5 June 2015

South African Revenue Service
Private Bag X923
PRETORIA
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BY E-MAIL: policycomments@sars.gov.za

Dear Sir/Madam,

SUBMISSION: DRAFT COMPREHENSIVE GUIDE ON CAPITAL GAINS TAX (ISSUE 5)

1. Please find the SAICA National Tax Committee’s response to the request for comments on the draft Comprehensive Guide on Capital Gains Tax (issue 5) (CGT Guide).

Paragraph 6 – Debt waiver references

2. Where reference is made to section 8(4)(m) or paragraph 12(5) in chapter 6, it should be made clear that such scenarios only apply to transactions before 1 January 2013 following the deletion of the section and paragraph and the introduction of section 19 and paragraph 12A with effect from 1 January 2013.

Paragraph 6.1.3.4

3. Consolidation of land gives rise to various problems such as the base cost where one asset is a pre-valuation asset and the other a post valuation date asset.

4. Though we would agree that the legislature would need to correct some of the anomalies some guidance should be provided in the interim.

5. Without some form of disposal rule to effectively recognise the deemed base cost on consolidation, it is unclear how this should be treated and guidance should be provided with examples.

6. Furthermore is the consolidated asset now a pre-valuation asset or a post valuation date asset?
7. Examples should also be added for subdivision and in our view, though paragraph 33 does not apply, some expression of opinion should be made as to reasonability of the use of same calculation as apportionment method.

Paragraph 6.2.5.6

8. Section 91A was deleted from the Act in 2011 yet the guide still refers to this section on page 111.

9. This matter is now dealt with under Chapter 14 of the TAA read with section 270 TAA.

10. However, it will also assist to clarify if write-off and compromise results in the same tax consequences.

11. It is noted that though the position may be technically correct, it would seem an unfair and nonsensical policy that tax results from the write-off of tax, essentially meaning that taxpayers and SARS would have to “gross up” these types of transactions. This does not happen in practice either. It is our view that this should be expressed by the guide as well as an “in practice” view by SARS.

Paragraph 6.2.6.7 (b) - Debt reduced by donation [paragraph 12A(6)(b)]

12. The reference to paragraph 12A(6) in the first sentence should be corrected to refer to paragraph 12A.

Paragraph 6.3.1 – Table 1 – time of disposal – paragraph 13(1)(g)(i)

13. Paragraph 2(a)(iii) has been deleted from the Act. The Guide should be updated accordingly or it should be clarified up to which date the paragraph applies.

Paragraph 6.3.3 – Example 2 result

14. We recommend that an explanation be provided as to why the date of disposal is 15 January 2014 to provide better guidance to taxpayers.

Paragraph 6.3.5 – Impact of time of disposal on time of accrual or incurral

15. This first paragraph is contradictory to the paragraph that follows thereafter, i.e., the first paragraph states that there are two disposal events when transfer of ownership of an asset occurs after the conclusion of the agreement while the second paragraph states that the transfer or delivery of the assets in a later year is ignored and does not qualify as a disposal in that year.

16. We are in agreement with the second paragraph, as to have two disposal events on the same transaction would result in double taxation which we do not believe is the intention of the legislature.
17. We recommend that this paragraph be re-worded and clarified to provide proper guidance to taxpayers.

**Paragraph 6.3.6 - Example 4 results**

18. The results of this example can be better illustrated. It seems to imply that there is no capital gain. It also states that “Tom becomes under an obligation to repay the R10 instalment”, however, based on the facts Ivan forfeits the initial instalment to Tom of R10.

19. Furthermore, there has been an increase in market value of the assets, therefore on that basis, one would expect CGT consequences but such consequences do not come through in the results.

20. We recommend that the results of this example be re-visited to provide better clarity to taxpayers.

**Paragraph 9.5.2. – ITC 1859 principle**

21. The CGT Guide cautions against the use of case ITC 1859 (which held that the loss on the redemption of redeemable preference shares did not result in a clogged loss) to other situations, such as the buy-back by a company of its own shares.

