

## Rate of Capital Gains Tax ("CGT")

CGT only taxes the profit one makes on a property when it is disposed of, and not the entire value of the property.

If the property is owned by an individual or a special trust, 25% of the capital gain made on disposal of the property must be included in their taxable income for the year of assessment in which the property is disposed of. The present maximum marginal rate of income tax for individuals is 40% and therefore individuals will pay a maximum of 10% of the capital gain.

If a property is owned by a company, a close corporation or an ordinary Trust, 50% of the capital gain must be included in their taxable income. The income tax rate for a company or close corporation is 29% and these entities will therefore pay 14.5% of the capital gain in CGT, while Trusts, whose income tax rate is 40%, will pay 20% of the capital gain.

If a capital loss is made on disposal of the property, it may be set off against any capital gains made in that year of assessment and, if no capital gains have been made, the loss may be carried forward to subsequent years of assessment.

For individuals, the first R12 500 of their capital gain or loss in any year of assessment will be exempt and thus disregarded. This figure increases to R60 000 in the year in which the individual dies.

Non-residents are liable for the payment of CGT on the disposal of any immovable property owned by them in South Africa or on the disposal of an interest of at least 20% in the share capital of a company where 80% or more of the net asset value of the company is attributable to immovable property.

## Calculating the Capital Gain, Valuations and Keeping Records

A capital gain is calculated by deducting the base cost of the property from the proceeds on disposal of the property. Disposal includes a sale, donation, exchange, vesting of the property in a beneficiary of a trust or emigration.

The following may be included in base cost:

- i. The costs of acquiring the property, including the purchase price, transfer costs, transfer duty, VAT and professional fees (eg. attorneys and surveyors).
- ii. The costs of improvements, alterations, renovations, etc.
- iii. The costs of disposing of the property, including agent's commission, advertising costs, valuation costs (including valuing the property for CGT purposes) and professional fees.

One is not entitled to deduct expenditure on repairs, maintenance, insurance and rates and taxes.

It has therefore now become essential to maintain accurate records of the above costs. If such records are not retained, no deduction will be allowed from the proceeds to determine the capital gain. Clients should therefore be advised to start searching for and compiling records relating to the costs and dates of acquisition of the property and subsequent costs relating thereto.

All records must be kept for a period of 4 years from the date of submission of the income tax return for the year in which the capital gain or loss is reflected. If no return is lodged, the records must be kept for 5 years from the date of disposal of the property. If a person lodges an objection or an appeal against a CGT assessment, all the records must be kept for the above periods and thereafter until the assessment becomes final.

For properties acquired before 1 October 2001, the following methods of valuing the asset as at that date may be used:

1. The property's fair market value as at 1 October 2001, ie. the price obtainable on a sale between a willing buyer and a willing seller at arm's length in an open market. The valuation must be carried out within 2 years from the effective date (ie. before 30 September 2003), but the property must be valued according to its condition and in terms of the prevailing economic and market conditions as at 1

October 2001.

The Act does not prescribe who may perform the valuation. The taxpayer may employ any third party to assist in the valuation or may elect to value the asset himself or herself. The proviso, however, is that the onus of substantiating the valuation rests with the taxpayer. The valuation workings should therefore reflect the procedure for carrying out the valuation as well as the particular method used. In this regard, working papers should be retained, as outlined above.

All valuations will be subject to audit by the Commissioner and, where he is not satisfied with the valuation, he may either request further information or adjust the valuation. Such an adjustment is subject to appeal by the taxpayer. If the valuation is determined by the Commissioner to have been inflated in order to limit the amount of the capital gain, penalties may be imposed. Valuers who are employed to carry out fair market valuations should therefore be cautioned against the danger of being sued for damages by clients in cases where the Commissioner rejects a valuation and levies penalties against the taxpayer for an incomplete declaration. Valuers are advised to include a disclaimer for any such loss in their valuations, warning that the valuation is to be relied upon by the taxpayer at his or her own risk.

According to the SARS website, the Commissioner may require the following information when auditing a particular valuation:

- i. The valuation itself, including the basis of the valuation and the relevant calculations;
- ii. The physical address of the property;
- iii. The size of the property;
- iv. Details of any improvements to the property;
- v. The plans of the property as at 1 October 2001;
- vi. Details of recent property sales in the same area;
- vii. The current municipal valuation of the property.

The valuation must be lodged with the taxpayer's income tax return in the year in which the asset is disposed of and must take a form prescribed in the Regulations. In the case of a property worth more than R10m, the valuation must be submitted to SARS with the first tax return submitted to SARS after 30 September 2003.

