SOUTH AFRICAN REVENUE SERVICE

TAX GUIDE FOR SHARE OWNERS

(Issue 3)

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South African Revenue Service

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TAX GUIDE FOR SHARE OWNERS

Foreword

This guide provides general guidance on the taxation of share owners. 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 a binding ruling under Part IA of Chapter III of the Income Tax Act, 1962. Should you require an advance tax ruling, visit the SARS website for details of the application procedure.

The guide examines –

- the tax consequences of holding shares as trading stock compared to holding them as capital assets;
- how to distinguish between profits of a capital and revenue nature using common law principles and statutory rules;
- the determination of a taxpayer's liability for capital gains tax;
- how dividends are taxed; and
- various corporate actions that can impact on the determination of a person's liability for tax.

This guide is based on legislation as at 10 January 2012 and primarily focuses on the 2012 year of assessment although much of the commentary will also apply to earlier years of assessment. In addition some legislative changes affecting the 2013 year of assessment are also examined.

For more information you may –

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

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CONTENTS PAGE

Foreword ii

Glossary 1

1. Introduction 1

2. Income tax or CGT? 1

3. Capital v revenue 2

3.1 Criteria for distinguishing between revenue and capital profits 3

3.2 Intention 3
3.2.1 Intention – the most important factor 3
3.2.2 Mixed intentions 3
3.2.3 Secondary purpose 3
3.2.4 Change in intention 3

3.3 Some general principles 4
3.3.1 Scheme of profit-making 4
3.3.2 Fortuitous gains 4
3.3.3 The "for keeps" test 4

3.4 Surrounding circumstances 4
3.4.1 The transaction-by-transaction approach 4
3.4.2 Shares acquired for dividend income 5
3.4.3 Scale and frequency of transactions 5
3.4.4 Forced sales shortly after purchase 5
3.4.5 Insufficient funds 5
3.4.6 Low or nil return 5

4. Income tax 5

4.1 Shares held as trading stock 5

4.2 Employee share incentive schemes 7
4.2.1 Shares or options acquired before 26 October 2004 (section 8A) 7
4.2.2 Broad-based employee share plans (section 8B) 8
4.2.3 Shares and options acquired on or after 26 October 2004 (section 8C) 9

4.3 Taxation of dividend income 11
4.3.1 Local dividends 11
4.3.2 Foreign dividends 12

5. Capital gains tax 17

5.1 Shares held as capital assets 17

5.2 The three-year rule 17

5.3 Determining a capital gain or loss 19

5.4 Disposal 19

5.5 Proceeds 19

5.6 Base cost 20
5.6.1 Identification methods 20
5.6.2 Amounts included in base cost 21
5.6.3 Pre-valuation date shares 22
5.6.4 Gain and loss limitation rules (the "kink tests") 26
5.6.5 Base cost of shares in foreign-listed companies 27

5.7 Determining a taxable capital gain or assessed capital loss 27
5.7.1 The basic computation 27
5.7.2 Annual exclusion 28
5.7.3 Assessed capital loss 28

5.8 Return of capital 29

5.9 Anti-loss rules 36

5.9.1 Losses arising from extraordinary dividends 36
5.9.2 "Bed and breakfast" sales 40

6. Corporate restructuring events 40

6.1 Unbundling transactions 40
6.2 Asset-for-share transactions 41
6.3 Amalgamation transactions 42
6.4 Share buy-backs 43
6.5 Roll-over relief for forced sale of listed shares 43
6.6 Capitalisation shares 45
6.7 Share splits / consolidations 45
6.8 Nil paid letters 45
6.9 Demutualisation shares 46

7. Changes proposed in the 2012 Budget 46

Glossary

In this guide unless the context indicates otherwise –

- **"dividends tax"** means dividends tax levied under section 64E;
- **"Eighth Schedule"** means the Eighth Schedule to the Act;
- **"income tax"** means the normal tax on ordinary income;
- **"paragraph"** means a paragraph of the Eighth Schedule;
- **"return of capital"** means a return of capital as defined in section 1 and includes a capital distribution as defined in paragraph 74 before its deletion with effect from 1 April 2012;
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act 58 of 1962; and
- any reference to any word or expression bears the meaning ascribed to it in the Act.

