = 33,3%

Taxable capital gain = 33,3% x R10 000
= R3 330

The taxable capital gain of R3 330 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 R2 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 R2 million in order to be subject to CGT. Before 1 March 2012 the primary residence exclusion was R1,5 million and before 1 March 2006 it 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, namely,

- 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 R2 million, the portion of the capital gain that exceeds R2 million will be subject to CGT. Similarly, if you have a capital loss in excess of R2 million, only the portion of the loss exceeding R2 million will be allowed as a capital loss.
- The capital gain or loss attributable to the portion of a property that exceeds two hectares is 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 2012 for R3,5 million.

	R
Proceeds	3 500 000
Valuation date value	1 000 000
Valuation fee	5 000
Swimming pool added in November 2005	45 000

		R	R
Proceeds			3 500 000
Less:	Base cost		
	Valuation date value	(1 000 000)	
	Valuation fee	(5 000)	
	Improvements	(45 000)	(1 050 000)
Gain			2 450 000
Less: Primary residence exclusion			(2 000 000)
Capital gain			450 000

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 erecting 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 primary residence exclusion of R2 million 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 R1 million. You will also each be entitled to the annual exclusion (2013: R30 000).

5. Effect of CGT on the calculation of certain deductions

The impact of a taxable capital gain on the calculation of certain deductions 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*)(i)(*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*) 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.

Example of a taxable capital gain

	R
Salary	80 000
Bonus (non-pensionable)	50 000
Capital gain	120 000
Pension fund contributions	7 500
RAF contributions	10 000
Medical expenses	12 000

<u>The first step is to work out the taxable capital gain</u>

	R
Capital gain	120 000
Less: Annual exclusion	(30 000)
Aggregate capital gain	90 000

Taxable capital gain = 33,3% x R90 000

= R29 970

The second step is to work out the taxable income (including the taxable capital gain)

		R	R
Salary			80 000
Bonus (non-pensionable)			50 000
			130 000
Less:	Pension fund contributions = 7,5% x R80 000	(6 000)	
	RAF contributions = 15% x R50 000	(7 500)	(13 500)
			116 500
Taxable capital gain (as calculated above)			29 970
			146 470
Less:	Medical expenses	12 000	
	Less: 7,5% x R146 470	(10 985)	(1 015)
Taxable income			145 455

Example of an assessed capital loss

	R
Salary	80 000
Bonus (non-pensionable)	50 000
Assessed capital loss from previous year	(150 000)
Pension fund contributions	7 500
RAF contributions	10 000
Medical expenses	12 000

		R	R
Salary			80 000
Bonus (non-pensionable)			50 000
			130 000
Less:	Pension fund contributions = 7,5% x R80 000	(6 000)	
	RAF contributions = 15% x R50 000	(7 500)	(13 500)
			116 500
Less:	Medical expenses	12 000	
	Less: 7,5% x R116 500	(8 738)	(3 262)
Taxable income			113 238

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.