



Legal & Policy

Income Tax

Guide on Valuation of Assets for Capital Gains Tax Purposes (Issue 3)



South African Revenue Service

Guide on Valuation of Assets for Capital Gains Tax Purposes

Preface

This guide provides general guidance on valuations. It does not go into the precise technical and legal detail that is often associated with tax, and should not, therefore, be used as a legal reference. It is not an “official publication” as defined in section 1 of the Tax Administration Act 28 of 2011 and accordingly does not create a practice generally prevailing under section 5 of that Act. It is also not a binding general ruling under section 89 of Chapter 7 of the Tax Administration Act. Should an advance tax ruling be required, visit the SARS website for details of the application procedure.

For more information you may –

- visit the SARS website at **www.sars.gov.za**;
- visit your nearest SARS branch;
- contact your own tax advisor or tax practitioner;
- contact the SARS National Contact Centre –
 - if calling locally, on 0800 00 7277; or
 - if calling from abroad, on +27 11 602 2093 (only between 8am and 4pm South African time).

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Glossary

In this guide unless the context indicates otherwise –

- “**CGT**” means capital gains tax, being the portion of normal tax attributable to the inclusion in taxable income of a taxable capital gain;
- “**Eighth Schedule**” means the Eighth Schedule to the Act;
- “**Estate Duty Act**” means the Estate Duty Act 45 of 1955;
- “**paragraph**” means a paragraph of the Eighth Schedule;
- “**section**” means a section of the Act;
- “**Tax Administration Act**” means the Tax Administration Act 28 of 2011;
- “**the Act**” means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Introduction

The rules for determining capital gains and losses for CGT purposes are largely contained in the Eighth Schedule and apply on or after 1 October 2001.

A capital gain or loss on disposal of an asset is determined by subtracting its base cost from the proceeds.

Pre-valuation date assets

The base cost of an asset acquired before valuation date is equal to its valuation date value plus any further allowable expenditure incurred on or after the valuation date under paragraph 20.

The valuation date is generally 1 October 2001 but for certain previously exempt entities it can be a later date. For example, the valuation date of a public benefit organisation approved by the Commissioner under section 30(3) is the first day of its first year of assessment commencing on or after 1 April 2006. The valuation date of a recreational club which applied for approval under section 30A on or before 31 March 2009 is the first day of its first year of assessment ending on or after 1 April 2007.

A recreational club approved under section 10(1)(d)(iv) that failed to apply for approval under s 30A by 31 March 2009 will have a valuation date equal to the first day of its first year of assessment ending after 30 September 2010.

Three methods are potentially available for determining the valuation date value of a pre-valuation date asset, namely –

- $20\% \times (\text{proceeds less allowable expenditure incurred on or after valuation date})$ (generally used when no records have been kept and no valuation was obtained at valuation date);
- market value (see 2); or
- Time-apportionment (This method of calculating the value of the asset takes into account how long you have owned it before and after valuation date.

Post-valuation date assets

The base cost of an asset acquired on or after valuation date is generally equal to the qualifying expenditure listed in paragraph 20, which includes amongst other things, the cost of acquiring or improving the asset and specified costs of acquisition and disposal. In some situations, however, a post-valuation date asset will be deemed to be acquired at market value, such as when it is acquired by donation or at a non-arm's length price from a connected person.¹ Assets acquired by inheritance from a resident testator are deemed to be acquired at market value on the date of death of the testator plus any further qualifying expenditure incurred by the executor² while an asset inherited from a non-resident is deemed to be acquired at market value.³

In some circumstances a taxpayer is deemed to dispose of an asset for an amount received or accrued equal to market value. Some examples include –

- the disposal of an asset by donation, for a consideration not measurable in money or to a connected person at a non-arm's length price (paragraph 38);
- cessation of residence (section 9H);
- commencement of residence [paragraph 12(2)(a)];
- asset ceasing to be part of a person's permanent establishment otherwise than by disposal under paragraph 11 [paragraph 12(2)(b)];
- conversion of a capital asset to trading stock [paragraph 12(2)(c)];
- asset that becomes a personal-use asset [paragraph 12(2)(e)]; and
- upon the death of a person (paragraph 40).

