DYKES VAN HEERDEN GROUP OF COMPANIES
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BRIEF GUIDE TO CAPITAL GAINS TAX

This brief guide is intended to outline in very broad and brief terms, the key principles that form part of Capital Gains Tax legislation in South Africa relating to immovable property

WHEN IS CAPITAL GAINS TAX (CGT) CHARGEABLE AND PAYABLE?

The occurrence that causes any CGT liability is the disposal of an asset, for instance a residential property. Unless such a disposal occurs, no gain or loss arises.

WHAT ARE AFFECTED CAPITAL ASSETS?

Affected capital assets are considered to be property of any kind, including assets that are movable or immovable, tangible or intangible, excluding trading stock and mining assets qualifying for an income tax deduction as capital expenditure.

WILL THE SALE OF MY PRIMARY RESIDENCE BE SUBJECT TO CGT?

A primary residence exclusion of a gain of up to R2 000 000.00 and no Capital Gains Tax being charged if the property is sold for the sum of R2 000 000.00 or less, means that most capital gains on the sale of a home will not be subject to CGT.

WHAT IS A PRIMARY RESIDENCE?

It must be a structure, including a boat, caravan or mobile home, which is used as a place of residence by a natural person. A natural person or special trust must own an interest in the residence, and the natural person with an interest in the residence, beneficiary of the special trust, or spouse of that person or beneficiary must ordinarily reside in the home and must use it mainly for domestic purposes as his or her ordinary residence.

Where the primary residence is disposed of together with the land on which it is situated (including unconsolidated adjacent land) the two million exclusion will apply to land:

i) To the extent that it does not exceed two hectares;

ii) That it is used mainly for domestic and private purposes together with the residence, and is disposed of at the same time and to the same person as the residence.

IS A PRIMARY RESIDENCE EXCLUSION AN UNLIMITED EXCLUSION?

The exclusion will not apply to any capital gain or loss in excess of two million rand. The exclusion will further only apply in respect of two hectares of property used for domestic or private purposes. The exclusion furthermore will not apply to any capital gain or loss in respect of the period on or after the valuation date when the person was not ordinarily resident in the primary residence.

<u>WILL IT APPLY TO A RESIDENCE HELD THROUGH A COMPANY OR TRUST</u>?

No, the owner is not a natural person.

<u>HOW ARE CAPITAL GAINS / LOSSES DETERMINED</u>?

A capital gain or loss is the difference between the base cost of an affected asset and the consideration realised or deemed to be realised upon the disposal or deemed disposal of that same asset.

<u>WHAT IS BASE COST</u>?

Base cost means the cost of an asset which is deducted from any proceeds upon disposal, to determine whether a capital gain or loss has been realised. Base cost includes those costs actually incurred in acquiring, enhancing or disposing of a capital asset that are now allowable as a deduction from income. The following are included in the base cost of an asset:-

i) Acquisition costs
ii) Incidental costs of acquisition and disposal
iii) Capital costs of maintaining title or rights to an asset
iv) Costs of improvement or enhancement
v) Costs of ownership of assets used exclusively for business purposes, listed shares and units in a unit trust scheme

<u>VALUATIONS</u>

The extended period in which to obtain valuations for the purposes of capital gains tax finally expired on the 30th of September 2004. As a result anybody who is the owner of property which was acquired after the 1st of October 2001 will no longer be entitled to use the valuation method for capital gains tax if the property had not been valued prior to the 30th of September 2004. A person (natural or otherwise) who was in fact the owner of immovable property as at the 1st of October 2001 and who obtained a valuation of such property prior to the 30th of September 2004 may still use the valuation method for capital gains tax purposes. However such party must submit the valuation for the property in the tax return for the year in which the property is sold. Failure to do so could result in the Receiver of Revenue not being prepared to accept the valuation method.

A person who purchased immovable property after the 1st of October 2001 may use the method referred to as the normal method referred to in A below for the purposes of calculating capital gains tax. A person who purchased the property prior to the 1st of October 2001 and obtained a valid valuation before the 30th of September 2004 may use any one of the 3 methods referred to below. A person who purchased a property before the 1st of October 2001 but did not obtain a valid valuation before the 30th of September 2004 can use either method A, B or C below.

