# CAPITAL GAINS TAX IN SOUTH AFRICA

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## ▪ INTRODUCTION

Albert Einstein once said that the "hardest thing in the world to understand is the income tax"[1]. It is thus most appropriate that Capital Gains Tax ("CGT") has not been introduced into South African law as a separate tax but has rather been added to the Income Tax Act 58 of 1962 ("the Act") by means of an Eighth Schedule ("the Schedule"), with the effect that the levying, collection and administration of CGT all take place in terms of the Act.

The detail of much of the South African version of CGT is difficult to come to grips with, as many of the provisions of the Schedule are lengthy and complex, and some of the key definitions and concepts are extremely technical.

A further problem with understanding CGT is that while the legislation pertaining thereto was introduced by the Taxation Laws Amendment Act 5 of 2001, such legislation was shortly thereafter amended by the Revenue Laws Amendment Act 19 of 2001 and further proposed amendments have already been gazetted in the form of the Second Revenue Laws Amendment Bill, no. 84 of 2001. It is thus apparent that the authorities intend regularly amending the CGT legislation in until it 'settles down'.

A final, and important, complicating factor is that the interpretation of many of the CGT provisions will remain uncertain until the courts pronounced thereon and there is thus case law to provide guidance. This will take some years and in the interim one is going to struggle to achieve a full understanding of the meaning, implications and consequences of CGT in South Africa. The fact that the wording of CGT legislation in other jurisdictions is different means that foreign case law will be, at best, persuasive.

This dissertation considers the Act and Schedule as they were at 1 December 2001, but does not attempt to canvass all aspects of the CGT regime. Rather it commences by looking at the rationale for CGT and then considers the basic mechanics of CGT before assessing the impact of these provisions in a number of important areas of interest.

References to paragraphs and sections are, unless otherwise stated, references to paragraphs and sections in the Schedule and Act respectively.

## A. THE RATIONALE FOR CGT

In his 2000 budget review, the Minister of Finance announced the introduction of a CGT in South Africa with effect from 1 April 2001 (in his 2001 budget review he extended this date to 1 October 2001) as part of a wider tax reform effort aimed at enhancing the integrity, efficiency and equity of the income tax regime. He suggested that the absence of CGT had encouraged taxpayers to convert income that would ordinarily be taxed into tax-free capital gains. Government has noted in this regard that:

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[1] 'Income Tax and Capital Gains Tax in South Africa, Law and Practice', RC Williams, 3rd Edition, Butterworth Publishers (Pty) Ltd, pg v

"The introduction of a CGT is most often justified on fiscal equity grounds, but other criteria are also important. International best practice strongly suggests that capital gains should ideally attract the full income tax as other forms of income as the continued preferential treatment of capital gains will perpetuate avoidance and decline in tax morality by the low income taxpayer who cannot afford the use of tax advisers. It widens the income tax base, secures the existing base by limiting tax avoidance activities, improves equity and reduces investment distortions."[2]

Nevertheless, CGT has been introduced in South Africa in the face of widespread opposition. Some of the grounds for such opposition as well as Government's rationale for the introduction of CGT are now considered.

## 1. Practicality and Appropriateness

One of the arguments against the introduction of CGT was that it would be impractical and inappropriate in the case of a developing country such as ours is and that in fact many developed countries are in the process of phasing it out. The Government has attempted to counter such argument by pointing out that comparative studies demonstrate that CGT is relatively common internationally, not only in developed and middle income countries but also in developing countries.[3]

## 2. Equity, Efficiency and Simplicity

The Government has suggested that tax policy and tax reform should be driven by three essential considerations: equity, efficiency and simplicity; and that it is in the light of these considerations that the concept of CGT should be judged.

Proponents of CGT argue that horizontal equity requires that taxpayers should bear similar tax burdens, irrespective of whether their income is received in the form of wages or capital gains, and thus the exclusion of capital gains from the income tax base fundamentally undermines the horizontal equity of the tax system. However, as pointed out by Professor Matthew Lester, "there is a misconception that all capital gains are totally tax-free at present. This may hold true as far as the income tax of individuals is concerned, but what about transaction taxes such as transfer duty and VAT? And what about the capital gains of companies, where the distribution of the income to the shareholders/members is subject to secondary tax on companies unless the company is liquidated or deregistered?"[4]

Vertical equity, on the other hand, requires that taxpayers with greater means to pay taxes should bear a greater burden of taxation. Noting that international experience indicates that the biggest share of CGT revenues can be attributed to the wealthiest individuals and that South Africa has an extraordinarily high discrepancy between the income levels of the rich few and the poor

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[2] Briefing, pg 4

[3] Briefing, Table 2, pg 5-9

[4] 'Lethal cocktail of CGT, inflation and other taxes', Professor Matthew Lester, 13/05/01, http://www.cgtsa.co.za/News/

masses, Government argues that it is "absolutely necessary to include capital gains ... [as it will] ... markedly improve the vertical equity of the income tax system in South Africa".[5]

With regard to economic efficiency, reference has already been made to the argument that the absence of a tax on capital gains provides arbitrage opportunities and, so the Government argues, "the application of scarce resources to tax planning and tax avoidance is clearly a dead-weight loss to society".[6] However, the extent of any gain in economic efficiency which may be achieved in this regard by the introduction of CGT remains to be seen. As Professor Lester points out:

"Those in favour of the new tax argue that the tax expert is able to manipulate income and turn it from being taxable revenue income into a tax-free capital gain - despite the fact that there are various case precedents and income tax provisions that effectively curb the tax expert's imagination".[7]

Government itself has conceded that CGT is difficult, if not impossible, to justify on the grounds of simplicity as CGT is a "rather complex tax".[8] Indeed while the postponement of the commencement date of CGT was apparently meant to give taxpayers more time to prepare for its introduction, the truth is that it would have been impossible to introduce workable legislation in time for the April 2001 commencement. The subsequent amendments, both enacted and in the pipeline, so soon after the introduction of the legislation in June 2001 clearly demonstrate the complexity of introducing the tax and to this end Professor Lester has commented:

"My greatest criticism of the implementation of CGT in South Africa is that the concepts are too complex for the man in the street to fully understand and there is not ready access to professional help. This leaves the taxpayer confused, frightened and bitter".[9]

## 3. The Capital versus Revenue Distinction

Some of those welcoming CGT have argued that its introduction will eliminate the need to distinguish capital gains and losses from 'revenue' gains and losses. Michael Stein dismisses this as an "obviously facile - indeed an absurd - argument"[10] because in determining capital gains and losses a percentage inclusion rate and, for certain taxpayers, an annual exclusion amount will be taken into account, which is obviously not the case in respect of 'revenue' gains and losses.

Proponents of CGT have suggested that the likely impact of its introduction is greater certainty in the distinction between capital and revenue (a result, if achieved, to be welcomed as, according

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[5] The Briefing, pg 11

[6] The Briefing, pg 11

[7] 'Prove it's capital or face paying 42% tax instead of 10,5%', Professor Matthew Lester, 25/03/01, http://www.cgtsa.co.za

[8] The Briefing, pg 12

[9] 'Prove it's capital or face paying 42% tax instead of 10,5%', Professor Matthew Lester 25/03/01, http://www.cgtsa.co.za/News/

[10] CGT Newsletter, No. 1 September 2001, Stein on Capital Gains Tax [Issue 1], Butterworth Publishers (Pty) Ltd

to the Commissioner, one in five cases litigated by the South African Revenue Service ("SARS") involves the capital versus 'revenue' distinction[11] which is a clear case of economic inefficiency):

"Since SARS will at least receive some tax in the case of capital gains, as opposed to the all or nothing of the past, it does not have the same imperative to contest every capital versus revenue matter".[12]

Once again, Michael Stein dismisses the argument with contempt:

"I for one, am sick and tired of reading [this] hoary old argument trotted out by the facile proponents of the introduction of CGT ... I cannot believe that SARS will be content to collect CGT of, say, 10,5% of a gain made by an individual when it could collect income tax of 42% on that gain. If it were to adopt the relaxed approach, the introduction of CGT would be a wonderful concession for taxpayers making 'revenue' gains who can persuade a compliant SARS that they are capital. What nonsense! SARS will most certainly prefer to collect a tax applied at a rate that is effectively four times that of an alternative tax. In fact, I believe that the reporting requirements for CGT will bring far more capital assets to the attentions of SARS and, therefore, increase the number of disputes with taxpayers".[13]

## 4. Corporate/Business Considerations

Michael Katz argues that "the policy of the owners of 'closely held' companies at present is to suppress dividends to avoid the secondary tax on companies ("STC"), since when they come to sell their shares they can realise the retained profits as a tax-free capital gain. In future, he says, they will distribute dividends and pay STC to avoid having to pay CGT on the retained profits on the eventual sale of the shares".[14]

Michael Stein counters that there are "two fallacies in this argument". Firstly, he claims that "the value of the shares that is attributable to retained profits cannot usually be realised without cost. While there may be no tax to pay, the prudent buyer of a company with undistributed profits will most certainly demand some discount for the potential STC that will have to paid if the company ever distributes those profits in the future". Secondly, he questions why an individual taxpayer would be "prepared to have his company pay STC now at the rate of 12,5% rather than pay CGT of up to 10,5% later (possibly very much later) on whatever amount the retained profits contribute to the selling price of the shares!"[15]

Katz also argues that "there has been a tendency to allocate a portion of the purchase price of a business to goodwill because this portion would be capital", but that "this tendency will change

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[11] The Briefing, pg 12

[12] 'The Impact of Capital Gains Tax in SA', Michael Katz, Personal Finance, Volume 4, July 2000

[13] 'CGT Fallacies', Michael Stein, http:/www.cgtsa.co.za/articles/

[14] 'The Impact of Capital Gains Tax in SA', Michael Katz, Personal Finance, Volume 4, July 2000

[15] 'CGT Fallacies', Michael Stein, 23/02/01,http:/www.cgtsa.co.za/articles/

now that the amount received for the goodwill will be subject to CGT".[16] However, Stein points out that SARS can if it so wishes reallocate an amount that is obviously incorrectly attributed to goodwill, and, if an amount is correctly attributed to goodwill and subjected to CGT rather than income tax, the rate of tax will still be very much lower than income tax. So why should anything change he asks?[17]

## 5. Economic Activity Considerations

Critics of CGT have suggested that taxing capital gains will have adverse effects on South Africa's economic performance in that it will reduce the level of savings, investment and economic growth, and will impinge on risk-taking and entrepreneurial activity.

In response, Government points out that national saving in South Africa has fallen in recent times and that the absence of CGT in the past does not seem to have influenced the level of saving much, especially if one considers that South Africa's savings rate is lower than many countries that do have CGT. [18]

It also notes that "there is little reason to think that the introduction of CGT will significantly affect the cost of capital" and that "there is substantial uncertainty in the economics literature regarding the responsiveness of investment spending to changes in the cost of capital."[19]

Government is furthermore of the opinion that there is no reason to assume a large impact of CGT on economic growth. "The effect of CGT is a problem of multiple elasticities - the change in the cost of capital resulting from the CGT; the change in investment resulting from the change in the cost of capital; and the change in economic output resulting from the change in investment. As has been noted: 'The problem of multiplied elasticities comes down to the fact that when three numbers much less than one are multiplied together, the resulting number is still quite small' ".[20]

With regard to the argument that CGT limits risk-taking and entrepreneurship by reducing the after-tax return from a high-risk project, Government counters that "by allowing deductions for capital losses, the potential loss from the project is also reduced, which reduces the variability of returns from any high-risk investments project, making these investments more attractive". While acknowledging that this advantage is reduced because capital losses are not set off against other income, Government suggest that "most investors in high-risk projects have diversified portfolios and are able to offset capital losses". [21]

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[16] The Impact of Capital Gains Tax in SA', Michael Katz, Personal Finance, Volume 4, July 2000

[17] CGT Fallacies', Michael Stein, 23/02/01, http:/www.cgtsa.co.za/articles/

[18] The Briefing, pg 16

[19] The Briefing, pg 17

[20] The Briefing, pg 17

[21] The Briefing, pg 17

## 6. Inflation

Finally, probably the biggest point of concern for opponents of CGT is that of inflation because a gain on the sale of capital assets includes a significant inflationary element and in the existing CGT legislation there is no adjustment to the measurement of such gain to take account of such inflationary growth, which can have the result that tax is imposed where the taxpayer has enjoyed no real gain.