22. However, the CGT Guide doesn’t distinguish between a buy-back where the proceeds are a dividend or out of the company’s contributed tax capital (CTC). There are specific rules in paragraph 19 in relation to where the proceeds are a dividend, which means that the real issue is where the buy-back takes place out of CTC.

**Paragraph 9.2.2.4. - Page 323 - Example 1 - Acquisition of interest in assets and liabilities of partnership**

23. In example 1 clarity should be provided as to why the base cost is R100 000.

24. Adele acquires an asset with a value of R100 000 and a net interest of R40 000, the base cost should be the amount of expenditure incurred for the acquisition of the asset.

25. The base cost of the asset can only be R100 000 if both the cash payment of R40 000 and the incurral of the joint obligation in respect of the liabilities of R60 000 are both seen as incurral of expenditure in terms of paragraph 20.

“The fact that Ackermans rid itself of liabilities by accepting a lesser purchase price than it would have received had it retained the liabilities, does not mean in fact or in law that it incurred expenditure to the extent that the purchase price was reduced by the liabilities. At the effective date no expenditure was actually incurred by Ackermans.”

27. The CGT Guide should therefore reconcile this statement to the position taken though in commercial principle we do agree that the base cost should be R100 000.

Paragraph 9.4.8 - Page 338 - Example - Asset acquired for non-arm’s length consideration before the valuation date

28. It would be useful to detail Albie’s CGT position in the example.

Paragraph 11 – previous residence

29. The definition of primary residence in paragraph 44 refers to “resided” and “used”, therefore past tense.

30. In this respect paragraph 45 does not require that the residence must be the primary residence on date of disposal as long as it was previously a primary residence.

31. This should be stated in the CGT Guide.

Paragraph 11.8 – page 390 – Example 1 apportionment for non-residential use

32. Paragraph 49 states:

“…..the portion of the capital gain or capital loss to be disregarded in terms of paragraph 45 must be determined with reference to the period on or after valuation date during which that person or beneficiary used that residence for domestic purposes as well as to the part of that residence used by that person or beneficiary mainly for purpose other than the carrying on of a trade.”

33. Paragraph 45(1)(a) states:

“…so much of a capital gain or capital loss determined in respect of…..as does not exceed R2 million…..”

34. From the wording of the Act it is clear that that the subject of paragraph 49 is not the capital gain or loss but the capital gain or loss disregarded in terms of paragraph 45 (i.e. the primary residence exclusion).

35. In example 1 the paragraph 49 apportionment is applied to the capital gain and capital loss and no apportionment is applied to the disregarded paragraph 45 capital
gain or loss. The paragraph 25 disregarded amount is then applied to the apportioned gain or loss.

36. This example is in our view incorrect and that the R2 million disregarded gain (i.e. primary residence exclusion) should have been apportioned by 7/12 (R1 166 66).

37. The aggregate capital gain would then be R3 million less R1,17 million.

Paragraph 14

38. Guidance is sought on whether a capital gain per paragraph 80(2) can be distributed to income beneficiaries as no opinion is expressed in this regard.

39. When a capital gain arises in the trust, SARS opinion is that the capital gain vested should be reflected by a transfer of economic benefit equal to that amount such as money, an asset or a loan.

40. In this regard, a trust deed will merely determine which types of assets can be transferred to a capital or income beneficiary, but paragraph 80(2) does not require that an attributed capital gain must be reflected by an amount that is only distributable to a capital beneficiary or that it can only be distributed to capital beneficiaries.

41. Ostensibly a capital gain can therefore be distributed to income beneficiaries if the economic benefit, such as cash, is distributable to the income beneficiary in terms of the trust deed.

42. Clarity should be provided on both whether the capital gain vested needs to be reflected by a corresponding economic benefit and whether a capital gain can be distributed to an income beneficiary.