2. Market value on valuation date

Paragraph 29 contains a number of transitional measures which apply to the valuation of assets on 1 October 2001. To the extent that the rules in paragraph 29 do not apply, the rules in paragraph 31 will apply.

2.1 Time limit for performing valuations

All valuations as at 1 October 2001 were required to be carried out by 30 September 2004.⁴ Under paragraph 29(4), a public benefit organisation or recreational club may not adopt or determine the market value of an asset unless it has valued the asset within two years from the valuation date.

Failure to comply with the time periods for performing valuations means that the market value method cannot be used to determine the valuation date value of the asset.

The asset must have been valued according to the factors prevailing on valuation date such as its condition at the time and prevailing economic conditions.

The requirement to value assets by 30 September 2004 does not apply to those assets whose prices as at 1 October 2001 were published in the Government Gazette such as shares listed on the JSE and participatory interests in collective investment schemes.

¹ Paragraphs 20(1)(h)(vi) (acquisition from non-resident) and paragraph 38.

² Paragraph 40(2)(b).

³ Paragraph 20(1)(h)(v).

⁴ This deadline was originally 30 September 2003 but was extended to 30 September 2004 by the Minister of Finance in GG 26026 of 20 February 2004.

Similarly, public benefit organisations and recreational clubs are not subject to a time limit for valuing financial instruments listed on a recognised exchange or participatory interests in collective investment schemes in securities or property.

2.2 Who may perform valuations?

The Act does not prescribe who may perform valuations. This task is the responsibility of the taxpayer and the onus of substantiating a valuation rests with the taxpayer. The taxpayer may, however, appoint a professional person to assist with a valuation.

2.3 Methods to be adopted in valuing certain assets

The table below sets out the methods to be used for valuing assets on valuation date.

Table 1 – Market values on 1 October 2001

Paragraph 29	Type of asset	Market value
(1)(a)(i)	Financial instruments listed on a recognised exchange in South Africa	Prices supplied in GG 23037 of 25 January 2002 and on SARS website under Types of Tax/Capital Gains Tax/Market values. Price based on five business days preceding 1 October 2001
(1)(a)(ii)	Foreign financial instruments listed on a recognised exchange outside South Africa	The ruling price on that recognised exchange on the last business day before 1 October 2001
(1)(b)(i)	Participation rights and "property shares" in South African collective investment schemes	Average "sell" price for the last five trading days before 1 October 2001. Prices supplied in <i>Government Gazette</i>
(1)(b)(ii)	Participation rights in foreign collective investment schemes	Same as for South African collective investment schemes, except based on last trading day before 1 October 2001. If no price quoted, the price which could have been obtained upon a sale of the asset between a willing buyer and a willing seller dealing at arm's length in an open market on 1 October 2001
(1)(c)	Any other asset	The market value determined under paragraph 31
(2) and (3)	Controlling interest in listed company (see Example 1)	Control premium/discount determined on disposal and applied to listed price at 1 October 2001 (see conditions below)

Conditions for valuing controlling interest under paragraph 29(2)

A holder of shares will be able to value a controlling interest in the manner described in paragraph 29(2) if –

- The company is listed on a recognised exchange;

- The entire controlling interest is disposed of to a person who is not a connected person in relation to the seller and the acquirer acquires the entire controlling interest; and
- The controlling interest comprises more than 35% of the company's equity shares [paragraph 29(3)].

2.4 Submission and retention requirements

The requirements for submission of the prescribed valuation forms (CGT 2L if completed after 30 September 2004 or CGT2 / Annexure if completed before that date) and related particulars are set out in paragraph 29(5) and (6).

High value assets [paragraph 29(5)]

For certain assets the valuation forms were required to be lodged with the first return of income submitted after 30 September 2004, irrespective of whether the relevant assets had been disposed of. These categories of assets are set out in the table below.

