CAPITAL GAINS TAX

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 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 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 any assets that is attributable to their permanent establishment 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.

On death a person is deemed to have disposed of all property at market value hence triggering a CGT liability. For non-residents this deemed disposal applies to immovable property situated in South Africa. In addition on death a person is liable for estate duty at 20% (after deducting a R2.5million abatement from net assets and after deducting any CGT payable by virtue of the deemed disposal of the property). In the case of a non-resident estate duty would be levied on immovable property situated in South Africa (subject however to the terms of any applicable Double Death Duties Act entered into by South Africa with any other State). The only exception to the foregoing is where a person bequeaths his or her estate to his or her spouse the bequest is exempt form both CGT and estate duty.

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:

1. The costs of acquiring the property, including the purchase price, transfer costs, transfer duty, VAT and professional fees (eg. attorneys and surveyors).

2. The costs of improvements, alterations, renovations, etc.

3. 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 had to be carried out within 3 years from the effective date (ie. before 30 September 2004), 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. Should no valuation have been carried out by 30 September 2004, this method may not be used.

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.

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

1. The valuation itself, including the basis of the valuation and the relevant calculations;

2. The physical address of the property;

3. The size of the property;

4. Details of any improvements to the property;

5. The plans of the property as at 1 October 2001;

6. Details of recent property sales in the same area;

7. 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. 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.

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 R1.5-m can be excluded. This will not apply to properties registered in companies, close corporations, Trusts or properties owned by natural person for investment purposes

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 lease 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.