30 June 2005

South African Revenue Service
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PRETORIA
0001

BY E-MAIL: cgt@sars.gov.za

Dear Sir

COMMENTS ON THE DRAFT COMPREHENSIVE GUIDE TO CAPITAL GAINS TAX

We refer to the call for comment that was placed on your website recently regarding the draft Comprehensive Guide to Capital Gains Tax (“Guide” and “CGT”). Set out below please find SAICA’s comments on the above-mentioned document, which have been provided by SAICA’s National Tax Committee.

At the outset, we would like to compliment SARS on producing a comprehensive and well thought-out document.

1. Chapter 1

Paragraph 1.5

The first sentence states “The application of scarce resources to tax planning and tax avoidance is clearly a dead weight loss to society”. The sentence is, with respect, made from the blinkered perspective of SARS with regard to the tax planning aspect of the comment.

Investors in any country are primarily concerned with their after tax return. It is a well known fact that tax advisors the world over are called upon to assist in tax planning and legal tax avoidance in order to maximise the after tax return to investors. Clearly this is something that SARS would prefer to see non-existent in South Africa. However the reality is that as long as we seek to attract both local and foreign investors into our economy and there remains a system of taxation, tax planning and legal tax avoidance will continue. Often the decision to proceed or not with an investment depends on tax planning to achieve the required return for the investors. Given that this is a SARS
2. Chapter 3

Table 1 on page 33, dealing with the inclusion, statutory and effective CGT rates for 2005, should be updated to reflect the rates for 2006 given that the draft is to be released after the end of the 2005 tax year. This comment is especially relevant in view of the fact that the corporate tax rate has reduced from 30% to 29% for 2006.

3. Chapter 4

3.1. The last sentence in paragraph 4.1.2 dealing with the definition of “asset” starts off with “Examples include personal liberty, personal authority, and rights flowing form…”. The word “form” should read “from”

3.2. In paragraph 4.1.6 dealing with the definition of “ruling price”, it is unfortunate that the Guide does not address the following practical problem with the definition of ruling price:

The ruling price is defined to mean the last traded price of a financial instrument unless there is a higher bid or a lower offer subsequent to the sale, in which case the price of that higher bid or lower offer will prevail as the ruling price.

In order for there to be a sale the offer price and bid price would have to be equal. After the last sale, it is most definitely conceivable to have a higher offer price with a lower bid price; hence there would not be a sale at these prices. Assume that a sale at R100 was concluded at 4pm and subsequently the offer price was R102 with a bid price of R99. In these circumstances the Guide is not helpful as to whether the ruling price will be deemed to be the R99 or the R102. Some clarity should be provided in this regard.

It is also not clear what the ruling price would be if the offer price was R102 but the bid price was R101 after the sale at R100.

3.3. Paragraph 4.2: Example 1 - Indirect interest of non-resident in immovable property in South Africa

The last sentence states “Where a liability cannot be linked to a particular asset, it should be allocated proportionately across the various assets.” It is not clear as to what the position would be if a liability relates to funding working capital as opposed to assets. Given a literal interpretation of the last sentence it would appear that in such circumstances, notwithstanding that the liability was incurred to fund working capital, such liability should be allocated proportionately across the various assets. We submit that in those circumstances the liability should be allocated only to current assets, being debtors and trading stock.
4. Chapter 8

4.1. Paragraph 8.5

On the second last and last lines of that paragraph, the expressions “(R80)” and “(R100)” should read “(R100)” “(R120)” respectively.

4.2. Paragraph 8.6

It is stated in the third bullet point that interest is included but raising fees are excluded by para 20(2)(a). Because the closing words to para 20(2) refer to “other than borrowing costs and expenditure contemplated in subparagraph (1)(g)”, we submit that if the raising fees are actually paid to the lender, as they sometimes are, the raising fees would not have to be excluded because they would form part of the interest referred to in sub-para (1)(g)(iii).