Acronyms

CFC	Controlled foreign company as defined in section 9D(1)
CGT	Capital gains tax, being the portion of normal tax attributable to the inclusion in taxable income of a taxable capital gain
JSE	The securities exchange operated by the JSE Ltd
STC	Secondary tax on companies levied under section 64B

1. Introduction

In recent years an increasing number of South Africans have become share owners. With interest rates at their lowest levels in thirty years many investors have turned to participation in the JSE either directly through share ownership or indirectly through collective investment schemes in an attempt to derive a return that beats inflation. The proliferation of broad-based employee share incentive arrangements has also contributed to share ownership among South Africans.

This guide summarises some of the key aspects shareholders need to be aware of in computing their liability for income tax and CGT. It is primarily aimed at resident individuals who own shares in their own names. However, many of the principles covered apply equally to companies and trusts, and when appropriate the more obvious differences in the treatment of these entities have been highlighted. Non-residents are generally only subject to CGT on the disposal of shares in companies holding immovable property in South Africa and this guide will, therefore, have limited application to such persons.[1]

2. Income tax or CGT?

Shares held as trading stock are ones that you bought for the main purpose of reselling at a profit. Any gain or loss you make on disposal of a share you held as trading stock will be of a revenue nature.

[1] Under paragraph 2(2) 80% of the market value of the equity shares at the time of disposal must be attributable directly or indirectly to immovable property in South Africa held otherwise than as trading stock. In addition the shareholder, together with any connected person in relation to that shareholder must hold at least 20% of the equity shares in the company. If these criteria are not met the non-resident shareholder will not be liable for CGT on disposal of the shares.

Revenue gains are subject to income tax at your marginal tax rate, which may vary between 18% (but effectively 0% if your tax rebates are taken into account) and 40%, depending on the level of your taxable income.

By contrast, if you hold a share as a capital asset (that is, as a long-term dividend-producing investment) any gain or loss upon its disposal will be of a capital nature.

Capital gains are subject to tax at a lower rate than income gains. For the 2012 year of assessment an individual must disregard the first R20 000 of the sum of capital gains and losses in the year of assessment for CGT purposes (2011: R17 500). This is known as the "annual exclusion". Of the balance remaining after applying the annual exclusion, and any assessed capital loss brought forward from the previous year of assessment, 25%[2] is included in your taxable income and taxed at your marginal tax rate in the same way as, say, your salary or pension income. The effective rate of tax on an individual's capital gain in a year of assessment can thus vary between 0% and 10%. The 0% rate would apply when –

- the sum of capital gains and losses does not exceed the annual exclusion;
- the sum of capital gains is less than or equal to the sum of capital losses; or
- your taxable income falls below the level at which tax becomes payable.

The 10% rate would apply when your marginal tax rate is 40%[3] (that is, 40% (marginal rate) x 25% (inclusion rate) = 10%).

Companies and trusts pay CGT at a higher rate than individuals. They do not qualify for the annual exclusion, and must include 50% of any net capital gain[4] in taxable income.

The effective tax rate on a capital gain for a company is 28% x 50% = 14%.

A trust which is not a special trust has an effective CGT rate of 40% x 50% = 20%.

A special trust is subject to the same tax rate (on a sliding scale) and inclusion rate (25%) as an individual. A special trust created for a person who suffers from a mental illness or serious physical disability qualifies for the annual exclusion. But a special trust created on death for relatives which include a beneficiary under the age of 21 does not qualify for the annual exclusion although it does qualify for the 25% inclusion rate.

For the 2013 year of assessment it has been proposed that the annual exclusion and inclusion rates be increased – see **7**.

3. Capital v revenue

The first step in computing your tax liability on a disposal of shares is to determine whether the gain or loss is of a capital or revenue nature.

Apart from the three-year holding rule in section 9C (see **5.2**), the Act does not provide objective rules to distinguish between amounts of a capital and revenue nature. This task has been left to the South African courts, which over many years have laid down guidelines for making this distinction. The more important of these are listed below.

[2] This is known as the inclusion rate. For individuals and special trusts it is 25% but for companies and trusts it is 50%.
[3] For the 2012 year of assessment the 40% tax rate applies to taxable income in excess of R580 000.
[4] A net capital gain arises when the sum of capital gains and losses in a year of assessment less any assessed capital loss brought forward from the previous year of assessment is a positive figure.

You will have to discharge the onus of proving that a particular amount is of a capital or revenue nature (section 82). To discharge the onus you must establish your case on "a balance or a preponderance of probabilities" (*CIR v Middelman*[5]).