Some of the reasons given by the Government for excluding explicit inflation indexation from the CGT regime include: "internationally, countries are moving away from inflation indexation in an attempt to simplify their tax systems"; "while conceptually simple, inflation indexation is difficult to administer and imposes considerable record-keeping and compliance cost on taxpayers"; "if capital gains are indexed, taxpayers receiving income in the form of capital gains (which tend to be the wealthier members of society) are favoured over other taxpayers, which receive income that is fully taxable (irrespective of the inflation rate)".[22]

However, the main reason has been expressed as follows: "at moderate levels of inflation and defensible real rates of return, the low inclusion rates ... and the deferral benefits arising because the tax is levied on a realisation basis ... more than adequately compensate for the effects of inflation". Furthermore, in this regard it was stated that "recently, South Africa's inflation rate has fallen and begun to stabilise at relatively low rates ... the outlook for inflation is also very positive".[23]

Since the latter statement was made (*circa* January 2001), the value of the Rand has plummeted to all time lows with the result that the South African economy, which has experienced high inflation rates for nearly 30 years, is almost certain not to achieve the government's own inflation targets of 3% to 6% a year (which, even if achieved, are rates well in excess of those of most developed countries). Thus, it appears that the basic premise for not adjusting for inflation, namely a low stable inflation rate, no longer exists in a South African economy where inflation is still a major problem.

## 7. Conclusion

Government concludes, after assessing all of the above factors, that "while CGT is complex to administer, it is a reasonable trade-off for the improvements in equity, anti-avoidance strategies and economic efficiency that will arise from the taxation of capital gains".[24] Whether or not this proves to be correct remains to be seen. However, whatever the arguments for (some more political than fiscal) and against CGT, the one inescapable fact is CGT in South Africa is now a reality and whether the said tax is fair or efficient is no longer the issue. The challenge now is to understand and come to grips with the CGT regime which has been introduced into our tax system.

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[22] The Briefing, pg 23
[23] The Briefing, pg 23
[24] The Briefing, pg 34

## B. THE BASIC MECHANICS OF CGT

### 1. The Legislation

As aforementioned, CGT has been introduced simply by way of the addition of a Schedule to the Act. "CGT thus forms an integral part of the income tax system. The general provisions of the Income Tax Act - inter alia, those relating to returns, assessments, objections, appeals, and the payment and recovery of tax - also apply to the CGT regime".[25]

In consequence of the addition of the Schedule, section 26A was inserted into the Act[26]. This section is the charging provision for CGT as it provides for the inclusion in the taxable income of a person of any taxable capital gain of that person determined in accordance with the provisions of the Schedule.

Thus although we speak colloquially of a 'capital gains tax' (in fact, the term 'capital gains tax' does not appear in the Act as amended), in practice the taxable capital gain is merely included in the taxpayer's other taxable income and normal tax is imposed thereon. The definition of 'taxable income' in section 1 of the Act has accordingly been amended to provide that 'taxable income' includes all amounts to be included or deemed to be included in the taxable income of any person in terms of the Act.

The fact that taxable capital gains are included directly in taxable income means that while the deductions and set offs provided for in the Schedule itself reduce them, the deductions and set off contained in Part I of Chapter II of the Act do not. However, while it appears that capital gains are to be determined solely under the Schedule, there is evidence in the Schedule itself of an "unauthorised" interplay with the other provisions of the Act. For example, paragraph 20(1) and paragraphs 20(1)(c)(vii) and (viii) of the Schedule are expressly made applicable despite sections 23(b) and (f), and section 23(d) respectively.[27]

Not only is the expression 'capital gains tax' colloquial, but it is also actually a misnomer because the Schedule does not expressly distinguish capital gains from those of a non-capital nature. "So-called CGT, is, in reality, a 'catch-all' tax which sweeps up the gains from the disposal of all assets, other than those specifically excluded and those which fall outside the ambit of the technical terms 'disposal' and 'asset'".[28]

The CGT legislation applies to the 'disposal' of any 'asset' of a 'resident' where the disposal occurs on or after 1 October 2001. These terms are now considered, whereafter the concepts of 'proceeds' and 'base cost' and of 'taxable capital gains' and 'assessed capital losses' are dealt with. Finally, the CGT anti-avoidance provisions are examined.

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[25] Williams, pg 1

[26] Both such addition and insertion were in terms of the Taxation Laws Amendment Act 5 of 2001, which Act also introduced other new provisions into and amended existing provisions of the Income Tax Act in order to accommodate and implement CGT

[27] Stein, pg 1-1 to 1-2

[28] Stein, pg 1-1 to 1-2

## 2. Residence

In keeping with the relatively recent change in South African's tax system from being primarily source-based to being primarily residence-based, CGT has a residence basis and thus the Schedule applies to any asset of a 'resident' and, in respect of non-residents, to two specified classes of assets situated in the Republic.[29]

### 2.1 Natural Persons

As far as a natural person is concerned, there are two ways in which he may qualify as a 'resident'. The first is if he should be "ordinarily resident in the Republic" during a particular year of assessment.[30] In view of the fact that South Africa has, as aforementioned, only recently adopted a residence-based tax system, there is little local case law on the meaning of 'ordinary resident', although it is clear from the leading Appellate Division case in this regard[31] that the 'ordinary residence' enqiry will depend on the facts of each particular case. Our courts may thus seek guidance from foreign case law and, if they do, it is submitted that they should not go as far as the British court did in Cooper v Cadwalader[32] where it held that a citizen of the United States, who lived in New York and routinely spent two months of every year grouse-shooting in Scotland where he hired a shooting lodge, was a resident in the United Kingdom!

However, even if a natural person does not qualify on the basis of 'ordinary residence', he may still be deemed to be a 'resident' on the basis of his mere physical presence in the Republic for a stipulated period or periods.[33] This provision may accordingly result in a natural person involuntarily acquiring residence, which could have "serious CGT consequences [as it would expose] all of that person's world-wide assets to the Republic's CGT regime (and its income tax regime), subject to such double tax relief as is available".[34]

### 2.2 Juristic Persons

Persons other than natural persons (for example, companies, close corporations or trusts) qualify for residency in one of two ways.

The first is by being "incorporated, established or formed" in the Republic.[35] In practice this means that the company or close corporation will be so 'incorporated' if it is registered by the Registrar of Companies / Close Corporations in accordance with the Companies Act[36] or the Close Corporations Act[37], and a trust will be so 'established or formed' if, for example, the trust instrument is executed in the Republic or is lodged with the office of the Master of the High

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[29] Paragraph 2(1)
[30] Paragraph (a)(i) of the definition of a 'resident' in section 1
[31] CIR v Kuttel (1992) 54 SATC 298
[32] 42 Sc LR 117, 5 TC 101
[33] Paragraph a(ii) of the definition of a 'resident' in section 1
[34] Williams, pg 7
[35] Paragraph (b) of the definition of a 'resident' in section 1
[36] Act 61 of 1973
[37] Act 69 of 1984

Court in terms of the Trust Property Control Act[38]. The effect of the aforegoing is that once a juristic person qualifies as a 'resident' on such basis, it remains a 'resident' forever even if it is not effectively managed in the Republic (the second ground of qualification) and even though it may sever all links with the Republic.

The second ground of qualification is that the juristic person "has its place of effective management in the Republic".[39] The Legislature has not defined the term 'place of effective management' and our courts have yet to pronounce upon its meaning. However, "foreign case law suggests that it is located where the entity is conducted and managed on a day-to-day basis, as opposed to where top-level strategic and policy decisions are taken"[40] i.e. where its operational management and control is located and, not necessarily where its board of directors meets. As far as a trust is concerned, its 'effective place of management' will probably be where its trustees effectively exercise their powers. Despite the aforegoing suggested interpretations of the said term, it is anticipated that difficulties will be experienced in many cases in determining the 'place of effective management'.

The definition of 'resident'[41] expressly excludes "international headquarter companies" (as defined[42]) from its ambit so as to provide an incentive for multi-national companies to establish their regional headquarters in the Republic.

### 2.3 Non-residents

As aforementioned, non-residents will only be subject to CGT liability in respect of two specified classes of assets situated in the Republic, namely (i) immovable property (and any interest or right of any nature therein) and (ii) assets of a 'permanent establishment'[43] through which a trade is carried on in the Republic.

In order to prevent a non-resident from escaping such liability in respect of the first class of assets by holding immovable property through a company or other entity, he will be regarded as holding an interest in immovable property situated in the Republic when he alone, or together with his 'connected persons'[44](it matters not whether they are residents or not), holds a direct or indirect interest of at least 20% in the equity share capital of the company or other entity and if 80% or more of the value of its net assets is attributable directly or indirectly (for example, through shareholdings in other companies) to immovable property situated in the Republic.[45] Note that there is no similar 'piercing of the corporate veil' in respect of the second class of assets.

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[38] Act 57 of 1988
[39] Paragraph (b) of the definition of a 'resident' in section 1
[40] Williams, pg 10
[41] Paragraph (b) of the definition of a 'resident' in section 1
[42] Section 1
[43] As defined in Section 1
[44] As defined in Section 1
[45] Paragraph 2(2)

The use of the word 'entity' in this regard has been criticised as "obscure" and it has been suggested that a reference to a 'person' would have been "more familiar and useful" because while the definition of a 'person' in the Act includes an insolvent estate, the estate of a deceased person and a trust, "it is doubtful whether any of them may be described as 'entities'."[46]

The reference to 'equity share capital' in this context is also problematic. While a close corporation is a 'company' as defined in section 1 of the Act, it does not have 'equity share capital' as defined[47] and cannot it seems to be regarded as any 'other entity' (in view of having been defined as a 'company'). It thus appears that this provision does not apply to interests held through a close corporation, which is a "strange and surely unintended, but nevertheless inevitable, result of the wording of the provision".[48]

## 3. Assets

An 'asset' is defined as including:

"(a) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and

(b) a right or interest of whatever nature to or in such property."[49]

The meaning and scope of paragraph (a) is relatively clear and should present few problems, especially in view of the fact that the term 'property' has a well-established interpretation[50]. It has been suggested that in order to constitute 'property' and thus an 'asset' in terms of paragraph (a), "a right must be a vested right, even if it is a contingent right" but that a *spes* "is not property and therefore cannot be an asset in terms of paragraph (a)".[51] It has also been suggested that "in order to fall within paragraph (a) an incorporeal item - such as a right - must constitute 'property'; in other words, it must be a proprietary right. A mere personal 'liberty' does not ... fall under paragraph (a)".[52]

As far as paragraph (b) is concerned, its interpretation is likely to present problems. At the outset, it should be noted that in referring to 'such property' it is referring to property of the kind falling within paragraph (a). Paragraph (b) is thus clearly referring to 'rights' and 'interests' which are not in themselves 'property' (otherwise they would fall under paragraph (a)) and the reason for extending the scope of the definition of an 'asset' beyond the concept of 'property' appears to be the development of Australian CGT legislation in this regard.

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[46] Stein, pg 2-5
[47] Section 1
[48] Stein, pg 2-5
[49] Paragraph 1
[50] Jones v Skinner 5 LJ Ch 90; McCaughey v Comm of Stamp Duties (1945) 46 SR (NSW)
[51] Williams, pg 19
[52] Williams, pg 20

Initially, an 'asset' was defined in the said Australian legislation as 'any form of property'. Thus a 'right' was an asset only if it could be classified as 'property', i.e. if it was a proprietary right. However it subsequently became apparent that such a definition excluded certain types of rights from CGT liability, for example rights under a contract of personal services, rights under an exclusive trade tie agreement, an agreement to withdraw an objection to a town planning application, etc. The Australian definition of 'asset' was thus amended to include any right whether or not it was a form of property, and the drafters of the Schedule appear to have been influenced by such amended definition.

However, it has been noted in this regard that the said drafters "took a quantum leap beyond the Australian model by extending the scope of an asset beyond 'rights' and into the unchartered realm of 'interest'" and that presumably they "decided to leave it to the courts to determine what interests should fall within the definition, and the courts now face the formidable task of finding a rational limitation to the kinds of interests whose 'disposal' (which as defined, includes variation or extinction) will be subject to CGT".[53]

Thus until our courts pronounce on the matter, the exact meaning of 'asset' in the CGT context will remain unclear and it will in the interim be arguable whether items such as personal goodwill and mere information (as opposed to the right to acquire information) are covered by the said definition.

Finally, the above quoted definition of 'asset' specifically excludes 'currency', which may be regarded as legal tender (coins and banknotes) but which probably excludes travellers' cheques and negotiable instruments.[54]

## 4. Disposal

A 'disposal' (or 'deemed disposal') of an asset during a year of assessment is the event that triggers a potential liability for CGT[55]. A 'disposal' is defined as "an event, act, forbearance or operation of law envisaged in paragraph 11 or an event, act, forbearance or operation of law which is in terms of the Schedule treated as disposal of an asset."[56]

Paragraph 11 (1) envisages a 'disposal', as defined, which results in the creation, variation, transfer or extinction of an asset.

The suggestion that the 'creation' of an asset constitutes a 'disposal' does not appear to make sense, nor does the fact that, in terms of paragraph 13(2), the person to whom the asset is disposed is the creator. However, what the Legislature seems to have intended to convey is that the 'creation' of an asset constitutes an acquisition of that asset by its creator. Not only is this logical but, as shall be seen, it is also crucial to fix the time of the acquisition of an asset if it is a

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[53] Williams, pg 22
[54] Willaims, pg 25
[55] Paragraphs 3 and 4
[56] Section 1

pre-valuation date asset and the taxpayer has elected to use the time-apportionment method, and to establish the acquisition costs of an asset in order to determine its base cost.