4.3. Paragraph 8.7

4.3.1 On page 107, Note 1 states that the actual cost is disregarded. This note ought to refer only to item (i) in Table 2 of the previous page – it does not apply in all circumstances, i.e. only to section 8A or 8C gains. In all other cases the actual cost is included.

4.3.2 The point raised above is clarified in the explanatory note to example 1 on page 108. But there, too, the word “disregarded” is used. In both cases this is the wrong description and the correct description, as later clarified in the explanatory note, is that the cost is excluded in terms of para 20(3)(a), which is not the same thing as saying it is disregarded.

4.3.3 Also in example 1, under the subheading “Result” it gives the impression that both the section 8A gain and the capital gain are determined during the year ending 28 February 2007, whereas the former is determined during the year ended 28 February 2003.

4.4. Paragraph 8.11

In example 1 on page 111, it is never a good idea to choose a midpoint amount, because one does not know which (in this example) R5 000 one is referring to. Rather state that Vlok agrees to accept R6 000 in which case the base cost would then be R46 000.

4.5. Paragraph 8.18

The last sentence in the last paragraph on page 122 does not read clearly. We suggest that the readability would be improved by stating:

“Proceeds (P) may be higher than market value (MV) but both P and MV are lower than expenditure before residence; or

MV may be higher than P but both MV and P are lower than expenditure before residence.”
4.6. Paragraph 8.19.1

In the third paragraph there could be a possible misinterpretation that identical assets are automatically excluded from paragraph 25(1), because it reads: “are applicable are excluded from this paragraph.” To make it clear that paragraph 32(3A) applies at the election of the taxpayer, it should instead read: “are made applicable by the taxpayer are excluded from this paragraph”.

4.7. Paragraph 8.20.1

In the last bullet point, again the impression is given that para 32(3A) is compulsory. Accordingly, after the expression “whose base cost is” in the last line, we suggest adding and the words: “at the election of the taxpayer”.

4.8. Paragraph 8.20.3

The statement in the second paragraph taxpayers “will have to give serious consideration to valuing their assets within the three-year period” is no longer relevant given the timing of the issue of this Guide.

4.9. Paragraph 8.20.4

We have reservations with the approach taken in 8.20.4 that one cannot use the time-apportionment base cost (TAB) for self-generated goodwill.

4.9.1 Such goodwill would arise where a business is started by the business-owner, as opposed to being acquired by it. It is therefore not correct to state that the date of acquisition is not known – on a practical, business sense approach the date of acquisition will generally commence when the business commences, and therefore it will commence in the year in which it is started.

4.9.2 Also, stating that it is problematic to identify the expenditure giving rise to goodwill is not necessarily correct. Symbol “B” in para 30 of the Eighth Schedule refers to expenditure “allowable in terms of paragraph 20”. It is not difficult to determine what expenditure is allowable. The fact that there may be circumstances where, from a practical point of view, it may be difficult actually to identify the costs, is an accounting and record-keeping problem. It is not, however, a legal problem, and legally it is not difficult to identify the expenditure giving rise to the goodwill – it will be expenditure less that excluded under para 20(3)(a). The fact that there may be practical difficulties in certain circumstances is not a reason for SARS to adopt a view that no-one will be entitled to use the time-apportionment basis for self-generated goodwill.

4.9.3 It also makes something of a nonsense to suggest that people have the choice of either using the time-apportionment or market value basis, and then to adopt this kind of restrictive interpretation.

4.9.4 The approach is also somewhat inconsistent with the approach taken on the very next page in the paragraph just preceding 8.20.6, where it is stated that an asset acquired for no consideration, for example, by
donation or inheritance, will have a cost of nil and therefore the TAB method can be used. There is surely very little difference in principle between acquiring an asset for no consideration and developing the asset oneself.

4.9.5 Finally, the approach could lead to anomalies. For example, take the situation of a taxpayer who starts a business and at a later stage acquires another business, for which goodwill is paid (prior to 1 October 2001), with the newly-acquired business simply being merged into the existing business. After 1 October 2001 the entire, merged, business is sold for a large goodwill. Clearly the goodwill disposed of is made up of an amalgam of (a) the goodwill on the original business, (b) the purchased goodwill, and (c) the growth in goodwill on the latter. How will SARS seek to apply its approach in 8.20.4 in these circumstances?