2. The time-apportionment base cost, ie. the percentage of the total gain that was made after 1 October 2001.
3. Where no fair market valuation was submitted and no accurate records maintained, the value as at 1 October 2001 will be deemed to be 20% of the proceeds on disposal.

All clients should be advised to carry out valuations within the 2 year period from 1 October 2001. This way, they will be able to decide later (when they sell the property) as to whether they wish to use the valuation method or the time-apportionment base cost. If no valuation has been obtained, they will have no choice. A valuation should also be carried out of a primary residence if now or in future the client may use the residence (or a portion of it) for trade purposes or if the ultimate capital gain might exceed R1-m.

## Primary Residence Exclusion

The primary residence exclusion will apply only to natural persons and special trusts. Upon disposal of a primary residence (on land not exceeding 2 hectares), any capital gains or losses up to R1-5m can be excluded. This will not apply to properties registered in companies, close corporations or Trusts.

A person who does not ordinarily reside in South Africa cannot have a primary residence in South Africa.

When only part of the residence is used for residential and part for business purposes, an apportionment must be done. Likewise, where the residence is occupied for a part period, an apportionment must be done but, where the residence was not inhabited because it was being offered for sale or was being erected or renovated or had been rendered accidentally uninhabitable, the exemption will apply for a period not exceeding 2 years.

If the owner is employed or trading more than 250km from his or her residence and lets it for a period not exceeding 5 years, the exemption will apply if the owner lived in the premises for a continuous period of at least 1 year prior to and after the letting period and does not treat any other residence as his or her primary residence

during that period.

Where more than one person holds an interest in a primary residence (eg. spouses married to each other out of community of property), the exclusion will be in proportion to the interest held by each party in the residence.

## Formation of a Company

1. It is recorded that the purchaser is acting as trustee for a company to be formed. The purchaser :
  - i. undertakes to effect registration of a company on the basis that section 35 of the companies act 1973 is fully complied with;
  - ii. undertakes to obtain adoption or ratification of this agreement by the company within seven (7) days after it has obtained a certificate to commence business;
  - iii. undertakes to procure the necessary bank or financial institution guarantee for payment of the balance of the purchase price complying with the terms of clause \* within seven (7) days of the company adopting or ratifying this agreement, should the institution which issued the guarantee in terms of clause \* require a new guarantee to be issued as a result of the adoption or ratification of this agreement by the company;
  - iv. in the event of the adoption and ratification referred to above binds himself as surety and co-principal debtor with the company for the due and faithful observance by the company of all the terms, conditions and stipulations of this agreement;
  - v. undertakes that in the event of registration of the company and the obtaining of its certificate to commence business not being effected within forty five (45) days of the date of signature of this agreement by the purchaser or within such extended period as may be allowed in writing by the seller, or should the company, when registered and entitled to commence business, fail to adopt and ratify the terms of this agreement within the period provided for herein, he in his personal capacity will accept transfer of the property and take over the purchase of the said property and pay the purchase price as if this agreement had been made in his personal capacity

## Formation of a close corporation

1. It is recorded that the purchaser is acting as a trustee for a close corporation to be formed. The purchaser accordingly:
  - i. undertakes to effect the registration of a close corporation on the basis that section 53 of the close corporations act no. 69 of 1984 is fully complied with;
  - ii. undertakes to obtain the ratification or adoption of this agreement by the close corporation within 7 (seven) days after its corporation;
  - iii. undertakes to procure the necessary bank or financial institution guarantee for payment of the balance of the purchase price complying with the terms of clause \* within seven (7) days of the close corporation adopting or ratifying this agreement, should the institution which issued the guarantee in terms of clause \* require a new guarantee to be issued as a result of the adoption or ratification of this agreement by the close corporation;
  - iv. in the event of the adoption and ratification referred to above binds himself as surety and co-principal debtor with the close corporation for the due and faithful observance by the close corporation of all the terms, conditions and stipulations of this agreement;
  - v. undertakes that in the event of the registration of the close corporation not being effected within 45 days of the date of signature of this agreement by the purchaser, or within such extended period as may be allowed in writing by the seller, or should the close corporation when registered fail to adopt and ratify the terms of this agreement within the period provided for herein, he, in his personal capacity will accept transfer of the property and take over the purchase of the property and pay the purchase price as if this agreement had been made by him in his personal capacity

\* The clause reference here will be to the guarantee clause in your Deed of Sale