The construction of the Schedule in this regard has been criticised on a couple of grounds. It has been pointed out that in respect of the 'creation' of an asset it is not apparent when the time of acquisition is - when the construction began or on completion; "this point could usefully have been made explicit in the legislation".[57] The Legislature has also failed to distinguish between where on creation an asset vests in its creator and where it vests in some other person (for example, where a builder erects a building on someone else's land). The distinction is important because in the latter scenario the definition of disposal in this regard "seems to impart that the creation of the asset by the creator and the disposal of the asset to another will occur simultaneously [and] the text of the Eighth Schedule ... is silent on the corollary that the person who 'created' the asset (and thereby 'disposed' of it to himself) must be regarded as not having paid any consideration for that fictitious disposal ... the Eighth Schedule ought to have dealt with the situation ... ".[58]

An example of the 'variation' of an asset is the variation of an agreement of sale of property. As has been pointed out, this can give rise to timing problems. For example, it may raise the question of when 'proceeds' are derived - initially in terms of the original agreement or subsequently in terms of the varied agreement?[59]

Paragraph 11(1)(a) in effect sets out forms of 'transfer' which include, *inter alia*, the sale, donation, expropriation, cession and exchange of ownership of an asset. However, the reference to 'any other alienation or transfer of ownership of an asset' has been described as "puzzling, and indeed incorrectly premised, as a sale or donation does not of itself pass ownership in an asset; delivery or registration of transfer is also required."[60]

It should be noted that when, for example, a contractual right is created, such 'asset' will in due course expire or be 'extinguished' and a 'disposal' will result. If no consideration is received in respect thereof, a capital loss may for CGT purposes be incurred on that 'disposal'.[61]

Paragraph 11(1) also sets out the following forms of 'disposal':

- the forfeiture, termination, redemption, cancellation, surrender, discharge, relinquishment, release, waiver, renunciation, expiry or abandonment of an asset;
- the scrapping, loss or destruction of an asset;
- the vesting of an interest in an asset of a trust in a beneficiary (even though the asset may not actually have been distributed to such beneficiary);

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[57] Williams, pg 27
[58] Williams, pg 28
[59] Williams, pg 29
[60] Williams, pg 32
[61] Williams, pg 29

- the granting, renewal extension or exercise of an option (as qualified by paragraphs 18(1) and 58);

- the decrease in value of a person's interest in a company, trust or partnership as a result of a 'value shifting arrangement'[62].

### 4.1 Part-disposals

A part-disposal occurs where part of an asset is the object of one of the acts or events referred to in paragraph 11(1) as a 'disposal'. While damage is not expressly described as a part-disposal, the fact that 'loss', extinction' or 'destruction' of an asset constitutes a 'disposal' means that damage which falls short thereof must clearly amount to a part-disposal. Where part of an asset is damaged with the result that the whole asset becomes useless, the asset will probably be regarded as 'destruction' of the asset i.e. an entire disposal as opposed to a part-disposal.

### 4.2 Non-disposals

The scope of the meaning of 'disposal' as set out in paragraph 11(1) is limited by paragraph 11(2) which lists certain events that may otherwise constitute 'disposals' and stipulates that such events shall not be regarded as 'disposals' of an 'asset' and shall thus not give rise to liability for CGT. The events listed include, inter alia, the transfer of an asset as security, or the retransfer of the asset on release of the security[63], the issuing of a bond, debenture, note, or other borrowing of money or the obtaining of credit from another person[64], the disposal by a person in order to correct an error in the registration of immovable property in his name.[65]

### 4.3 Deemed Disposals

In contrast to the provisions of paragraph 11(2), paragraphs 12(1)-(2) provide that in certain circumstances a person is deemed to have disposed of an asset at its market value for the purposes of the Schedule and to have reacquired it immediately at the same market value. This has three main consequences. Firstly, events which would not normally have constituted a 'disposal' are deemed to constitute 'disposals'. Secondly, although one in fact receives no consideration for such deemed 'disposals', one is regarded as having received the market value of the said assets. Thirdly, one is further deemed to have immediately reacquired the assets for expenditure equal to such market value.

As has been pointed out, a 'deemed disposal' may result in liability for CGT despite the fact that no consideration has been received, which might oblige a taxpayer to actually 'dispose' of the asset in order to pay the said CGT as there is no roll-over relief or deferral of tax in such circumstances. However, a 'deemed disposal' followed by an actual 'disposal' will not result in double taxation as the real sale will break even for CGT purposes i.e. the sale will be at market value which is also the deemed base cost of the asset.[66]

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[62] As defined in paragraph 1
[63] Paragraph 12(2)(a)
[64] Paragraph 12(2)(d)
[65] Paragraph 12(2)(g)
[66] Williams, pg 40

The various circumstances giving rise to deemed disposals are now considered.

- When a person ceases to be a resident or is treated as a non-resident in terms of a double taxation agreement, he is deemed to have disposed of all his assets (both foreign and local), except those which would still be taxed when disposed of once he becomes a non-resident, at their market value which will give rise to a capital gain or loss being the difference between such market value and their base cost.[67] In this regard, it is important to note that formal and factual emigration is not necessarily required; merely ceasing to be a resident will suffice to activate this provision.

- When a person commences to be a resident he will be regarded as having 'disposed' of all of his assets (except those which are subject to CGT even if held by a non-resident) and he will also be deemed to have reacquired such assets at their market value[68]. Thus when he eventually actually disposes of the assets, a capital gain or loss will result being the difference between the disposal proceeds and the said market value. An important point to note in this regard, especially in view of the current economic climate, is that once a person commences to be a resident he becomes "subject to South African CGT on the increase in value of his world-wide assets, and any decline in the value of the rand on foreign market exchange markets will have a multiplier effect on capital gains expressed in South African currency".[69]

- When an asset of a non-resident becomes an asset of his permanent establishment in South Africa other than by way of acquisition, or when an asset ceases to be an asset of his permanent establishment other than by way of disposal[70]. "The first situation would apply, for example, when a private asset is introduced into a permanent establishment, while the second situation would occur, for example, when the non-resident withdraws an asset from his permanent establishment and begins to use it for private purposes or when the permanent establishment ceases to operate as such (say, because its business is discontinued), but retains the relevant assets".[71]

- When an asset that was not trading stock becomes trading stock (for example, as the result of a change in the intended use of the asset from a capital asset to trading stock) the person holding such asset will be deemed to have disposed of it at its market value at the time of its conversion to trading stock[72] and to have simultaneously reacquired the asset at the same market value; he will be able to deduct this amount for income tax purposes as the cost of the trading stock.[73] However, where a person ceases to hold trading stock as such, he is deemed to have disposed of same for an amount equal to the amount included in his income for income tax purposes in terms of section 22(8) and to have immediately reacquired it for a

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[67] Paragraph 12(2)(a)
[68] Paragraph 12(4)
[69] Williams, pg 41-42
[70] Paragraph 12(2)(b)
[71] Stein, pg 5-2
[72] Paragraph 12(2)(c)
[73] Section 22(3)(a)(ii)

cost equal to that amount[74] i.e. there will be a deemed recovery or recoupment with consequential income tax implications as well as CGT consequences.

- When a person begins to use as a 'personal-use asset' an asset which was not previously held by him as such ("for example, he may withdraw a capital asset, such as a motor car, that he had used in his trade and instead use it for private purposes"[75]), a deemed disposal at market value will take place[76] which will give rise to a capital gain or loss being the difference between the said market value and the asset's base cost. On the other hand, if a person ceases to use a personal-use asset as such, he is deemed to have disposed of it and to have simultaneously reacquired it, both at market value. The effect hereof is to establish a base cost at such date of change in status for the purpose of determining a capital gain or loss on any subsequent disposal.[77]

- When a long term insurer referred to in section 29A of the Act transfers an asset from one of its policy-holder funds to another, the transferor fund will be deemed to have disposed of it at its market value and the transferee fund will be deemed to have acquired it at the same value for the purposes of the Schedule.[78]

- Where a debt has been reduced or discharged for less than full consideration, the debtor is regarded as having acquired a claim to the portion of the debt that was reduced or discharged for no consideration and the base cost of the claim will be deemed to be nil. He will further be deemed to have simultaneously disposed of the claim for proceeds equal to the amount of the reduction or discharge.[79] It has been submitted that the terms 'reduced' or 'discharged' "imply a positive act on the part of the creditor" and thus that this provision will not apply "if a debt is simply unpaid but the creditor retains the right to claim the amount owing".[80]

- When property is disposed of by a spouse married in community of property and that property falls within the joint estate of the spouses, the disposal is deemed to have been made in equal shares by each spouse. But if it was excluded from the joint estate, the disposal is regarded as having been made solely by the spouse making the disposal. It has been noted that "it is unclear whether the reference here to 'property' rather than to 'asset', which is used elsewhere in the Schedule and defined in paragraph 1, is of any significance"[81].

### 4.4 Time of Disposal

Paragraph 13(1) sets out the time of disposal, which determines the year of assessment in which the proceeds of that disposal are to be taken into account in determining any capital gain or loss arising out of the disposal. This is important as the time of disposal and of accrual of the

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[74] Paragraph 12(3)
[75] Stein, pg 5-4 to 5-5
[76] Paragraph 12(2)(e)
[77] Paragraph 12(2)(d)
[78] Paragraph 12(2)(f)
[79] Paragraph 12(5)
[80] Stein, pg 5-5
[81] Stein, pg 6-6

proceeds may impact on the amount of tax which one might pay on any such capital gain because one is effectively taxed at one's marginal rate of tax for the applicable year of assessment and such rate can vary from year of assessment to year of assessment. Furthermore, one can only set capital losses off against capital gains made in the same or a subsequent year of assessment. Thus the time of disposal will in certain circumstances determine whether or not such a set off can occur in a particular year of assessment. One should note, however, that the year of assessment in which a disposal occurs and that in which the proceeds of the disposal are received or accrue for the purposes of determining a capital gain or loss need not necessarily coincide.

The times of disposal determined in terms of paragraph 13(1) are also regarded as the date of acquisition of the asset by the person to whom it is disposed.[82] Such times of disposal are as follows:

- A number of deemed times of disposal occur in consequence of a change in ownership by virtue of an event, act, forbearance or by operation of law.[83] The question has been asked whether this provision means that these times of disposal may not occur until there has been a change of ownership. "This is an inherent contradiction in that times of disposal in consequence of a change of ownership are made to arise before the change of ownership occurs. One way to make sense of an otherwise meaningless situation is to assume that the times of disposal arise when the stipulated occurrences come about even if they precede the change of ownership or for some unforeseen reason may not even result in a change of ownership. Any other interpretation would, it is submitted, make the provision meaningless".[84]

  Specific examples include:

  - Where the disposal of an asset is a consequence of a change in ownership of an asset by virtue of an agreement, the time of disposal is the date on which the agreement is concluded, not the date on which ownership passes.[85] As has been pointed out in this regard, "this may have adverse cash flow consequences where the CGT liability precedes the receipt of the proceeds of the disposal, for example in a sale of land".[86]

  - If the agreement is subject to a suspensive condition, the time of disposal is the date on which the condition is satisfied.[87]

  - The time of disposal of a donated asset is the date of compliance with all the legal requirements for a valid donation.