4.9.6 In summary, SARS’ approach here is based on certain envisaged difficulties that may or may not arise, depending upon the circumstances but the approach is not sound, based on legal interpretation. And it is the legal interpretation that is paramount here. (This was the approach taken by the SCA in the as-yet unreported decision in Chipkin (Natal) (Proprietary) Limited v C: SARS at para 16 of the judgment.)

4.10. Paragraph 8.20.6

4.10.1 In the paragraph just before the example on page 131, it should be clarified that it is only the expenditure incurred after 1 October 2001 that must be known – if market value is adopted it is irrelevant whether or not the original cost is known.

4.10.2 In the example on page 132, under step 2, there is a typing error. The expression “1R50” should read “R150”.

4.11. Paragraph 8.21.1

In the last bullet point, after the word “determined” there should be a comma and there should be added the words: “at the election of the taxpayer”.


4.12.1 In example 5 on page 138, the word “adopted”, which is used twice (in the first sentence under “Facts” and again in the first sentence under “Results”), should read “determined” in each case.

4.12.2 In example 6 on page 138, it is stated that the facts are the same as in Example 1, but this should read Example 5 not 1.

4.13. Paragraph 8.22.4

In footnote 120, the word “worksheet” is spelt incorrectly.

4.14. Paragraph 8.23.2
4.14.1 The last sentence in the first paragraph states that “in certain circumstances the Commissioner, after consultation with the recognised exchange and the Financial Services Board, must determine the market value of a financial instrument”. For the benefit of taxpayers, it might be useful to list all the circumstances where the Commissioner is required to consult with the recognised exchange.

4.14.2 In the third paragraph, it is stated that, in the case of suspended listings, the shares are considered to have “a value of zero unless subsequently revised by the Commissioner for SARS upon receipt of a properly motivated representation”. It would be useful if the Guide could clarify what would constitute a “properly motivated representation” to assist the taxpayers preparing these representations.

4.15. Paragraph 8.23.3

4.15.1 As a preamble to this paragraph, it would be useful to explain to the users of the Guide why different valuation methods are used for financial instruments that are listed in the Republic and those not listed in the Republic.

4.15.2 Surely, if the taxpayer can provide a properly substantiated Volume Weighted Average Price (VWAP) instead of using the ruling price, the results should be acceptable to SARS, even if the values cannot be published by SARS (for practical reasons)?

4.16. Paragraph 8.23.7

The Guide only elaborates on the valuation of a controlling interest in a listed company and no comment is given on the valuation of a controlling interest in an unlisted company. It would be useful if the Guide could elaborate here on how to value a controlling interest in an unlisted company or provide a cross-reference to where this matter is explained; otherwise the Guide appears to be incomplete.

4.17. Paragraph 8.23.9

4.17.1 The last sentence in the second paragraph states: “A non-resident who is not required to lodge a tax return because of an absence of SA source income, and who holds SA immovable property will only be required to submit a return (and the CGT 2 form) when the property is disposed of”. The Guide does not address the question of an SA resident who is not required to submit a tax return in terms of the Act, e.g. where the local income threshold is below R60 000. SAICA has recommended in the past that a simplified form should be introduced for this purpose.

4.17.2 Table 1 – High value assets in respect of which proof of valuation must be submitted: It is suggested that it be explained in this table whether or not “intangible assets” includes goodwill.
In the first paragraph below Table 1, the second sentence should read, “if the market value is translated into Rands (not rand).

Example 2 is incomplete. In the last paragraph, the assets in respect of which a valuation must be submitted appear to have been mistakenly omitted from the box.