A FOR PROPERTIES ACQUIRED AT ANY TIME (I.E. BEFORE OR AFTER THE 1ST OF OCTOBER 2001):-

<u>THE NORMAL METHOD</u>

The capital gains tax is calculated on the difference between the price for which the property is eventually sold and the purchase price which was initially paid for the property. In addition transfer costs, estate agent's commission (on the sale of the property) and the documented costs of any capital improvements to the property can be deducted from the capital gain. It is important to note that capital improvements refer to items which increase the value of the property and do not constitute maintenance of the property. This would include things such as adding an extra bedroom to the house or installing a swimming pool. It would not include costs of repainting the property, repairing the roof or any other items which are treated as expenditure for income tax purposes. Thus the interest on the bond, rates and taxes, charges for water and electricity and similar charges cannot be deducted for the purposes of calculating the capital gains profit.

B ONLY FOR PROPERTIES PURCHASED PRIOR TO THE 1ST OF OCTOBER 2001:-

TIME APPORTIONMENT METHOD

The value of the property as at 1 October 2001 is calculated using the following formula:-

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

Once one has calculated the value of the property as at 1 October 2001 then one would calculate the capital gains on the normal basis. For example if a holiday home was bought for R500 000.00 on 1 August 1995 (seven years before the 1st October 2001) and was sold for a net amount of R1 400 000.00 on the 28th February 2015 (fourteen years after the 1st October 2001), the base cost will be calculated as follows:-

Valuation date value = R500 000.00 + [(R1 400 000.00 – R500 000.00) x 7 / 21] = R800 000.00
Base cost = Valuation date value + post 1 October 2001 expenditure

The calculation would then be as follows:-

Nett proceeds	R1 400 000.00
Less: Base cost as calculated	R800 000.00
Capital Gain	R600 000.00

A part of a year is treated as a full year.

If there were expenses incurred both before and on or after 1 October 2001 a separate formula is used to determine the "proceeds" which are to be used in the above time apportionment formula.

C THE 80/20 PRINCIPAL

In terms of the same, the expenditure incurred on or after the valuation date is deducted from the proceeds and thereafter multiplied by 20% which then determines the value of the property as at the 1st of October 2001. The amount of the value of the property as at 1 October 2001 is then added to the expenditure incurred on or after the valuation date in order to determine the base cost.

Valuation date value	:	20% x (Proceed - Post 1 October 2001 expenditure)
Base cost	:	Valuation date value + post 1 October 2001 expenditure

D FOR PROPERTIES PURCHASED PRIOR TO THE 1ST OF OCTOBER 2001 AND A VALID VALUATION WAS OBTAINED BEFORE THE 30TH OF SEPTEMBER 2004

THE VALUATION METHOD

Capital gains tax is calculated on the difference between the price for which the property is eventually sold and the valid valuation of the property as at the 1st of October 2001. In addition estate agent's commission (on the sale of the property) and the documented costs of any capital improvements to the property affected after the 1st of October 2001 can be deducted from the capital gain. Capital improvements prior to the 1st of October 2001 cannot be deducted as they have already been taken into account in the valuation of the property as at the 1st of October 2001.

Any tax payer who owned the immovable property before the 1st of October 2001 and sold the property subsequent to the 1st of October 2001 is entitled to elect which of the four methods referred to above such party wishes to utilize (assuming of course that such party obtained a valid valuation prior to the 30th of September 2004). If the party did not obtain such valid valuation prior to the 30th of September 2004, then the party can only use methods 1, 2 and 3 referred to above. It is advisable for a taxpayer to work out the net effect in respect of each of the methods before electing which of the methods to utilize.

IS THERE ANY RELIEF ON THE INCLUSION OF A CAPITAL GAIN IN TAXABLE INCOME?

The following inclusion rates are to be applied to nett capital gains:-

i) Legal persons (including companies, close corporations and trusts) – 80%
ii) Natural persons (individuals and special trusts) – 40%

In other words, a company, close corporation or trust will only include 80% of the nett capital gain in taxable income (20% is exempt from tax) and an individual will only include 40% of the nett capital gain in taxable income (60% is exempt from tax).

The table below outlines effective tax rates in respect of CGT:-

TAX PAYER	INCLUSION RATE	STATUTORY TAX RATE	EFFECTIVE TAX RATE PERCENTAGE
Individuals	40%	0 – 45%	0 – 18%
Companies (standard)	80%	28%	22.4%
Trusts	80%	45%	36%

The above should be seen as a brief comment and our interpretation thereof and should not be seen as an extensive guideline. Please obtain a full legal opinion if you wish to act on any aspect hereof as the guideline is not fully comprehensive.

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