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[82] Paragraph 13(2)
[83] Paragraph 13(1)(a)
[84] Stein, pg 6-1 to 6-2
[85] Paragraph 13(1)(a)(ii)
[86] Williams, pg 43
[87] Paragraph 13(1)(a)(i)

- An asset is deemed to have been disposed of by scrapping, loss or destruction, or by expropriation when the taxpayer receives full compensation (in the case of loss or destruction, from, for example, an insurer, and in the case of expropriation, as agreed to or finally determined by a competent tribunal or court[88]). In the former context, if no compensation is payable, the time of disposal will either be when the scrapping, loss or destruction is discovered or when it is established that no compensation will be payable, whichever occurs later. The reference to 'full compensation' means that if part of the compensation is received in one year of assessment and the balance in the next year, the said initial part of the compensation is not received in the year in which the disposal occurs. The result may well be that such initial part of the compensation will escape taxation. "It could not be taxed in the year in which it arose because the disposal had not yet occurred. And it cannot be taxed in the subsequent year when the disposal occurs because it is not received and does not accrue in that year".[89]

- Paragraph 13(1)(g)(i) provides that the time of the deemed disposals referred to therein, is the day immediately before the date when the relevant event occurs "because the occurrences in question, by their very nature, change the status of the taxpayers or of the assets involved."[90]

- The proceeds from the disposal of a partner's interest in an asset of the partnership are deemed to have accrued to him at the time of the disposal, which means that each partner will have to account for the capital gain or loss on the disposal of his share in the asset when it is disposed of.[91]

- In the case of a number of other specified events, the time of their disposals is the date when the relevant event occurs.[92]

## 5. Proceeds

The 'proceeds' from the disposal of an asset are made up of the amount received by or accrued to one, or which is treated as having been received by or accrued to one, as a result of such disposal.[93] The use of phrase 'received or accrued' means that the determination of 'proceeds' is done on the same basis as the determination of 'gross income'. The meaning of 'received' is self evident, while it now appears settled that 'accrued' means 'entitled to' in the sense that one has an unconditional right to an amount, even though the said amount may not yet have been received by one.[94]

What is not settled, however, is whether the amount of 'proceeds' payable in the future should be determined to be the full monetary sum still owing or a discounted figure that takes account of

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[88] Paragraph 13(1)(a)(iv) and (c)
[89] Stein, pg 6-3
[90] Stein, pg 6-5
[91] Paragraph 36
[92] Paragraphs 13(1)(a)(v), (vi), (vii) and (viii), and 13(1)(b), (d), (e), (f) and (g)(ii)
[93] Paragraph 35(1)
[94] CIR v People's Stores (Walvis Bay) (Pty) Ltd 1990 (2) SA 353 (A), 52 SATC 9

the fact that the money is only payable in the future. It has been suggested that the relevant provision in respect of gross income is "arguably ambiguous"[95] and it appears that the corresponding CGT provision is no different. On the one hand it has been submitted that it is not apparent "whether [the reference in paragraph 35(4) to] 'that amount' means 'the nominal or face value of the taxpayer's right to future payment of the sum at issue'"[96], and on the other hand it has been submitted that "it [is] clear that the full face value of an [accrued] amount ... must be accounted for ... and that the proceeds cannot be said to be only the present value of [the said] amount."[97]

Paragraph 35(1) specifically includes as 'proceeds' the amount by which a debt owed by one has been reduced or discharged (to prevent the contention that there is no receipt or accrual in such circumstances and thus no 'proceeds') and an amount received by or accrued to a lessee from the lessor for improvements effected to the property (to prevent the possible contention that there has been no disposal and thus no 'proceeds').

The 'proceeds' which arise from a value shifting arrangement are determined as the market value of the interests immediately prior to the disposal less the market value of the interests immediately after the disposal i.e. the amount of this 'reduction' in value is regarded as having been received or accrued.[98]

'Proceeds' are reduced by any portion of the 'proceeds' which must be or has been included in one's gross income or which must be or has been taken into account in the determination of one's taxable income before the inclusion of the taxable capital gain.[99] The Schedule makes no distinction between capital assets and 'revenue assets', and thus once an amount in respect of an asset has been included in one's gross income it cannot also constitute 'proceeds' in respect of the determination of a capital gain or loss on the disposal of the same asset, otherwise double taxation would result.

'Proceeds' must also be reduced by any portion of the 'proceeds' which has been repaid or becomes repayable to the person to whom the asset was disposed of.[100] As paragraph 4(b)(i)(cc) deals with this scenario in respect of amounts repaid/repayable in the present year of assessment in respect of an asset disposed of in a previous year of assessment, this provision appears to deal with the same scenario but in respect of an asset disposed of in the current year of assessment.

Finally, 'proceeds' are reduced by the reduction in any accrued portion thereof as a result of the cancellation, termination or variation of an agreement or due to the prescription or waiver of a claim or release from an obligation or any other event.[101] With regard to the 'prescription or waiver of a claim', the significance of that provision has been summed up as follows: "While

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[95] Williams, pg 173
[96] Williams, pg 173
[97] Stein, pg 7-4
[98] Paragraph 35(2)
[99] Paragraph 35(3)(a)
[100] Paragraph 35(3)(b)
[101] Paragraph 35(3)(c)

paragraph 35(1)(a) treats as proceeds in the hands of a debtor an amount by which a debt owing by him has been reduced or discharged, this provision serves to reduce the proceeds derived by a creditor as a result of his waiving a debt [or the debt becoming prescribed]".[102]

## 6. Base Cost

For income tax purposes, taxable income is determined by subtracting the aggregate amount of deductible expenditure from the aggregate amount of gross income. However, as far as CGT is concerned, there is no concept of 'deductible expenditure' as such. Rather, one must determine separately for each asset the capital gain or loss arising from its disposal, which, as aforementioned, is done by deducting the 'base cost' of the asset from the 'proceeds' of its disposal. Expenditure which forms part of the 'base cost' of an asset is in this sense 'deductible'.

### 6.1 Base Cost Expenditure

Part V of the Schedule defines what types of expenditure qualify for inclusion in 'base cost' ("base cost expenditure"); "the inclusion or non-inclusion of expenditure in 'base cost' is thus a matter of statutory interpretation, and is not determined by principles of accountancy or business practice."[103]

Paragraph 20(1) provides that the 'base cost' of an asset is the sum of:

- expenditure incurred in respect of the cost of acquisition or creation of the asset;
- expenditure incurred in valuing the asset for the purposes of the determination of a capital gain or loss;
- expenditure incurred which is directly related to the acquisition or disposal of the asset, such as remuneration of a valuer, transfer costs and duty, advertising costs, the cost of moving and installing the asset, etc;
- expenditure incurred for purposes of establishing, maintaining or defending a legal title to or right in the asset;
- expenditure incurred in effecting an improvement to or enhancement of the value of the asset provided that it is still reflected in its state or nature at the time of its disposal; it has been suggested that this is a prime example of the "many arbitrary distinctions [in paragraph 20(1)] in regard to what expenditure may or may not be so included"[104] and noted that the said proviso "is a highly impractical one in that it will be difficult, if not impossible, to keep a record of successive improvements when an asset is refurbished or improved more than once over its lifetime. Apart from anything else, the book-keeping records will be completely out

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[102] Stein, pg 7-4
[103] Williams, pg 46
[104] Williams, pg 46

of line with the records normally maintained for accounting purposes, in which improvements, as distinct from repairs, are capitalised as part of the cost of the asset."[105]

- the market value on 1 October 2001 of an option acquired prior to that date where the asset is acquired in terms of that option;

- expenditure incurred which is directly related to the cost of ownership of an asset used wholly and exclusively for business purposes, or that constitutes a listed share/an interest in a qualifying portfolio (only a third of this expenditure will be included because "when these assets are held on capital account the bulk of such expenditure is incurred in order to earn dividend income"[106]); examples include repairs and maintenance, insurance and protection, rates and taxes on immovable property, interest on loans to finance the cost of acquiring an asset and any improvements thereto, etc;

- specified amounts which have been subjected to income tax; this provision prevents double taxation because "since [the amounts] must be added to the base cost of the asset, they effectively reduce the capital gain or increase the capital loss on the asset in the determination of the taxable capital gain made on the disposal of the asset";[107]

- in respect of a value shifting arrangement, an amount determined in accordance with paragraph 23.

Paragraph 20(1) expressly provides that although domestic or private expenses or amounts incurred in the production of exempt income are not allowed as deductions for income tax purposes, such expenditure may, for CGT purposes, constitute part of the base cost of an asset.

As far as the value-added tax element of the base cost expenditure is concerned, such expenditure would "by implication exclude value-added tax not allowed as an input credit for value-added tax purposes."[108] Base cost expenditure also excludes (except to the extent that it is deductible under paragraph 20(1)(g)):

- borrowing costs, including interest or raising fees;

- repairs, maintenance, protection, insurance, rates and taxes, or similar expenditure; and

- the valuation-date value of an option or right to acquire a marketable security contemplated in section 8A(1).

Base cost expenditure must be reduced by the following:[109]

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[105] Stein, pg 7-8
[106] Explanatory Memorandum, at 46
[107] Stein, pg 7-9
[108] Explanatory Memorandum, at 43
[109] Paragraph 20(3)

- any amount that is or was allowable as a deduction in determining the taxable income of the person before the inclusion of a taxable capital gain (this provision thus prevents double deduction of expenditure);

- any amount that has for any reason been recovered or become recoverable or that has been paid by any other person, whether before or after the incurral of the expense to which it relates (this provision would thus cover expenditure which is refundable or against which the person in question has been indemnified, for example by insurance, and the provision is intended to mirror the recoupment provisions in section 8(4)(a) and (m) in relation to income tax);

- any unpaid amount that is not due and payable in the year of assessment (this provision refers to "expenditure unpaid and not due and payable when the asset is disposed of"[110] and is basically an anti-avoidance measure; while such expenditure is not included in base cost, it can be claimed separately as a capital loss in a subsequent year).

It has been noted that "major problems will arise for taxpayers in recording [base cost] expenditure on their assets, since many of the amounts to be included - or excluded - from base cost are out of line with what would be revealed in a person's accounting records and his records for normal tax purposes".[111]

Paragraph 21, which is similar to Section 23B of the Act dealing with the prohibition of double deductions for income tax purposes, contains an "anti-double-count provision" and an "anti-carry-forward provision"[112] as follows:

(1) when an amount qualifies or has qualified as an allowable expenditure or may otherwise be taken into account in the determination of a capital gain or loss under more than one provision of the Schedule, the amount or portion thereof is not taken into account more than once in determining that capital gain or loss;

(2) no expenditure shall be allowed in terms of paragraph 20(1)(a) or (e) where it has qualified under any other provision of the Schedule but has been limited in terms of that other provision (for example, where an asset is disposed of by a donation, a portion of the donations tax, calculated in terms of paragraph 22, is regarded in terms of 20(1)(c)(vii) as base cost expenditure; any balance of such donations tax not so regarded may not then qualify as base cost expenditure in terms of paragraph 20(1)(a)).

### 6.2 Pre-valuation Date Assets

The base cost expenditure included in the base cost of a 'pre-valuation date asset'[113] is only such expenditure incurred after the 'valuation date'[114] in respect of that asset.[115]

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[110] Explanatory Memorandum, at 20(3)
[111] Stein, pg 7-12
[112] Williams, pg 52
[113] As defined in paragraph 1
[114] As defined in paragraph 1

Where an asset was acquired before the 'valuation date', the determination of its base cost is "complex because of the difficulty - and inevitable imprecision - in determining its value as at 1 October 2001. Even a market-value valuation by an expert is only an educated estimate".[116] The base cost of a pre-valuation date asset is the sum of its valuation date value and the base cost expenditure incurred in respect thereof after the valuation date.[117] Where the proceeds from the disposal of such an asset, other than a stipulated interest-bearing instrument[118], exceed the base cost expenditure incurred on it both before and after the 'valuation date', the person who disposed of it must ascertain its valuation date value by electing one of the three following methods[119]. The election is made at the date of disposal of the asset and must take place in respect of each asset. Thus a person is free to elect one method of valuation for some assets and another method for others (although methods are prescribed where disposal proceeds do not exceed base cost expenditure incurred both before and after the 'valuation date' and where a section 24J instrument is involved[120]).

### 6.2.1 Market Value

Paragraph 29 sets out how a valuation date value is ascertained by determining the market value of the asset. It applies to certain financial instruments, local and foreign unit trusts and the controlling interest in listed shares (the provisions of paragraph 29 in respect of certain of these assets are considered under other headings below), and provides that the said market values of all other pre-valuation date assets are to be determined in terms of paragraph 31. Since paragraph 29 only deals with determining market value at the valuation date, it has been described as a "transitional measure"[121], whereas paragraph 31 sets out the 'permanent' market valuation rules.

A person may only adopt the market value as the valuation date value of an asset if that person has valued that asset (as at 1 October 2001) within two years of the valuation date, although the Commissioner can extend this period by notice in the Government Gazette. Such valuation must be submitted with the first return furnished after the said period. Where a person disposes of a 'valued' asset before he is obliged to submit the valuation, such valuation must be submitted with the return for the year of assessment during which the asset was disposed of.[122]

Where the value of the asset exceeds the stipulated threshold for that class of asset, the valuation must be in the form prescribed by the Commissioner in section 107(1)(f).[123] This section allows the Commissioner to make regulations in this regard which he has yet to do. Furthermore, where the value of the asset falls below the stipulated threshold value, there is no prescribed form for the valuation nor is it prescribed who may validly conduct such valuations. It is, however, stipulated that the Commissioner is not obliged to accept a valuation, even if timeously furnished

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[115] Paragraph 25
[116] Williams, pg 53
[117] Paragraph 25
[118] Paragraph 28
[119] Paragraph 26(1)
[120] Paragraphs 27 and 28
[121] Explanatory Memorandum, at 29
[122] Paragraph 29(6)
[123] Paragraph 29(5)

in the proper form, and is entitled to call for further information or documents relating to that valuation. Where he is not satisfied with any valuation, he can adjust the value accordingly although his decision is subject to objection and appeal.[124]

Finally, paragraph 26(3) contains a limitation rule which eliminates 'phantom' capital losses where the market value has been adopted at valuation date but proceeds exceed actual or historic cost.