4.18. Paragraph 8.23.10.1

The inclusion of the last paragraph is considered unfortunate, as it is more intimidating than helpful. The paragraph should rather include circumstances that will be taken into account by SARS in coming to a conclusion that a valuation has been “backdated” or “inflated”. The paragraph should also elaborate on the liability of a taxpayer that has simply accepted a valuation as performed by a professional valuer and clarify whether such taxpayer will be liable if it turns out that the valuation has been inflated.

4.19. Paragraph 8.23.10.2

It will be useful if the Guide could include a list of items in a tabular format that would render a valuation valid or invalid.

4.20. Paragraph 8.23.12

This paragraph should be more extensive and explain the process, including timelines for responses and manner of correspondence that will be entered into by the Commissioner, before an adjustment to a valuation could be made.

4.21. Paragraph 8.24.6.1

The last bullet point refers to “a taxpayer who deliberately omits post-valuation date expenditure”. The Guide should document under this paragraph what the implications will be for a taxpayer that, for some reason (poor record keeping, fire, etc), was unable to determine the amount of post-valuation expenditure. In other words, will an estimate be acceptable where a taxpayer honestly cannot determine post valuation expenditure, as opposed to one that deliberately omits this information?

4.22. Paragraph 8.24.6.2

This paragraph appears to imply that all transactions of this nature are entered into to avoid tax, hence the reference to section 103. The paragraph should distinguish those transactions that are validly entered into for commercial or other purposes other than to avoid tax.

4.23. Paragraph 8.24.10.1

The second bullet point should read:

“• The asset must be a depreciable asset in respect of which capital allowances were allowable,” (not “claimed”).
4.24. Paragraph 8.25.1

This paragraph explains the treatment of VAT where a vendor was entitled to claim input tax credit in terms of section 16(3) of the Value-Added Tax Act. The paragraph should also explain the situation where the vendor was entitled to claim VAT but for some reason, did not claim the input tax credit, i.e. whether the input tax must then be taken into account in the market value.

4.25. Paragraph 8.25.2

The last row of the first column has no reference to the relevant paragraph of the Eighth Schedule; reference should be made to para 31(3).


Unfortunately the Guide does not elaborate on this issue. Again, it would be useful if the treatment or practice likely to be applied by SARS could be explained more fully.

4.27. Paragraph 8.27.9

It would be useful to list the circumstances in which a transaction would not be regarded as a part-disposal of a separate business, and to elaborate on what impact the closure, as opposed to the disposal, of a separate business unit would have on the remaining goodwill.

5. Chapter 9

5.1 Paragraph 9.1.1

In the section dealing with Specific inclusions, the second bullet point should be amended to state “any amount received by or accruing to a lessee from the lessor for improvements effected to the leased property”.

5.2 Paragraph 9.2.2.4

5.2.1 In example 3 - Admission of a partner, the last sentence should read “A, B and C each receive R7 500 of the amount paid by D (R22 500/3)”.

5.2.2 In example 7 – Depreciable asset, it is stated that the individuals claim section 12C allowances in their 2002 returns of income and that one of the partners decides to sell his share in the helicopter in 2003. Strictly speaking, the partner selling his share would be entitled to a further section 12C allowance in 2003. This would alter the calculation in the sense that the recoupment would amount to R400 000 (i.e. R200 000 x 2) and the proceeds would amount to R650 000. Similarly, the base cost would amount to R600 000. The capital gain would still remain at R50 000.

5.3 Paragraph 9.2.2.5
Clarification should be provided as to what would constitute a “large partnership”. It seems unfair that only “large partnerships” would qualify for this dispensation. The test should rather be formulated on the basis of whether or not new partners are required to pay for goodwill and whether retiring partners are paid goodwill. This would remove the unfair application of the connected person definition i.e. all partnerships would qualify whether large or not.

5.4 Paragraph 9.3

We suggest that the second paragraph be reworded as follows

“The paragraph applies in the case of a trust or company, the interest in which or shares of which, are owned directly or indirectly by a natural person, and
• that trust or company owns….; and
• there is a decrease in the value…; and
• the interest in the trust…;
that person……”.