Table 2 – Submission requirements for high value assets

Type of asset	Applies	Where market value exceeds
Intangible assets (such as goodwill and trade marks)	Per asset	R1 million
Unlisted shares	All shares held by the person in the company	R10 million
All other assets	Per asset	R10 million

See Example 2.

Other assets [paragraph 29(6)]

It is no longer required that the valuation form be submitted with the return of income reflecting the disposal of the asset concerned. Instead, proof of the valuation must be retained and submitted only when called upon by SARS to do so.

Retention requirements

The periods for which the valuation forms and any related valuation documentation must be retained are set out in section 29 of the Tax Administration Act.

A person who has submitted a return of income reflecting a capital gain or loss must retain records, books of account or documents supporting the determination of that capital gain or loss for a period of five years from the date of submission of the return.

A person who is required to submit a return but has not done so will have to retain the relevant records for at least five years after the date on which the return is eventually submitted.

A person who is not required to submit a return under the criteria set out in the annual notice to furnish returns, for example, because the sum of capital gains or sum of capital losses during the year of assessment does not exceed R30 000, must retain the records pertaining

to any capital gain or loss for at least five years from the end of the year of assessment in which the asset was disposed of.

2.5 Loss limitation rules

Paragraphs 26 and 27 contain rules to limit losses when the market-value method is used to determine the valuation date value of an asset. These rules are designed to prevent the creation of phantom losses arising from inflated valuations, but apply equally when the valuation is realistic and the market value exceeds the proceeds. For more information on this topic see the *Comprehensive Guide to Capital Gains Tax* in Chapter 8.

2.6 Burden of proof

Under section 102(1)(e) of the Tax Administration Act, the taxpayer bears the burden of proving that a valuation is correct.

The fact that a valuation was done by a qualified valuer will not prevent the Commissioner from auditing the valuation. The Commissioner may, if dissatisfied with a valuation –

- request further information or documents relating to the valuation [paragraph 29(7)(a)]; or
- adjust the valuation [paragraph 29(7)(b)]. The Commissioner's right to adjust the valuation is subject to objection and appeal [section 3(4)(h)].

The following are examples of the detail which the Commissioner may require:

Residential property

- Valuer's valuation, including basis of valuation and calculations
- Physical address
- Size of property
- Details of improvements to property
- Plans of the property as at 1 October 2001
- Details of recent property sales in the same area
- Municipal valuation of the property
- Any other information which may be relevant

Farming property

- The detail requested in the Land Bank questionnaire used for valuing immovable property on which *bona fide* farming operations are carried on is a useful aid when farm land is valued using the market-value method.
- As from 1 February 2006, Land Bank valuations no longer apply and the market value must be the fair market value as per paragraph (b) of the definition of "fair market value" in section 1(1) of the Estate Duty Act, namely, the price that could be obtained between a willing buyer and willing seller dealing at arm's length in an open market, less 30%.

Mineral rights

- Valuer's valuation, including basis of valuation and calculations
- The description of the mineral right and its registered number at the Deeds Office

- Type of mineral
- Location and extent of mineral right
- Exploitation of mineral right as at 1 October 2001
- Original cost of mineral right
- Quantification of reserves still to be mined
- Remaining life of mine
- If exploitation has not commenced, details and results of prospecting undertaken as at 1 October 2001
- Department of Minerals and Energy valuation
- Any other information which may be relevant

Note: A mineral right is a capital expense to a mining company but a revenue expense to a prospecting or exploration company. Only companies involved in mining activities, or which intend mining any areas covered by mineral rights which they possess, are required to value their mineral rights for CGT purposes.

Unlisted shares

- Valuer's valuation, including basis of valuation and calculations
- The method used will depend on the degree of control which the particular block of shares enables the holder to exercise over the affairs of the company, which may vary from full control to a small or non-existent influence.
- Possible valuation methods include the following:

Dividend-based valuations may be used for minority holdings when the company has a history of paying dividends.

Earnings-based minority holding valuations may be used in cases of influential minority holdings (concentrating on net earnings per share and price earnings ratios).