### 6.2.2 Time Apportionment

"Essentially, time-apportionment assumes that the value of an asset acquired prior to 1 October 2001 and disposed of after that date increased at an even rate (in other words, in a straight line if plotted on a graph) from the date of acquisition to the date of disposal. On this assumption it is then possible to determine its value as at 1 October 2001."[125]

One is obviously not able to utilise this method if one has not kept a record of the acquisition cost and other base cost expenditure (which one was not obliged to do before CGT was introduced), in which case one must utilise either of the other two methods.

Paragraph 30 provides for two variations when utilising the time-apportionment method, namely a formula which applies where there were additions or reductions to the asset in more than one year of assessment before the valuation date and another formula which applies where there were not.

### 6.2.3 The '20% Rule'

The colloquially termed '20% rule' provides that the valuation date value of an asset amounts to 20 per cent of the disposal proceeds less the base cost expenditure incurred after the valuation date. This method assumes that 80% of the disposal proceeds, less the base cost expenditure (generally the selling price), constitutes a gain in value which occurred after the valuation date and which is thus subject to CGT.

It has been noted in this regard that "if the taxpayer had acquired the asset very shortly before 1 October 2001 and sold it thereafter at a profit, this might be the most advantageous of the three methods to use, since in reality 100% or close to 100% of the increase in value would in fact have occurred after 1 October 2001."[126] However, other than in such case, it seems that the '20% rule' will only be utilised where the other valuation methods cannot, for example where one has not had the asset valued timeously or where one cannot prove the acquisition cost thereof.

## 6.3 Other Base Cost Provisions

The concept of 'market value' is not only relevant in respect of the valuation of pre-valuation date assets on the valuation date, but also in a number of other instances which may have CGT implications, such as the death or emigration of a taxpayer, the donation of an asset, etc. Paragraph 31 thus contains 'permanent' market valuation rules in respect of the following

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[124] Paragraph 29(7)
[125] Williams, pg 57
[126] Williams, pg 58

categories of assets: listed financial instruments; long term insurance policies; local and foreign unit trusts; fiduciary, usufructuary and other like instruments as well as property subject thereto; immovable farming property and unlisted shares. Where applicable, such rules are also considered under other headings below.

As far as any other asset is concerned, paragraph 31 provides that the market value thereof is the price that could have been obtained on a sale of the asset between a willing buyer and a willing seller dealing at arm's length in an open market. The difficulty of applying the concept of 'dealing at an arm's length' where the parties are not actually at arm's length was considered by the Appellate Division in CIR v Louw [127] with regard to section 103(1). The court held that where parties to a transaction are not strangers but are in a 'special relationship', the question in terms of section 103(1)(b)(ii) is whether, in the context of the particular type of special relationship, each of the parties was seeking to "extract from the transaction the best possible advantage for himself".[128] Apparently the Australian courts have adopted a similar approach in this regard[129], and there appears to be no reason why same should not apply in respect of CGT in South Africa.

Paragraph 32 sets out the three methods of determining the base cost of 'identical assets'[130], namely (1) the specific identification of the asset disposed of; (2) the FIFO assumption, i.e. the assumption that the first-acquired asset is sold first; and (3) weighted average, in terms of which the average cost is calculated after each acquisition by adding the cost of newly acquired assets to the base cost of the assets on hand and dividing that amount by the new total number of assets. Once one has adopted one of these three methods, one must utilise such method until all the 'identical assets' concerned have been disposed of. One may not adopt the weighted average method where the base cost of an asset is determined using time-based apportionment, because time-based apportionment is based on the actual cost and date of acquisition of the assets concerned, and when 'identical assets' are pooled same cannot be determined.

Where part of an asset is disposed of, the proportion of the base cost attributable to the part disposed of is the amount which bears to the base cost of the whole asset the same proportion as the market value of the part disposed of bears to the market value of the whole asset immediately before disposal.[131] However, where part of the base cost can be attributed to the part of the asset that is disposed of or retained, then the aforegoing apportionment does not apply because specific identification can be used to determine the part of the base cost disposed of. As has been noted, "this provision dispenses with the need for unnecessary valuations".[132]

Where one reduces or discharges a debt owed to a creditor by disposing of an asset to that creditor, the asset must be treated as having been acquired by the creditor at a cost equal to the market value of that asset at the time of the disposal.[133] "This prevents any double counting, in

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[127] 1983(3) SA 551 (A)
[128] 1983(3) SA 551 (A) at 574C-E
[129] Williams, pg 163
[130] Paragraph 32(2)
[131] Paragraph 33
[132] Williams, pg 168
[133] Paragraph 34

the creditor's hands, of an amount equal to the gain or loss determined in respect of the exchange of the creditor's claim for that asset".[134]

## 7. Taxable Capital Gains and Assessed Capital Losses

Section 26A of the Act provides that a person's taxable income for a year of assessment includes the person's 'taxable capital gain' for the year of assessment calculated as provided for in the Schedule, i.e. by means of the following steps: determining the 'capital gains' or 'capital losses', determining the 'aggregate capital gain' or 'aggregate capital loss', determining the 'net capital gain' or 'assessed capital loss' and finally determining the said 'taxable capital gain'.

### 7.1 Capital Gains and Losses

'Capital gains' and 'capital losses' are determined by the amount by which the proceeds received or accrued in consequence of the disposal of an asset during a particular year of assessment respectively exceed or fall short of the base cost of the asset,[135] and such determination must be done separately in respect of each asset (unless one of the statutory exclusions apply[136]). The question has been asked whether the fact that a 'capital loss' is the amount by which the base cost of an asset exceeds the said proceeds means that there can be no 'capital loss' unless there are at least some proceeds, and it has been submitted that "this could not have been intended, but the provision would be improved if [it] made reference to the proceeds 'if any' received or accrued".[137]

The effect of paragraph 3(b)(i) is that in determining a 'capital gain' in a current year of assessment not only are proceeds received or accrued in such year in respect of a disposal that same year taken into account, but so too is any part of the proceeds received or accrued in the current year from a disposal from a previous year of assessment that has not been taken into account during any year of assessment.

Similarly, paragraph 4(b)(i) provides that 'capital losses' arise not only from disposals and proceeds that respectively occur and accrue/are received in the same year of assessment, but also where an asset has been disposed of in a previous year of assessment and in the current year a person is no longer entitled to any part of the proceeds which were previously taken into account (as a result of the cancellation, termination, or variation of an agreement, the prescription or waiver of a claim, a release from an obligation or any other event)[138] or any part of such proceeds become irrecoverable[139] or have been repaid or become repayable[140]. The amount to which the person is no longer entitled or which becomes irrecoverable or which has been repaid/becomes repayable is the amount of the 'capital loss' in question.

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[134] Williams, pg 170
[135] Definitions of 'capital gain' and 'capital loss' in section 1 and paragraphs 1, 3(a) and 4(a)
[136] See Parts VII and VIII of the Schedule
[137] Stein, pg 3-2 to 3-3
[138] Paragraph 4(b)(i)(aa)
[139] Paragraph 4(b)(i)(bb)
[140] Paragraph 4(b)(i)(cc)

However, as has been previously noted, "it would seem that there is no way in which proceeds arising in a year of assessment before the year of disposal may be taxed under the Schedule. Nor, it is submitted, may they be taxed in a subsequent year of assessment in which the disposal occurs, for they will not be received or accrue in that year and amounts may constitute proceeds (as distinct from deemed proceeds) only in the year of assessment in which they are received or accrue".[141]

Paragraph 3(b)(ii) provides that a 'capital gain' will arise in a current year of assessment when any part of the base cost of an asset, which part has previously taken into account in the determination of the 'capital gain' or 'loss' on the disposal of that asset, is recovered or recouped during that current year. For example, when the supplier of an asset reduces the purchase price and refunds an amount to the buyer.

Once again similarly, paragraph 4(b)(ii) provides that a 'capital loss' will also arise in a current year of assessment when any part of the base cost of an asset disposed of in a previous year, which part has not previously been taken into account in the determination of the 'capital gain' or 'loss' on the disposal of that asset, is paid or becomes due and payable during that current year.

### 7.2 Aggregate Capital Gains and Losses

One's 'aggregate capital gain' or 'loss' for a year of assessment is determined by the amount by which one's capital gains for the year respectively exceed or fall short of his capital losses for the year or, in the case of a natural person or a special trust only, of the sum of such capital losses and the annual exclusion for the year[142] (which is currently R10 000[143]).

Any unused balance of the annual exclusion cannot be carried forward into the following year and "a natural person or special trust can therefore avoid or reduce liability for CGT by staggering the disposal of assets over a period of years, thereby utilising the annual exclusion to the full."[144] However, as has been noted, "it is ironic that the annual exclusion that is allowed as a form of relief [in respect of aggregate capital gains] to a natural person or special trust also constitutes a 'penalty' of sorts in the determination of an aggregate capital loss, since it reduces that loss".[145]

### 7.3 Net Capital Gains and Assessed Capital Losses

A person's 'net capital gain' for a year of assessment is the amount by which his aggregate capital gain for that year exceeds his assessed capital loss for the previous year.[146]

A person's 'assessed capital loss' for a current year of assessment will be the amount by which his assessed capital loss brought forward from the previous year of assessment exceeds the

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[141] Stein pg 3-2

[142] Definitions of 'aggregate capital gain' and aggregate capital loss' in section 1 and paragraphs 1, 6 and 7

[143] Paragraph 5(1)

[144] Williams, pg 16

[145] Stein, pg 3-4

[146] Paragraphs 1 and 8

amount of his aggregate capital gain for the current year[147], or the sum of his aggregate capital loss for the current year of assessment and his assessed capital loss brought forward from the previous year,[148] or, where he has neither an aggregate capital gain or loss for the current year but incurred an assessed capital loss in the previous year, such assessed capital loss[149].

Since section 26A specifies that one's taxable capital gain for a year of assessment must be included in one's 'taxable income', an 'assessed capital loss' cannot be set off against one's ordinary income and therefore does not increase one's 'taxable income', nor does it increase any assessed loss of a revenue nature. As has been noted, "the timing of gains and losses is obviously significant in this context, since if a person makes a gain in one year and incurs a loss in the next year, he will not be able to set the loss off against the gain. But if he makes the loss before the gain, the loss will be set off, thus reducing the taxable gain."[150]

An assessed loss may be carried forward indefinitely and set off against capital gains arising in a future year of assessment. One should note in this regard that unlike in the case of 'conventional' assessed losses for 'normal' tax purposes[151], there are no restrictions on the preservation of assessed capital losses.

### 7.4 Taxable Capital Gain

In order to determine the applicable 'taxable capital gain' in appropriate circumstances, the net capital gain for the year of assessment is multiplied by a prescribed percentage.[152]

As the taxable capital gain so determined is then included in one's 'taxable income', it is then subject to one's applicable marginal income tax rate. Accordingly, the effective rates of tax (i.e. the marginal income tax rates multiplied by the prescribed net capital gain percentages) currently payable on net capital gains are up to 10,5% for natural person and special trusts, 15% for companies (including close corporations), and up to 21% for 'ordinary' trusts.

### 7.5 Limitation of Losses

Part IV of the Schedule sets out a number of situations in which, for CGT purposes, capital losses must be disregarded:

- in respect of certain specified assets, as set out in paragraph 15, to the extent that such assets are used for purposes other than the carrying on of a trade.[153]

  The use of the final phrase ("to the extent that ...") means that where an asset is used for both trade and other purposes, an appropriate apportionment will have to be made. As no basis of apportionment is set out, some reasonable basis, depending on the circumstances in each

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[147] Definition of 'assessed capital loss' in section 1 and paragraph 9(a)
[148] Definition of 'assessed capital loss' in section 1 and paragraph 9(b)
[149] Definition of 'assessed capital loss' in section 1 and paragraph 9(c)
[150] Stein, pg 3-6
[151] See section 20
[152] Paragraph 10
[153] Paragraph 15

case, would have to be used, "probably based on the time for which the asset is usually used for trade purposes or the portion of its extent that is so used."[154]

The said specified assets are specifically excluded as 'personal-use assets'[155] and thus gains on the disposal thereof are subject to CGT. One would thus have expected losses on the disposal thereof to similarly have constituted capital losses. The reason why such losses, as well as losses in respect of any lease of immovable property, do not has been justified as follows:

"It would be theoretically correct to determine capital gains or losses on the disposal of assets [whose reduction in value is most likely attributable to the personal use and consumption of the asset] ... by reference to a base cost that has been reduced by applying a notional wear and tear allowance to reflect personal use and consumption. This would be complex for both taxpayers and the administration and, in common with other jurisdictions, it [was] proposed that losses on disposal be disregarded and that only gains in excess of the unadjusted base cost be taxed."[156]

- Where an intangible asset, as defined[157], was acquired before 1 October 2001 from a connected person or was acquired before such date but was associated with a business taken over by that person or any connected person in relation to that person.[158] The rationale for this provision has been set out as follows: "SARS is of the view that substantial abuses of the valuation of intangible assets [such as goodwill] have occurred and are still occurring, albeit on a lesser scale, on the acquisition of businesses."[159]

- Where they result from the forfeiture of deposits in respect of assets which are not intended for use wholly and exclusively for business purposes[160]. Note the reference to the term 'business purposes', as opposed to the extremely broad term 'trade'[161] in paragraph 15. The former term has a much narrower scope and, coupled with the term 'wholly and exclusively', the ambit of this provision is thus more restricted than that contained in paragraph 15.