5.5 Paragraph 9.4

5.5.1 We suggest that the heading be amended to read “Disposal by way of donation, consideration not measurable in money and transactions between connected persons not at an arm’s length price”.

5.5.2 On page 206, the paragraph dealing with “Pre-valuation date disposals” states that paras 29(4) and (8) provide that valuation date valuations must be carried out within 3 years of valuation date. This should be amended to reflect the correct position i.e. that para 29(4) allows for a 2 year period from valuation date which was extended by a further year in terms of para 29(8).

5.6 Paragraph 9.5

5.6.1 In example 1 on page 208, we suggest that the reference to Subco be changed to “Sco”. This would remove the uncertainty as to whether Holdco and Subco formed part of the same group of companies prior to the transaction and illustrate that they only form part of the same group of companies after the transaction and as a result of the transaction.

5.6.2 In example 2 on page 209, we make the same suggestion in regards to Subco Trust i.e. to call it the Sco Trust.

6. Chapter 10

6.1. Paragraph 10.2

Table 1: Under section 24M(2), the effect should read “Deems unquantified amounts not to be incurred until they are quantified”.

6.2. Paragraph 10.2.1

We recommend that consideration be given to defining more clearly what is meant by “cannot be quantified”.

6.3. Paragraph 10.3.2

The provision applies to the scenario where “all” the proceeds have not accrued. Clarity is needed as to what level of certainty would need to be provided by the taxpayer that “all” proceeds have in fact accrued.

6.4. Paragraph 10.3.3

6.4.1 Example 2 on page 218: under the Facts, the amounts ultimately received should read “…R400 000, R200 000, R150 000 etc”.

6.4.2 Example 4 on page 219: The facts indicate that Lance sells the property to Trudy after the 2007 instalment. This would mean that the base cost would be R190 000 plus R200 000 i.e. R390 000 and not R540 000 as indicated in the solution. The capital gain would therefore amount to R230 000 (R620 000 less R390 000). The solution can be amended or alternatively amend the facts to refer to a disposal after the 2008 instalment has been paid.

6.5. Paragraph 10.3.4

Clarity is needed as to what would constitute acceptable proof that no further proceeds would accrue.

6.6. Paragraph 10.4.2

The third sentence should read “…consideration in respect of…”.

7. Chapter 11

7.1. Paragraph 11.2.4.1

The comments in para 11.2.4.1 regarding “ordinarily resident” relate to the definition of “resident” in the Income Tax Act or context and do not have any influence on the residence (home) of the taxpayer. The quote from Cohen’s case and the sentence “...these tests do not seem appropriate...” are not relevant to the issue of primary residence. It is clear that a non-resident would also qualify for para 48 and 50.

A residence is clearly something in which a person resides and that person may so reside even if he or she is not a resident of the RSA.

7.2. The same comments apply to example 1 in paragraph 11.6

7.3. Paragraph 11.3

7.3.1. In the first paragraph under the definition it is stated that a tent would possibly not qualify as a residence. It is interesting to note,
however, that in the Value-Added Tax Act, the definition of “commercial accommodation” does include a tent.

7.3.2. In the example on non-qualifying appurtenance, it is not clear why the second floor is not something to be enjoyed with the residence and why it does not belong to the residence.

7.4. Paragraph 11.4.3

In the example on page 229 it is stated that “it is accepted that the Cape Town home is his primary residence”. Paragraph 45(3) does not prescribe which one residence must be treated as the only one and it is obviously up to the taxpayer to make an election in circumstances where more than one residence was used as a primary residence. This should be clarified in the example.

7.5. Paragraph 11.4.4

In example 1 on page 230 it is assured that the persons are not spouses. This should be clearly stated.

7.6. Paragraph 11.5

In the example on page 234 it is stated: “Please note that the apportionment in the first part of this calculation has been assumed.” It would be useful to have some guidance on this matter as it is a practical problem that will present itself in these circumstances. It is stated at the end of the example that acceptable bases may be used, but no indication is provided of what bases have been used in the example. This is particularly relevant where farm residences are concerned (refer to para 11.10).