Earnings-based whole company valuations for majority holdings (concentrating on maintainable pre-tax profits, a capitalisation factor and a discount which takes cognisance of the size of the shareholding).

- Proof of shareholding
- Full description of the business carried on by the company
- The company's annual financial statements for the last three years before the valuation date
- If there are different classes of shares, documentation proving the rights of each class, in particular those concerning voting, dividends and distributions on liquidation of the company
- Any other information which may be relevant

3. Market value of assets otherwise than on valuation date

The permanent market valuation rules, as opposed to the transitional market valuation rules on valuation date, are contained in paragraph 31 and are summarised in the table below. These rules apply to –

- pre-valuation date assets not covered by the transitional valuation rules in 2;
- other occasions, such as –
 - cessation and commencement of residence;
 - death or donation; and
 - connected person transactions at a non-arm's length price.

Table 3 – Market values otherwise than on valuation date

Paragraph 31	Type of asset	Market value
(1)(a)	Financial instrument listed on a recognised exchange	The ruling price at close of business on last business day before disposal
(1)(b)	Long-term insurance policy	Greater of – <ul style="list-style-type: none"> • surrender value; and • insurer's market value (assume policy runs to maturity)
(1)(c)(i)	Participation right in a portfolio of a collective investment scheme in securities or property	Management company's repurchase price
(1)(c)(ii)	Participation right in a foreign collective investment scheme which is comparable to a collective investment scheme in participation bonds or securities	Management company's repurchase price or, if not available, selling price based on willing buyer, willing seller acting at arm's length in open market
(1)(d) read with (2)	Fiduciary, usufructuary and other like interests (see Example 3)	Present value of future benefits discounted at 12% a year over life expectancy of person entitled to asset or lesser period of enjoyment. Commissioner may approve less than 12% if justified
(1)(e)	Property subject to fiduciary, usufructuary or other like interest	Market value of full ownership, less value of fiduciary, usufructuary or other like interest as determined above
(1)(f) read with (4)	Immovable property on	Market value less 30%; ⁵ or

⁵ As determined under paragraph (b) of the definition of "fair market value" in section 1(1) of the Estate Duty Act.

Paragraph 31	Type of asset	Market value
	which a <i>bona fide</i> farming undertaking is carried on	<p>Price based on willing buyer, willing seller at arm's length in open market</p> <p>On disposal by death, donation or non-arm's length transaction, "market value less 30%" may only be used if it is used in determining the base cost of the disposer on –</p> <ul style="list-style-type: none"> • Valuation date; or, if applicable • Date acquired by inheritance, donation or non-arm's length transaction at Land Bank value or market value less 30%. <p>Note: As from 1 February 2006 the market value must be the fair market value as per paragraph (b) of the definition of "fair market value" in section 1(1) of the Estate Duty Act, namely, the price that could be obtained between a willing buyer and willing seller dealing at arm's length in an open market, less 30%.</p>
(1)(g)	Any other asset	The price which could have been obtained upon a sale of the asset between a willing buyer and a willing seller dealing at arm's length in an open market
(3)	Unlisted shares	<p>The price which could have been obtained upon a sale of the share between a willing buyer and a willing seller dealing at arm's length in an open market subject to the following:</p> <ul style="list-style-type: none"> • no regard shall be had to any provision – <ul style="list-style-type: none"> ➤ restricting the transferability of the shares, and it shall be assumed that those shares were freely transferable; or ➤ whereby or whereunder the value of the shares is to be determined; • if upon the winding-up of the company that person would have been entitled to share in the assets of the company to an extent that is not in proportion to that person's holding of shares, the value of the shares held by that holder of shares must not be less than the amount to which

Paragraph 31	Type of asset	Market value
		<p>that holder of shares would have been so entitled if the company had been in the course of winding-up and the said amount had been determined as at valuation date.</p> <p>The valuation must reflect the extent to which a potential buyer of the shares can control or influence the company. There are many degrees of control, usually determined by the voting power of a particular block of shares, running from full control (including power to liquidate the company) to a small or non-existent influence over the company's affairs of a minority shareholding. It follows that, unless there are exceptional circumstances, if the degree of control is less than complete, the value of the shares will be less than a <i>pro rata</i> proportion of the overall value of the company.</p>

4. Examples

Example 1 – Valuation of controlling interest in listed shares

Facts:

Sweet Pea Ltd holds 51% of the issued shares of Pea Ltd, a company listed on the JSE since 1990 when Sweet Pea Ltd acquired its holding. Sweet Pea Ltd disposed of its entire holding in Pea Ltd to OH (Pty) Ltd for cash.