  Not all losses arising from forfeiture of deposits are disregarded. Some of these losses in respect of certain specified personal-use assets are specifically excluded[162] because "a decline in the value of these kinds of personal-use assets is more likely to be attributable to market forces than to wear and tear in the course of personal use".[163]

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[154] Stein, pg 8-7
[155] Paragraph 53(3)
[156] Explanatory Memorandum, at 15
[157] Paragraph 16(2)
[158] Paragraph 16
[159] Williams, pg 119
[160] Paragraph 17(1)
[161] See definition in Section 1
[162] Paragraph 17(2)
[163] Williams, pg 120

- Where one is entitled to exercise an option to acquire an asset not intended to be used wholly and exclusively for business purposes or to dispose of an asset not used wholly and exclusively for such purposes, and one suffers a capital loss on abandoning the option, allowing it to expire or disposing of it in any other manner apart from exercising it.[164]

  This provision applies to most personal-use assets as they are not subject to CGT and the reduction in their value can be mainly attributable to personal use. It does not, however, apply to a coin made mainly from gold or platinum whose market value is mainly attributable to the material from which it is minted or cast, immovable property (except property that the person intends to acquire as his primary residence or that he had the option to dispose of), a financial instrument, or a right or interest in any of the aforegoing assets.[165]

- Where one disposes of a share in a company within two years of acquisition by one of that share[166]. One must disregard any capital loss arising from the disposal to the extent of any extraordinary dividends received by or accrued to one in respect of that share within that period. This is an anti-avoidance provision designed to prevent persons from generating artificial capital losses through dividend stripping.

### 7.6 Disregarded Gains and Losses

Over and above the primary residence exclusion dealt with below, capital gains and losses must be disregarded in the circumstances and to the extent set out in Part VIII of the Schedule when determining the aggregate capital gain or loss of a person:

- The disposal of a 'personal-use asset' by a natural person or a special trust subject to certain specified exceptions.[167] It has been noted that this provision is significant for two reasons: "First, there is no ceiling on the amount that is exempt; provided the asset is a personal-use asset, the full amount of the gain (or loss) is disregarded. Secondly, the Eighth Schedule draws no distinction between the kind of everyday personal-use assets that the average person possesses ... and those that are the preserve of the rich ... By contrast, the Australian capital gains tax legislation does draw a distinction".[168] In our country where there is as aforementioned, such a massive discrepancy between the income levels of the wealthy few and the poor masses, it is submitted that a similar distinction should be introduced into our CGT regime.

- In relation to retirement benefits,[169] long-term assurance benefits,[170] and debt defeasance whereby a creditor disposes of a claim owed by a debtor who is a connected person in relation to the creditor[171] ("this [latter provision] is intended to prevent persons from

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[164] Paragraph 18
[165] Paragraph 18(2)
[166] Paragraph 19
[167] Paragraph 53
[168] Williams, pg 63
[169] Paragraph 54
[170] Paragraph 55
[171] Paragraph 56

receiving the benefit of losses on a debt which probably represents a disguised gift or capital contribution, neither of which would otherwise create a capital loss").[172]

- In respect of the disposal of small business assets, subject to stipulated conditions and limitations.[173] This provision provides relief to small business persons who, instead of providing for their retirement, have reinvested their resources into their businesses.

- In respect of the termination of an option as a result of the exercise by one of that option[174], because any amount paid for an option, other than in respect of a personal-use asset, is part of the base cost of the asset.

- In respect of the disposal of a claim resulting in a natural person or a special trust receiving compensation for personal injury, illness or defamation of that person or a beneficiary of that trust.[175] It has been noted in this regard that "it is not clear what the 'disposal' is that results in the receipt of compensation, since it would seem that no 'asset' as defined in paragraph 1 would be involved, in the sense of 'property' of any nature or a right or interest in such property".[176] The reason given for this exclusion is that "no capital gain can arise. Any compensation received is merely a restoration of the asset, being the natural person or beneficiary of the special trust, injured or defamed."[177]

- Capital gains and losses arising from gambling, games and competitions except those derived by companies, close corporations or trusts, or arising in respect of foreign gambling, games and competitions.[178] It matters not whether the winnings are in the form of a prize or cash. The reason for the distinction between local and foreign activities has been supplied as follows: "Local gambling activities contribute to the fiscus indirectly in the form of betting taxes and value-added tax. In the case of the National Lottery a portion of the proceeds is used for the upliftment of the needy, which can be linked to a form of indirect taxation. Since foreign gambling does not contribute in this manner there is no reason to confer an exemption on such gains. In order to protect the tax base, capital losses are in all instances disregarded".[179]

- Those made by a unit portfolio of any unit trust scheme;[180] those in respect of a donation or bequest of an asset to a public benefit organisation;[181] those arising out of the disposal of an

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[172] Williams, pg 204
[173] Paragraph 57
[174] Paragraph 58
[175] Paragraph 59
[176] Stein, pg 8-5
[177] Explanatory Memorandum, at 59
[178] Paragraph 60
[179] Stein, pg 8-6
[180] Paragraph 61
[181] Paragraph 62

asset to a person who is exempt from tax;[182] and those in relation to assets used to produce exempt income, subject to a couple of stipulated exemptions[183].

### 7.7 Roll-overs

In contrast to the disregarding of capital gains and losses, part IX of the Schedule provides for certain roll-overs of certain capital gains or losses i.e. the triggering of the said capital gain or loss, which would normally occur on disposal of the asset in question, is deferred to a later act or event. This occurs, subject to certain time stipulations and to provisions in regard to the acquisition of a replacement asset, where:

- A person disposes of an asset, other than a financial instrument, by way of expropriation, loss or destruction in return for proceeds exceeding base cost;[184]

- A person disposes of an asset which qualifies for a capital allowance or deduction in terms of section 11(e), 12B, 12C, 14 or 14*bis*;

- A person disposes of an asset to his or her spouse. That spouse is regarded as having taken over the asset at the base cost to the disposing spouse and the capital gain or loss is thereby deferred until the recipient spouse disposes of the asset.[185]

## 8. Anti-Avoidance Provisions

Just as the Act contains anti-avoidance provisions in respect of income tax, so too does the Schedule in respect of CGT:

- Where an asset is disposed to anyone by way of a donation or for a consideration not measurable in money, to a 'connected person' (other than a spouse) for a consideration which differs from the arm's length price, the said asset must be regarded as having been disposed of for proceeds equal to the market value of that asset as at the date of disposal. Similarly, the person acquiring the said asset is deemed to have acquired it at a cost equal to the market value.[186]

- Where one disposes of an asset to a 'connected person' (as defined for the purposes of this paragraph[187]) and makes a capital loss, it must be disregarded in determining one's aggregate capital gain or loss. It may be deducted only from one's capital gains in respect of disposals to the same person during that or a subsequent year, but only if such person is still one's

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[182] Paragraph 63
[183] Paragraph 64
[184] Paragraph 65(1)
[185] Paragraph 67(1)-(2)
[186] Paragraph 38
[187] Paragraph 39(3)

'connected person' at the time of such subsequent disposals.[188] This provision has been described as "severe".[189]

- Paragraph 42 aims to prevent what are colloquially known as 'wash sales' or 'bed and breakfasting', whereby one disposes of financial instruments towards the end of a year of assessment so as to realise a capital loss to set off against capital gains made in that year. The financial instruments are then reacquired shortly after year end and a new, higher base cost is achieved. Where such disposals occur, one is deemed to have disposed of the financial instruments for proceeds equivalent to their base cost and thus no capital loss is incurred.

- In order to prevent people from "artificially inflating the base cost of an asset for purposes of determining its time-apportionment base cost in terms of paragraph 30"[190], paragraph 86 provides, in respect of the transitional period (i.e. 23 February 2000, the day the introduction of CGT was announced in parliament, to 30 September 2001, the day before the valuation date), that where a person acquired or reacquired an asset in specified circumstances as a result of a non-arm's length transaction or from a 'connected person', the base cost of the asset in the hands of the person from whom it was acquired, as well as the period for which the latter held the asset prior to that transaction, will be attributed to the person who acquired it should the latter wish to determine and use the time-apportionment base cost of that asset as its valuation date value.

Part X of the Schedule contains provisions which aim to prevent the avoidance of CGT by providing for capital gains to be attributed in specified circumstances to one other than the one receiving such gain or to whom such gain accrues. Such provisions to a large extent mirror the provisions of section 7 which deal with the same or similar issues in the context of income tax:

- Paragraph 68(1) provides that, in certain specified circumstances, one's capital gain is disregarded and instead taken into account in determining the capital gain or loss of one's spouse. This provision, which is aimed at preventing collusive arrangements between spouses whereby capital gains and losses are transferred between them in order to avoid or reduce CGT, mirrors that of section 7(2). Hence the use of familiar income tax expressions such as 'donation, settlement or other disposition' (hereinafter referred to as "disposition") and 'transaction, operation or scheme'.

- On the other hand, paragraph 68(2), while containing a similar anti-avoidance provision in that it attributes a certain amount of one's capital gain to one's spouse where one has stipulated business dealings with one's spouse or with an entity in which one's spouse has an interest, contains expressions and concepts, such as 'in association with', 'in any way connected' and 'principal', which have been described as "vague" and "undefined".[191] It thus remains to be seen how this provision will actually be applied in practice and interpreted by our courts.

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[188] Paragraph 39
[189] Stein, pg 11-2
[190] Explanatory Memorandum, at 114
[191] Williams, pg 221

- Paragraph 69 aims to prevent a parent from eliminating or reducing a CGT liability by arranging, by means of a disposition to a minor child, for a capital gain to accrue to that minor. It is thus similar to sections 7(3) and (4) and it has been noted that it "will be particularly significant in relation to trusts with minor beneficiaries, where the parent of one of the minor beneficiaries donates or sells to the trust, at an undervalue, a capital asset which later increases in value, with the result that such increase in value occurs within the trust, and not within the parent's estate".[192] Unlike with paragraph 68, this provision applies even if there is no intention to avoid tax.

- Paragraph 70 is similar to section 7(5) but applies to the withholding of capital, as opposed to income, as a result of conditional vesting and does so by attributing the said capital gain to the person making the disposition in question until the said condition is fulfilled. Whether the exercise by a trustee of his discretion constitutes the fulfillment of a condition within the meaning of section 7(5) is still unclear. While in certain instances it has been held that it does,[193] the Appellate Division has not decided the matter one way or another.[194] The interpretation of paragraph 70 in this regard will no doubt, mutatis mutandis, follow that of section 7(5).

- Paragraph 71 mirrors section 7(6). It applies when a capital gain arises as a result of a revocable disposition and attributes such capital gain to the person who retains the power of revocation. Such attribution only takes place where the capital gain has 'vested' in the beneficiary and it has been submitted that "vesting cannot occur until the capital gain in question has been realised, and that this will occur only when an actual 'disposal' of an asset (as opposed to a deemed disposal, such as is contemplated in paragraph 12(2)) occurs".[195]

- Paragraph 72 attributes a capital gain which has 'vested' or 'is treated as having vested' in a non-resident to a resident where such resident has sought, by means of a disposition to the non-resident, to exclude future capital gains which arise from such disposition from CGT. While it has been submitted that "a capital gain ... does not 'vest' in a person until the latter has disposed of the asset in question ... paragraph 72 does not explain in what circumstances a capital gain will be 'treated as having vested' in a non-resident".[196]

Finally, the assessed loss anti-avoidance provisions of section 103(2) of the Act have been amplified to allow the Commissioner, in certain circumstances, to prevent a company or trust from setting off an assessed loss, capital loss or assessed capital loss against a 'tainted' capital gain. The 'tainted' capital gain is dealt with similarly to the way in which 'tainted' income has been dealt with, namely "the set-off of the offending capital gain is disregarded, meaning in

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[192] Williams, pg 222
[193] Hulett v CIR 1944 NPD 263, 13 SATC 58 and ITC 1033 (1959) 26 SATC 73
[194] CIR v Berold 1962(3) SA 748(A), 24 SATC 729 and Estate Dempers v SIR 1977 (3) SA 410
[195] Williams, pg 226
[196] Williams, pg 226

effect that the assessed loss, capital loss or assessed capital loss is ring-fenced and only available for set-off against untainted capital gains".[197]

## C. SELECTED TOPICS

### 1. Immovable Property

A significant feature of the CGT legislation as far as immovable property is concerned is the primary residence exclusion which allows natural persons and special trusts to disregard capital gains and losses arising from the disposal of a 'primary residence' to the extent that such gains and losses do not exceed R1 million.[198]

A 'primary residence' is defined as a residence (1) in which a natural person or a special trust [reference hereinafter is simply made to a "person"] holds an 'interest'; and (2) which that person, or his spouse, (i) ordinarily resides or resided in as his main residence and (ii) uses or used mainly for domestic purposes.[199] The exclusion thus does not apply to companies, close corporations or other trusts.