7.7. Paragraph 11.6

Refer to the comment made in 7.1.

7.8. Paragraph 11.7

The fourth item in paragraph 11.7 could be referenced to Chapter 16.

8. Chapter 12

8.1. Paragraph 12.4

On page 249, under “The employee/director exclusion”, in the third paragraph the following statement is made:

“Where an employee or director leaves the employer and takes over the policy, the value of the policy at the date of termination will be included in the employee’s or director’s gross income in terms of para (i) of the definition of gross income as a fringe benefit.” (Our emphasis added).

The inclusion in gross income via paragraph (i) is an interesting contention as it has always been generally accepted that such awards form part of gross income in terms of paragraph (c) or (d) of that definition, which leads to the
R30 000 exemption and rating formula application in terms of section 7A(4A) in the appropriate circumstances (the paragraph (i) inclusion, it is submitted, does not debar the R30 000 exemption or application of section 7A(4A)).

However, paragraph 20(1)(h)(ii)(bb) specifically refers to paragraph (i) inclusions which makes the application of this paragraph not applicable should paragraph (c) or (d) of the gross income definition apply. In any event paragraph 20(1)(h)(ii)(bb) would only be relevant if the exclusion did not apply.

8.2. Paragraph 12.6

8.2.1 Example 1 on page 257 is technically incorrect because each taxi is a separate CGT asset. The example should state that each taxi has an equal cost and equal proceeds (although this is not realistic). The buyer of a business (lock, stock and barrel) would surely have paid some goodwill (which is a separate CGT asset).

This example could therefore enhance the misconception that the “business” is a CGT asset.

8.3. Paragraph 12.7

8.3.1 In example 1 on page 258, it is submitted that the logic is not correct. The proceeds on exercise of the option is not the difference between the strike price and the market value of the underlying asset because no amount was received or accrued from that disposal (the gain is an unrealised gain which does not constitute an amount received or accrued).

8.3.2 The purpose of para 58 is to disregard the loss on the exercising of the option and to allow that loss to form part of the cost of the underlying asset (in fact example 2 confirms that this is the correct approach).

Therefore.
Proceeds from disposal of option (on exercising) -
Base cost 100 000
Capital loss R100 000

8.4. Paragraph 12.13

It is suggested that an example be given to illustrate this exclusion. The most obvious situations are excluded from the concession.

9. Chapter 14

9.1. Paragraph 14.1
Table 1 highlights a significant interpretation issue relating to the interaction between personal rights, real rights and vested rights in the context of trusts. It is true that a vested beneficiary will have a personal right against the trustees of a trust to claim transfer of a trust asset at some point in time depending on the nature of the vested right (legal ownership of the trust assets vesting in the name of the trustees).

When the asset is transferred by the trustee to the beneficiary the submission is made in the Guide that, from the beneficiary’s perspective, he or she has disposed of a personal right for a real right (the asset).

This is based on the disposal rules found in para 11(1). Clearly, from the trustee’s perspective (and therefore the trust) no disposal takes place in terms of para 11(2)(e). But it could be contended that para 11(2)(e) should be widely interpreted so that the conversion of the beneficiaries’ personal right to a real right does not represent a disposal (the trigger for the disposal being the transfer of the asset by the trustee to the beneficiary).

This approach certainly makes the rules less complex (it would also be in line with the wind-up trust position).

This approach would have an impact on examples in the Guide. The solution to example 1 on page 303 could thus be as follows:

“The sale of the interest in the vesting trust is equivalent to the sale of the shares resulting in a capital loss of R80 000. The distribution of R100 000 to Willem is for the disposal of the shares resulting in a capital gain in his hands of R80 000.”

9.2. Paragraph 14.8

In the example on page 299, item 3 should read “Jane is unrelated to John but is also a beneficiary (not “member”) of the John Smith Trust”.