Paragraph 23.1 - page 677 - Timing of provisional tax payments

43. The CGT Guide indicates that where a taxpayer has realised a capital gain, the tax on the gain must be included in the taxpayer’s second provisional tax payment.

44. This is contrary to the Draft Provisional Tax Guide which states that if the taxpayer reasonably expects to make a capital gain during the year of assessment, the taxpayer must include an estimate of that gain for purposes of determining their first provisional tax payment.

45. The approach in the Provisional Tax guide would however give rise to practical difficulties, such as estimation of timing and proceeds of the expected disposal, hence the approach set out in the CGT Guide is preferable.

46. However, this contradiction as to timing should be noted or updated in the Provisional Tax guide.
Paragraph 23.7.15 - First example on page 697

47. The first example refers to the disposal by the CFC of a machine used in its manufacturing operation in the CFC’s country of residence and the disposal is to a resident connected person.

48. The CGT Guide concludes that the CGT gain on the disposal of the machine must be imputed to the resident shareholder, because it is the disposal of goods to a resident connected person, which is not exempt under the normal foreign business establishment rule.

49. We have some reservations on this conclusion.

50. Firstly, the example ignores the fact that the foreign business establishment exemption applies even where goods are disposed of to resident connected persons, if the income is attributable to a permanent establishment of the CFC. A manufacturing operation could well constitute a permanent establishment, in which case the gain would remain exempt from imputation.

51. Secondly, the application of the term “goods” to a machine used in a manufacturing operation is unreasonably wide. If it is SARS’ intention to apply the term “goods” to capital assets, then a specific definition should be included in the Eighth Schedule.

52. Thirdly, the example appears to ignore the 5% imposition of tax in the tax haven. Although the foreign tax may not affect the imputation of the capital gain, it is our view that the example should indicate how the 5% imposition of foreign tax reduces the ultimate South African tax paid by Holdco.

Paragraph 24.4 - page 719

53. In the definition of “term” in the first paragraph on page 831, the words “in relation to an instrument means” are repeated in the quoted definition.

Paragraph 24.6 – Page 725 - Example 1

54. We respectfully disagree with the explanation in the solution provided for in this example.

55. No explanation is provided as to how Jane acquired a damages claim totalling R30 000 as legally that is not what happened. When the contract is breached, Jane in law is entitled to claim the return of the property by cancelling the sale agreement. No reacquisition of the asset occurs and it was never transferred even though it was disposed of per paragraph 13.

56. No claim for damages automatically exist as she can in claim in addition for damages against the purchaser in respect of damages suffered (e.g. loss of profit, legal and
estate agency fees etc.). This is however based on different particulars of claim such as per example 1 on pg.41.

57. For CGT purposes, the contract in the example gives rise to two separate CGT events (1) the adjustment of proceeds (same tax year) or gain (different tax year) and (2) the creation of right to retain the deposit on the happening of the resolutive condition which changes the nature of the deposit and why it is paid.

58. If cancelled in the same year, paragraph 35(3)(b) applies and the proceeds of R120 000 is reduced to Rnil, hence no gain. If cancelled in a subsequent year paragraph 4(b)(cc) applies. Therefore a capital gain applies in year 1 and a capital loss applies in year 2. Note that in our view the full purchase consideration becomes repayable, however due to the resolutive clause applying, the seller becomes entitled to the R10 000 as a result of that clause and not the sale. Set-off effectively applies.

59. For example if a R40 000 deposit was paid and R10 000 forfeited, the repayment would be R40 000 as that pertained to the purchase price of the house and R10 000 debt is created by the resolutive clause. By set-off only R30 000 becomes repayable.

60. In respect of the right of claim of R10 000, the proceeds is the R10 000 retained and the base cost would be any amount incurred, such as legal fees that were incurred in creating the right. Should one fee have been paid for the creation of the right and sale of the house apportionment would have to be applied.

Yours faithfully

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The South African Institute of Chartered Accountants