Date of sale	1 October 2015
Total number of Pea Ltd shares held by Sweet Pea Ltd	3 000 000
Last buying price for each Pea Ltd share on 30 September 2015 (per JSE)	R1,95
Last selling price for each Pea Ltd share on 30 September 2015 (per JSE)	R2,05
Price for each share under sale agreement	R2,20
Price for each Pea Ltd share as at valuation date per <i>Government Gazette</i>	R1,50

Result:

Step 1 – Calculate market value on valuation date

Valuation date market value (3 000 000 × R1.50)	R4 500 000
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Step 2 – Calculate control premium or discount

Average last price quoted (R1,95 + R2,05) / 2	R2,00
Control premium (R2,20 – R2,00) / R2,20	10%

The control premium is determined by deducting the price per share per the sale agreement from the average last price quoted on the JSE and dividing the result by the selling price per the sale agreement.

Step 3 – Determine base cost

	R
Valuation date market value (3 000 000 × R1.50)	4 500 000
Control premium R4 500 000 × 10%	<u>450 000</u>
Base cost	<u>4 950 000</u>

Step 4 – Determine capital gain

	R
Proceeds R3 000 000 × R2,20	6 600 000
Less: Base cost	<u>(4 950 000)</u>
Capital gain	<u>1 650 000</u>

Example 2 – Submission requirements for valuations*Facts:*

Andrew owns 10 shares in Enne (Pty) Ltd, a company with a 31 August financial year-end. His accountant valued his shares on 31 August 2003 at R1, 5 million each as at 1 October 2001. The accountant's valuation of the assets in the company was as follows:

	R
Fixtures and fittings	10 000 000
Goodwill	2 500 000
Trade marks	1 700 000
Liquor licence	800 000

The fixtures and fittings are made up of numerous small items, each valued at less than R200 000.

Enne (Pty) Ltd submitted its return for the year ending 31 August 2003 on 31 August 2004 and obtained an extension to submit its return for the year ending 31 August 2004 by 31 August 2005. Andrew submitted his return for the year ending 28 February 2004 on 28 February 2005.

Andrew and Enne wish to adopt the market value basis for all their assets.

Result:

Andrew and Enne (Pty) Ltd will be permitted to use the market value basis for the following assets if proof of valuation was submitted to SARS with the return of income specified:

Asset	Reason	Proof to be submitted with return for year ending:
<i>Andrew</i>		
Shares in Enne (Pty) Ltd	MV > R10 million	28 February 2004
<i>Enne (Pty) Ltd</i>		
Goodwill	MV > R1 million	31 August 2004
Trade marks	MV > R1 million	31 August 2004

Note: The furniture and fittings do not fall within paragraph 29(5) because their individual values do not exceed R10 million. The prescribed valuation form for the fixtures and fittings is no longer required to be submitted with the return of income reflecting their disposal but must be retained for five years from the date of submission of that return.

Example 3 – Valuation of usufruct

Facts:

The market value of Tim's farm less 30% is R800 000. He donated a usufruct over the farm to Kevin for the rest of Kevin's natural life. Kevin is 30 years old.

Result:

The value of the usufruct is determined as follows:

- Annual value: $R800\ 000 \times 12\% = R96\ 000$
- According to the life expectancy tables for males, Kevin's life expectancy is 38,48 years.
- Present value of R1 capitalised at 12% a year for 38,48 years = R8,22694

Value of usufruct:

$R96\ 000 \times 8,22694 = R789\ 786$