9.3. Paragraph 14.11.4

9.3.1. In example 2 on page 304, based on the above approach the solution could read:

“Xaner has a capital loss of R80 000.

Yanga has no gain or loss but has a base cost of shares of R20 000. Yanga has an unrealised capital gain and CGT is deferred but paragraph 38 and 39 anti avoidance rules would come into operation assuming the parties were connected persons”.

9.3.2. Example 3 on page 304/305, is confusing, particularly the statement that the trustees distribute the proceeds from the loan to Zahir as a non-refundable payment in respect of her interest in the trust. What does this mean? How can she receive R150 000 when her loan account in the trust is R100 000 (or trust capital is R100 000) unless
she is borrowing R50 000 from the trust (can she dispose of her interest to the trust?)?


9.4.1. In example 1 on page 309, why would someone pay R150 000 for a contingent right to an asset unless the trustees have agreed to vest the asset in the hands of the new beneficiary? Surely the reasoning for the base cost to be nil is because the interest is worthless until vesting takes place?

9.4.2. A general comment is that the examples tend to use a lot of “slang”. It is suggested that the wording be more formal.

10. Chapter 15

10.1. Paragraph 15.1

Application of the in duplum rule refers. It is imperative that fiscal legislation be underpinned by the same considerations of economic reality, public interest and protection of borrowers. There is no justification for limiting the application of this rule in the determination of the quantum of interest to be attributed to a donor in terms of the so-called attribution rules.

10.2. Paragraphs 15.4 and 15.5

In respect of pre-valuation date assets, where interest free loans used to fund these assets are considered ‘continuing donations’, an equitable consequence would be for the pre-valuation date interest computed, to be allowed to be set off against the capital gain attributed to the donor.

10.3. Paragraph 15.6

Where a vesting is revoked in a subsequent year and there is no fraud, misrepresentation or non-disclosure of material facts on the part of the trust, the donor or beneficiary, for all practical purposes the quantum of the capital gain in question should only be included in the tax return of the donor/trust in the year in which the beneficiary’s rights are revoked.

11. Chapter 16

11.1. Paragraph 16.1.1

This chapter states that there may be capital gains consequences for the heirs or legatees. It is clearly only with respect to their base cost that there is any implication for the heirs. Capital gains consequences will only arise if they dispose of the relevant assets.

11.2. Paragraph 16.1.2.3

We disagree with the statement in the last sentence that where market value is adopted it must be reduced by the value that was allowed under section 11(a).
This is not in accordance with para 25. The market value must be taken as the base cost with no adjustment.

11.3. Paragraph 16.1.2.4

The same comment as point 11.2 is relevant to this paragraph (again in the last sentence).

11.4. Paragraph 16.1.3.3

This paragraph could be cross-referenced to the relevant parts in Chapter 11.

11.5. Paragraph 16.1.4

Example 2 on page 328 is incorrect in its treatment of the assets transferred to the spouse. We submit that the intention is that there is no disposal and therefore that there is no capital gain or loss to roll over. Whilst it may lead to the same result, it is in contradiction with para 40 and should be ignored in the capital gain calculation.

11.6. Paragraph 16.2

The provisions of para 41 may not solve all the problems. It is a requirement of para 41 that there must be cash in the estate to pay at least 50% of the duty. This would then mean that in any estate where there is insufficient cash, the option would not be available and assets will have to be realised. Although the notes and example are correct, one wonders if some sort of relief may not be warranted in these circumstances.

12. Chapter 17

It is not certain whether SARS’ practice of treating an individual’s insolvent estate as a special trust – thereby denying him or her the benefit of the primary rebate and the interest exemption - is supportable. The section 1 definition of a trust speaks of “any trust fund ... administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust, or by agreement or under the will of a deceased person”. The administrator of an insolvent estate is not such a person (sequestration of the estate is effected by an order of court).