The reference to 'spouse' appears to have been intended to cater for the position where a person owning a 'primary residence' is employed away from it and does not own another 'primary residence' but his spouse resides apart from him in the said 'primary residence'. Where he does own another 'primary residence' in which he resides, he is obliged to nominate one of the properties as his 'primary residence' because "the Act does not cater adequately - or at all - for this situation"[200], but rather provides that a person may only have one 'primary residence' at any one time[201] (subject to an exception mentioned below).

Where more than one person jointly holds an interest in a 'primary residence', the exclusion must be apportioned amongst them.[202] But what happens where different people hold separate interests in the same residence rather than a single interest jointly: "Can they be said to jointly hold an interest in the residence or is this a form of co-ownership that is different from holding an interest 'jointly'? The legislature's intention is unclear."[203] On the other hand it seems clear that when a person holds an interest in a residence with, for example, a company, only a portion of the exclusion, apportioned in accordance with the person's interest in the residence in relation to that of the company, would apply in respect of the person.

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[197] Williams, pg 88
[198] Paragraph 45(1)
[199] Paragraph 44
[200] Stein, pg 9-2
[201] Paragraph 45(3)
[202] Paragraph 45(2)
[203] Stein pg 9-2

Similarly, "a person who ceases to be a resident but retains his former primary residence in the Republic will qualify for the R1 million exclusion on an apportionment basis."[204]

A 'residence' is defined as any structure, including a boat, caravan, or mobile home, which is used as a place of residence by a natural person, together with any appurtenance belonging thereto and enjoyed therewith.[205] The type of structure envisaged is "one of a more permanent nature where the level of facilities make that structure habitable. An underground structure or a structure built into a cliff-face would possibly qualify whereas a tent would not possibly qualify as a residence ... an 'appurtenance' would be considered as an appendage or something forming part of the residence such as a separate garage, various out buildings, a swimming pool or tennis court."[206]

Finally, an 'interest' is defined as (1) any real or statutory right; or (2) a share owned directly in a share block company as defined in the Share Blocks Control Act No. 59 of 1980 or a share or interest in a similar entity that is not a resident; or (3) a right of use or occupation, but excluding a right under a mortgage bond or an interest in a trust.[207]

The intention behind extending the definition of 'interest' beyond a right of ownership to, *inter alia*, a right of use or occupation is to allow a person to hire a 'residence' as a 'primary residence' and then to utilise the exclusion in respect of any capital gain or loss arising out of the disposal of the right of occupation. However, does the legislation achieve this aim? It has been submitted not and pointed out that the reference is to the disposal of a 'primary residence' which has been defined as a 'residence' i.e. basically a structure and not an 'interest' in a 'residence': "if a person disposes of an interest he would not be disposing of a residence and, by definition, would not be disposing of a primary residence ... accordingly a lessee or usufructuary of a 'residence' which constitutes that person's primary residence, for example, would not be able to claim the primary residence exclusion when disposing of that person's rights under the lease or usufruct."[208] It thus appears that an amendment to the legislation is required in this regard.

A 'primary residence' includes the land on which it is situated as long as it does not exceed two hectares, is used mainly for domestic or private purposes and is disposed of at the same time and to the same person as the residence is.[209] Where the property exceeds two hectares a reasonable apportionment will have to be applied[210]. The reference to 'private purposes' is to include use of the property, such as for parking, which may not necessarily be regarded as domestic use.

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[204] Explanatory Memorandum, at 77
[205] Paragraph 44
[206] Explanatory Memorandum, at 77-78
[207] Paragraph 44
[208] 'Primary residence exclusion: the cracks appear' - Ben Strauss and Liezl van Zijl, http://www.cgtsa.co.za/articles
[209] Paragraph 46
[210] Explanatory Memorandum, at 46

The exclusion is to be apportioned in respect of periods where the person or his spouse was not ordinarily resident in the primary residence.[211] As has been pointed out in this regard, "the Act defines 'resident', but the meaning of 'ordinary resident' will have to be determined with reference to case law. However, that case law is concerned with the meaning of 'ordinarily resident' vis-a-vis a country, not vis-a-vis a 'residence', and the criteria may therefore have to be adapted."[212] It has also been suggested there is a "fundamental problem with this provision ... the apportionment provided by paragraph 47 is not brought into play when the person concerned was ordinarily resident in the residence throughout his period of ownership, but did not use it mainly for domestic purposes for any period during his ownership of the residence ... The problem is that the residence would not qualify as his 'primary residence' while it is not 'used mainly for domestic purposes' ... It is submitted that the legislature needs to address this anomaly, say, by addressing the issue of use of the premises in paragraph 47."[213]

In the following circumstances a person may be regarded as having been ordinarily resident in a 'primary residence' where he has been absent therefrom for a continuous period not exceeding two years: (1) the 'primary residence' was offered for sale and vacated due to the (intended) acquisition of a new 'primary residence'; (2) the 'primary residence' was busy being erected (note that land on its own cannot be a 'primary residence' as a 'residence' is defined as 'any structure'); (3) the residence was accidentally rendered uninhabitable (for example, when destroyed by "fire, flood, earthquake, landslide, wind or other similar act"[214]); (4) the person was deceased.[215]

The amount of the exclusion is reduced where a part of the 'primary residence' was used for the purposes of carrying on a trade, and also where the property was not used as a primary residence for the whole period of ownership after the valuation date.[216] It has been noted in this regard that "interestingly, [this provision] does not apply when the residence or part of it was used for trade purposes by the spouse of the natural person owning the residence".[217] It has also been submitted that "this provision does not gel with the definition of a 'primary residence' in that it ignores the requirement that a person be ordinarily resident in the residence and that it be used 'mainly' for domestic purposes ...Yet this provision seems to require an apportionment that will make the exclusion available if, and for the period during which, the residence was used for domestic purposes (even though not 'mainly' for these purposes). On top of this, a further apportionment must be made in recognition of the fact that part of the residence was used mainly for purposes other than the carrying of a trade".[218]

A concession to the above provision does exist in that a person will, subject to specified conditions, be treated as having used a residence for domestic purposes even though he is absent

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[211] Paragraph 47
[212] Williams, pg 192
[213] Stein, pgs 9-6 to 9-7
[214] Explanatory Memorandum, at 83
[215] Paragraph 48
[216] Paragraph 49
[217] Stein, pg 9-9
[218] Stein, pg 9-9

from it for a continuous period of up to five years while it is being let.[219] However, it appears that if the period of five years is exceeded, the concession will be entirely lost and no apportionment will be made.[220]

Certain individuals hold their 'primary residences' in the name of a company or trust and thus will not qualify for the exclusion. In order to assist those wishing to transfer such residences out of the company or trust into their personal names, provision has been made for them to do so, subject to certain stipulated conditions, without financial prejudice in that the company or trust is treated as having disposed of the residence at its market value on 1 October 2001, while the person is treated as having acquired it at its market value on that date. Furthermore, the Transfer Duty Act[221] and Stamps Duties Act[222] have been amended to waive transfer and stamp duty in such circumstances.

As a person will pay CGT on any capital gain arising, after the valuation date, in respect of the disposal of his 'primary residence' (but only on the portion of such gain, if any, which exceeds the exclusion), as well as the disposal of other immovable property (such as any holiday, non-primary residential, commercial or industrial property), owners of immovable property acquired before the valuation date must have a value for it as at such date. Determining the market value (i.e. a price based on a willing buyer and seller contracting in an open market) is the obvious way to ascertain such value. However, in view of the fact that the Schedule does not specify who may perform valuations and how they should do so, there has been a great deal of uncertainty regarding how to arrive at a market value acceptable to the Commissioner. One can do the valuation oneself but, as the onus is on the taxpayer to substantiate the valuation, one will have to be able to justify such valuation. One can also utilise a sworn appraiser or an estate agent but this will not prevent SARS from reviewing any such valuation.

However, the cost of obtaining a valuation or the hassle of trying to do it oneself means that the market valuation method is not always ideal unless one has only owned the property for a couple of years. Utilising the time apportionment method is easier, there is no cost involved and "with this method the longer you have owned the property before the implementation of CGT, the lower the effective rate of CGT you will pay on the total difference between the original price and the sale price."[223]

## 2. Death and Deceased Estates

The introduction of CGT has made estate planning all the more important because on death not only is there an estate duty liability but also CGT liability as a deceased person is now deemed to have disposed of his assets to his estate.[224] Such deemed disposal gives rise to proceeds equivalent to the market value of the assets at his death. However, no such deemed disposal

[219] Paragraph 50
[220] Explanatory Memorandum, at 84
[221] 40 of 1949
[222] 77 of 1968
[223] Personal Finance, pg 49
[224] Paragraph 40

occurs in respect of: (1) assets transferred to the surviving spouse[225] (there is thus a "roll-over" of CGT implications until she disposes of the said assets, and because she is deemed to have acquired them at their base cost to the deceased, the calculation of any capital gain or loss on the disposal is made with reference to such base cost); (2) assets bequeathed to approved public benefit organisations;[226] (3) a long-term insurance policy of the deceased which, if the proceeds had been paid to the deceased, the capital gain or loss would have been disregarded in terms of paragraph 55.

There is thus a potential CGT liability on death because in the final assessment the deceased will make a capital gain or loss determined by the difference between the said proceeds of the deemed disposal less the base cost to him of the assets concerned. However, the deceased is entitled to an increased annual exclusion of R50 000 in the year of assessment in which he dies.[227]

On the other hand there are no CGT implications arising from the disposal of assets by the estate to heirs or legatees (other than the surviving spouse or an approved public benefit organisation) or a trustee of a trust because the proceeds of such disposal amount to the estate's base cost in respect of such assets (i.e. the market value of the assets at the date of the deceased's death)[228]. There would, however, be CGT implications if the executor were to dispose of certain assets to anyone else in the course of winding-up the estate, because in such a case the proceeds would not be deemed to be the same as the base cost of the said assets.

It is also provided that an heir, legatee or trustee is deemed to have acquired assets from the estate at a cost equivalent to the estate's said base cost in respect of such assets[229] (thus if the executor incurs any base cost expenditure in improving the assets, such costs are deemed to be part of the base cost of the heir or legatee). When the heir, legatee or trustee disposes of assets so acquired a capital gain or loss will arise being the difference between the proceeds of the disposal and such base cost.

For CGT purposes, the disposal of an asset by the estate shall be treated in the same manner as if it had been disposed by the deceased.[230] This means that the estate would be able to claim, for example, the same primary residence and personal use asset exclusions available to the deceased during his life-time. However, it appears to go further than that: "it is the intention that the estate would, for example, be taxed at the same rate, and enjoy the same inclusion rate and exclusions that the deceased would have enjoyed if the deceased had disposed of the assets".[231] It has been noted in this regard that "this seems to be a rather generous interpretation of the law, but, if correct, enables the deceased estate to claim the annual exclusion of R10 000.00 and the inclusion rate of 25% available to natural persons".[232]

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[225] Paragraph 67(2)(a)
[226] Paragraph 62
[227] Paragraph 5(2)
[228] Paragraph 40(2)(a)
[229] Paragraph 40(2)(b)
[230] Paragraph 40
[231] Explanatory Memorandum, at 73
[232] Stein, pg 10-7

Various measures have been introduced to soften the potential impact of both estate duty and CGT on an estate. For example, the rate of estate duty has been reduced from 25% to 20% with effect from the valuation date. Furthermore, when the CGT payable reaches a certain level[233] and the executor is obliged to dispose of an asset in order to pay such CGT, the heir or legatee to which the asset was due (but for the CGT liability) may elect to pay the CGT which exceeds the said level within a stipulated period.[234] It is not clear whether the heir or legatee will be required to pay interest and, if so, from when. Another interesting consideration is whether such CGT, if paid, will form part of the heir/legatee's base cost as expenditure incurred in acquiring the asset. It has been submitted that "the tax may not be added to the cost of the asset since section 23(d) prohibits the deduction of tax and section 23(d) is specifically made inapplicable in paragraph 20(1)(c)(vii) and (viii), which expressly permits donations tax to be added to the base cost of an asset in certain circumstances".[235]

Finally, while proceeds of life assurance policies (with certain limited exceptions) constitute dutiable assets for estate duty purposes, such proceeds do not give rise to CGT liability and thus "life assurance remains an affordable, tax efficient solution to provide the necessary cash liquidity in a deceased estate"[236] which is important because "not only do you need to protect yourself against paying unnecessarily high estate duty and CGT, but you also need to ensure that your estate has resources to pay these taxes".[237]

### 3. Insolvent Estates

Section 25C provides that a person's estate prior to sequestration and his insolvent estate will be treated as one and the same person for tax purposes, and so will his insolvent estate and his estate after the sequestration order is set aside. However, paragraph 83(2) disallows any pre-sequestration assessed capital loss from being carried forward, while paragraph 83(1) provides that the disposal of any assets by the insolvent estate is treated in the same manner as if they had been disposed by the person himself, and does so "to ensure that the insolvent estate will not be taxed on the disposal of personal-use assets of the insolvent, such as a primary residence or private motor vehicle. It also confers the same 25% inclusion rate on the insolvent estate"[238]

### 4. Trusts

Trusts have become an important tool in estate planning as they can be used to avoid paying estate duty, but it seems that for this reason they have been targeted by the CGT provisions and generally pay the highest effective rate of CGT.