13. Chapter 18

13.1. Paragraph 18.3

Paragraph 76(1)(b) requires that where a capital distribution is received after valuation date, the amount of the capital distribution must be treated as proceeds when the share is disposed of. Paragraph 76(2) provides that if the weighted average method is used for shares that are identical assets and a capital distribution is received after valuation date, the amount must be treated as a reduction in the base cost when the capital distribution is received or it accrues.
Practically, para 76(2) makes sense and even where para 76(1)(b) applies, it makes practical sense to reduce the base cost of the relevant asset which effectively increases proceeds. This issue is not addressed in the Guide. It may be useful to address this, if SARS agrees that base cost could be reduced in para 76(1)(b) circumstances, rather than keeping records of additional proceeds until the share is disposed of.

13.2. Paragraph 18.4

On page 354 a space is required before the heading: “Disposal and time of disposal”.

14. Chapter 19

14.1. This chapter is difficult to follow. The inclusion of clear headings and numberings would add clarity.

14.2. Paragraph 19.1

In Table 1 under the column headed “Example” and on the line relating to paragraph 43(1) and (2), the examples should be more clearly set out. For example it should state:

“These paragraphs apply to:
   • Immovable property situated outside South Africa;
   • Movable property forming part of a permanent establishment situated outside South Africa of a resident;
   • Foreign loan, advance or debt owing to the SA resident.”

14.3. Paragraph 19.2

14.3.1 On page 368 reference is made to “The list of recognised exchanges in countries outside the Republic…”. We suggest that the list should be attached as an Annexure.

14.3.2 Table 4 on page 371 is very similar to Table 1. We suggest that the two tables be merged.

14.3.3 The wording in Table 5 and Example 3 on page 372 is very difficult to understand and should be revised.

14.3.4 In Table 7 on page 377, under the column headed “Paragraph”, the second line should read (a)(ii) (not (i)).

15. Chapter 20

15.1. The section does not make it clear that the provisions are primarily directed to natural persons and trusts under certain circumstances, and not companies. This should be spelt out.
15.2. The set-out of the chapter is difficult to follow. We suggest that clear headings and numberings would add clarity.

15.3. Paragraph 20.1:
The wording and set-out of this page should be improved.

16. Chapter 21

16.1 As section 103 is being revised, the Guide will have to be amended to take into account the new provisions.

16.2 The examples provided in terms of value shifting and dividend stripping are simple. If taxpayers intend to enter into such transactions they are likely to be far more elaborate schemes than the examples illustrate.

17. Chapter 23

17.1. Paragraph 23.7.14
We disagree with the comment that the term “business establishment” is very similar to a “permanent establishment”. This comment should be deleted.

17.2. Paragraph 23.7.15.2
The use of the words “exception” and “exemption” must be clarified and placed in context. In certain instances it may be appropriate to use the term “exception”, e.g. as it relates to the passive income exception, but the word “exemption” should be used in the context of the “banking, insurance, financial service, etc”. Overall, the term “exemption” will be more useful.

17.3. Paragraph 23.7.20
In the last sentence of last paragraph, insert a comma after “... the 50%”.

18. Chapter 24

Paragraph 24.1
In the example on page 448, change the word “Proceed” to “Proceeds” in the top line of the example.

20. General Comments

21.1 In the opening paragraph as well as elsewhere in the Guide, there is a tone that could be construed as implying that all taxpayers are inherently dishonest. We suggest that wording such as “to avoid income as being treated as capital” should rather be used.
21.2 We suggest that consideration be given to addressing the issue of how to deal with the situation where a South African donor to 1. a local trust and 2. an offshore trust, emigrates. Does this trigger a disposal in the hands of the donor and as a result should the resultant gain be taxed in the hands of the donor based on the market value of the attributable assets in the trust the day before s/he leaves South Africa?

21.3 The Guide does not deal with the group relief provisions in Part III of the Act, i.e. sections 41 to 47 inclusive. As these are an integral part of the whole CGT scenario, we believe that it would be appropriate for the Guide to deal with this Part as well.

CONCLUSION

I trust that these comments are helpful. Please do not hesitate to contact me if you wish to discuss any of these issues.

Yours faithfully

J Arendse

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