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[233] Paragraph 41(1)(a)
[234] Paragraph 41(1)(b)
[235] Stein, pg 10-8 to 10-9
[236] 'Capital Gains Tax: Will the cost of dying increase soon?'; http://www.cgtsa.co.za/articles
[237] Personal Finance, pg 56
[238] Explanatory Memorandum, at 112

Subject to the aforementioned anti-avoidance provisions, where an asset vests in a beneficiary, either in terms of the trust deed or the trustees exercising their discretion, a disposal occurs which may give rise to a capital gain (i.e. if the market value of the asset at the time of vesting exceeds the base cost of the asset to the trust). However, such capital gain will give rise to a CGT liability not for the trust but for the beneficiary[239], unless the said beneficiary is not a South African resident in which case the trust would be liable. The same position would apply where the asset itself does not vest in the beneficiary but rather what vests in him is a capital gain made by the trust on the disposal of the asset[240]. (Subject to paragraph 70, any capital gain which does not vest in a trust beneficiary in the year in which it arises will be taxed in the hands of the trust at the effective rate applying to the trusts).

It has thus been suggested that trust deeds should "empower the trustees to vest assets or [capital gains] in resident beneficiaries at their discretion" because "the trustees will then have the flexibility to ensure that a beneficiary, rather than the trust, pays [CGT] in the appropriate circumstances".[241] This will result in significant tax savings because not only do natural persons pay a lower effective rate of tax on capital gains but they also qualify for an annual exclusion and trusts do not.

A person's interest in a discretionary trust must be treated as having a base cost of nil, but when a trust asset vests in a resident beneficiary as the result of the exercise of a discretion, the base cost of his interest in the trust must be increased by the cost of acquiring the asset[242] which is its market value at the date of disposal.[243]

When a connected person (in this context a trust beneficiary or a relative of the trust beneficiary) disposes an asset to a trust for a consideration that does not reflect an arm's length price, the proceeds of the disposal and the costs of acquisition will both be deemed to be the market value of the asset at the time of the disposal.[244] If such disposal results in a capital loss, he may only deduct the loss from capital gains that he makes on the disposal of other assets to the trust (as opposed to any other persons) in the same or any subsequent year of assessment. However, he may only do so if he is still a connected person of the trust when making those capital gains.

Since currency does not constitute an 'asset' for CGT purposes, a cash donation to a trust will not result in a CGT liability (although the donor would be liable for donations tax). Contrast this with the previously common estate-planning scenario where a natural person sold an asset to a trust which did not pay the purchase price. The person then used to write off or waive such debt in increments of R25 000.00 per year in order to benefit from the section 56(2)(b) donations tax exemption. In the future he will remain exempt from donations tax, but the provisions of the Schedule will render him liable for CGT.[245]

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[239] Paragraph 80(1)
[240] Paragraph 80(2)
[241] Stein, pg 10-2
[242] Paragraph 81
[243] Paragraph 38
[244] Paragraph 38
[245] Paragraph 12(5)(b) and 35(1)(a)

When the beneficiary of a 'special trust' dies then, in terms of the definition in section 1, such trust will no longer constitute a 'special trust'. However paragraph 82 extends, for the purpose of the Schedule only, the existence of the special trust until the earlier of the date of disposal of all the assets of such trust or of the expiry of two years from the date of death of the beneficiary. The effect hereof is that for such extended existence, the trust would continue to enjoy the annual exclusion of R10 000,00 and a 25% inclusion rate. However, it would have to pay the rates of normal tax payable by ordinary trusts (as opposed to those payable by special trusts) as rates of normal tax are dealt with in the Act, not the Schedule.

The 'conduit principle'[246] is given effect in section 25B which provides that income and losses generally 'flow through' a trust and are dealt with in the hands of the beneficiary. As seen above, such principle is also recognised in the capital gains scenario but only in respect of resident beneficiaries. Capital gains which vest in non-resident beneficiaries will be taxed in the resident trust (subject to the anti-avoidance provisions). However, this is in conflict with the said 'conduit principle' and, where the asset concerned is a fixed asset, appears to be inconsistent "with the principle that a non-resident is not subject to CGT except in respect of fixed property".[247]

## 5. Unit Trusts

It has been noted that "logically, if CGT is to be imposed on each gain realised from the sale of shares in a share portfolio, then CGT should be imposed directly on unit trusts. Fortunately, this was accepted as being a bridge too far".[248] Thus unit trust funds are exempt from CGT and the 'conduit system' is used to calculate capital gains on unit trust investments, which "means that although a unit trust management company may buy and sell underlying investments, any capital gains or losses incurred on the trades will not be subject to CGT, which applies [in respect of unit holders] only to gains or losses made in the overall performance of the [unit trust investment]".[249]

It is important to bear in mind that a unit holder does not incur a CGT liability whenever his unit trust investments improve in value over any particular year of assessment, but rather only when units are disposed of (or deemed to be disposed of) which would occur, *inter alia*, where he sells units, switches them from one fund to another, emigrates or dies.

As far as units already owned at the valuation date are concerned, the value of units in a local unit trust fund at such date is determined by the average last 'repurchase price' (i.e. the price one would receive if one sold the units) quoted on each of the five trading days before the valuation date.[250] The valuation-date value of units in a foreign mutual fund is determined by the last published price at which a unit sold before 1 October 2001 to the management company of the scheme, or, where there is no such company, the arm's length price which could have been

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[246] Armstrong v CIR 1938 AD 343 and SIR v Rosen 1971 (1) SA 173

[247] 'Are South African trusts effective investment vehicles for non-residents? A CGT perspective', Sipho Mokgoatlheng, http://www.cgtsa.co.za/articles

[248] 'Unit trusts have the edge when it comes to CGT', Professor Matthew Lester, http://www.cgtsa.co.za/News

[249] Personal Finance, pg 53

[250] Paragraph 29(1)(b)(i)

obtained upon a sale between a willing buyer and a willing seller in an open market.[251] Should one sell pre-valuation date units after the valuation date, the capital gain or loss arising out of such disposal is determined by deducting the said valuation-date value from the 'repurchase price' realised, whereas should one sell units acquired after the valuation date, the capital gain or loss will be the difference between the 'repurchase price' and the 'selling price' (i.e. the price at which the units were initially sold to one).

Finally, as far as accounting for capital gains and losses arising out of unit trust investments is concerned, "all the work will be done ... by the unit trust management company."[252] They are obliged to furnish SARS annually with a statement setting out, in respect of each unit holder, stipulated information regarding disposals of units after the valuation date.[253]

## 6. Business/Corporate Issues and Shares

When owners of 'small businesses' sell their business to retire, they are afforded a special concession because many of them build up retirement capital in such businesses. Whether the business is directly owned or held in a company, close corporation or partnership, the capital gain or loss on its disposal is disregarded under, *inter alia* and generally, the following conditions: the market value of the assets of the business may not exceed R5 million; where the business is held in a company, the natural person concerned must hold at least 10% of the share capital; such person must have owned the business or held shares/an interest in the legal entity owning the business for at least 5 years and must have been involved in the operation of the business during that period; when the business is sold the person must be at least 55 years old or must be retiring due to ill-health; although this exemption may apply to more than one business, the person's aggregate exemption in a life time may not exceed R500 000,00; all the gains must be realised within two years of the first disposal; and if more than one business is sold, the total market value of their assets may not exceed R5 million.[254]

Paragraph 19 is an anti-tax avoidance provision to combat so-called 'dividend-stripping' and it requires in such cases that a portion of the capital loss be disregarded. However, "there is no provision to provide relief in the opposite situation i.e. for the cascading effect that arises when there are 'vertical holdings' in groups of companies. If a subsidiary makes a capital gain, the holding company will again effectively be taxed when it sells the shares in the subsidiary, to the extent that the value of those shares is swollen by its own after-tax retained capital gains. And the same principle applies when an individual sells his shares in a company that has made a capital gain".[255]

Although dividends earned from shares of local and foreign companies are not subject to CGT, all gains made on shares from the valuation date will be subject to CGT. Thus once again a

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[251] Paragraph 29(1)(b)(i)
[252] Personal Finance, pg 54
[253] Section 70A
[254] Paragraph 57
[255] Stein, pg 12-7

valuation date value will have to be determined for shares held at that date. One has a choice of three methods.

The first is to use the weighted average price determined by SARS by taking the total selling price on each of the last five trading days before the valuation date and dividing the price by the number of shares traded. In order to prevent price manipulation, SARS will compare the weighted average price with the ruling prices for the first fourteen trading days in September 2001. If there is a gain of more than five percent, SARS will have the power to decrease the weighted average price.

An apportionment method may also be utilised whereby the capital gain over the period commencing when the share is purchased and ending when the share is disposed of, is divided by the number of years making up such period and then multiplied by the number of years between the valuation date and the date of disposal.

Finally, where one has no records of the original share prices, one can chose to declare 20 percent of the proceeds of the disposal of the shares as a capital gain.

Of concern to taxpayers who hold shares is that, arising out of the introduction of CGT, income-generating speculation is being targeted, because whereas many such taxpayers used to omit to advise SARS when they bought and sold shares (which made it difficult for SARS to prove that one was a 'speculator' as opposed to a 'passive investor'), now anyone who administers a portfolio of shares on one's behalf and has a mandate to buy and sell for one is required to supply SARS with information pertaining to disposals and acquisitions of financial instruments and to capital gains made.[256]

It should be noted that one faces double taxation in respect of shares in listed investment companies, because the company will be subject to CGT on any capital gains or losses it makes and one will be subject to CGT on any capital gains or losses when one disposes of the shares in the company, and that valuing pre-valuation date shares in unlisted companies will no doubt prove problematic as one is required to do so by determining the price one can obtain on a sale between a willing buyer and seller dealing at arm's length in an open market.

Finally, part XI of the Schedule provides for where a company distributes cash or assets in respect of previously existing shares and addresses the impact of such distributions in respect of the distributing company and in respect of the recipient shareholder.

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[256] Section 70B

- **CONCLUSION**

As is apparent from all of the above, CGT is a complex tax to understand and there is no doubt that it will be a difficult tax to monitor, plan for, compute and administer. Such complexity and difficulty were aggravated by an amendment to the Schedule before it was even implemented and the situation has been compounded by the fact that a further substantial amendment of the Schedule is imminent. It has thus been noted that CGT "will raise relatively modest sums, but the huge complexity of the legislation will result in massive policing costs for SARS as well as additional compliance costs to taxpayers and business in general'.[257] Thus there are many who predict that the CGT regime will be an administrative nightmare for SARS and taxpayers and who question whether SARS will in fact be up to the challenge of implementing it properly.

However, if they do meet the challenge, there may possibly be at least one upside to the introduction of CGT: "If it is properly implemented it will complement the new computer system at the SARS. This has the potential to broaden the tax base by identifying more unregistered taxpayers and transactions that are not being disclosed in tax returns. If this can be achieved and there can be a greater sharing of the load, we can hope that tax rates may decline in years to come".[258]

Whether this actually transpires remains to be seen. However, the concern (raised by many in opposition to the introduction of CGT) remains that of inflation. As we have seen, Government dismissed such concerns on the basis of a (then) positive inflationary outlook for South Africa. As things presently stand, such outlook is anything but positive and the dander persists that taxpayers are "going to be saddled with a tax liability that is partly due to the ravages of inflation and cannot be properly considered a capital gain."[259]

Furthermore, it is worth noting that in addition to the concern that the current CGT legislation makes no direct allowance for inflation, is the fact that while the Government claims that the effective CGT rates are low enough to ignore inflationary adjustment, "there is also absolutely no assurance that rates will not be increased after implementation. If what happened with retirements funds tax and skills development levy [is anything to go by] it would seem that increases in the CGT rate [are] also on the agenda". [260]

The future is uncertain, as is the success of the introduction of CGT in South Africa.

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[257] Personal Finance, pg 67

[258] 'Members reap first benefits of Money Club', Professor Matthew Lester, http://www.cgtsa.co.za/News/

[259] Personal Finance, pg 67

[260] 'Members reap first benefits of Money Club', Professor Matthew Lester, http://www.cgtsa.co.za/News/

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