3.1 Criteria for distinguishing between revenue and capital profits

The intention of a taxpayer is the most important factor in determining the capital or revenue nature of a particular profit or loss. Establishing a taxpayer's sole or main intention is not always an easy task as taxpayers can sometimes have more than one intention in relation to an asset. The courts have held that a taxpayer's evidence as to his or her intention must be tested against the surrounding circumstances of the case. These include factors such as the frequency of transactions, method of funding and reasons for selling.

3.2 Intention

3.2.1 Intention – the most important factor

The most important factor in determining whether a profit is of a capital or revenue nature is your intention at the time when you bought and sold your shares (*Elandsheuwel Farming (Edms) Bpk v SBI*[6]). If they were bought as a long-term investment to produce dividend income the profit is likely to be of a capital nature. But if you bought the shares for the purpose of resale at a profit, the profit will be of a revenue nature.

In order for a profit to be of a capital nature you need not exclude the "slightest contemplation of a profitable resale" (*SIR v The Trust Bank of Africa Ltd*[7]).

3.2.2 Mixed intentions

If you had mixed intentions (that is, you bought the shares either to sell at a profit or to hold as an investment), your intention will be determined by your dominant or main purpose (*COT v Levy*[8]).

3.2.3 Secondary purpose

A profit will be of a revenue nature when you have a secondary or alternative purpose of making a profit, (*CIR v Nussbaum*[9]). An example of this can be found in *CIR v Tod*[10] in which the taxpayer who purchased shares cum div (that is, ripe with dividends), received the dividends and then sold the shares ex div. The court held that the resulting profits were of a revenue nature.

3.2.4 Change in intention

A change in your intention can result in shares you hold as a capital asset becoming trading stock, and in shares you hold as trading stock becoming a capital asset.

[5] 1991 (1) SA 200 (C), 52 SATC 323.
[6] 1978 (1) SA 101 (A), 39 SATC 163.
[7] 1975 (2) SA 652 (A), 37 SATC 87.
[8] 1952 (2) SA 413 (A), 18 SATC 127.
[9] 1996 (4) SA 1156 (A), 58 SATC 283.
[10] 1983 (2) SA 364 (N), 45 SATC 1.

It has been held that something more is required to effect this change in character than a mere decision to sell the asset.[11] For cases in which shares held as trading stock became assets of a capital nature see *New Mines Ltd v CIR*[12] and *CIR v Modified Investments (Pty) Ltd.*[13]

What are the implications of such a change in the character of your shares? A change from trading stock to a capital asset will trigger an income inclusion equal to the market value of the shares.[14] A change of a capital asset to trading stock will trigger a disposal for CGT purposes at market value.[15]

A change in your intention will be irrelevant once section 9C applies to your shares. Section 9C deems the proceeds on the sale of JSE-listed equity shares and equity shares in resident companies to be of a capital nature once they have been held for at least three years. Section 9C does not, however, trigger a deemed disposal of your shares held as trading stock after you have held them for three years because the shares technically remain trading stock despite them only being able to produce proceeds of a capital nature.[16]

3.3 Some general principles

3.3.1 Scheme of profit-making

Any profit or loss on disposal of your shares will be of a revenue nature if you purchased them for resale as part of a scheme of profit-making, (*Californian Copper Syndicate (Limited and Reduced) v Harris (Surveyor of Taxes)*[17]).

3.3.2 Fortuitous gains

A profit on sale of shares is more likely to be of a revenue nature if it was not fortuitous, but designedly sought for and worked for (*CIR v Pick 'n Pay Employee Share Purchase Trust*[18]).

3.3.3 The "for keeps" test

The usual badge of a fixed, capital investment is that it is acquired for better or for worse, or, relatively speaking, for "keeps", and will only be disposed of if some unusual, unexpected, or special circumstance, warranting or inducing disposal, supervened (*Barnato Holdings Ltd v SIR*[19]).

3.4 Surrounding circumstances

3.4.1 The transaction-by-transaction approach

Just as an occasional swallow does not make a summer, so an occasional sale of shares yielding a profit does not of itself make a seller of shares, a dealer therein (*CIR v Middelman*[20]).

[11] *John Bell & Co (Pty) Ltd v SIR* 1976 (4) SA 415 (A), 38 SATC 87.
[12] 1938 AD 455, 10 SATC 9.
[13] 1982 (1) SA 331 (T), 43 SATC 257.
[14] Section 22(8)(*b*)(v).
[15] Paragraph 12(2)(*c*).
[16] The shares fall within paragraph (i) of the definition of the term "trading stock" in section 1 because they were purchased for the purposes of sale.
[17] 41 Sc LR 694, 5 TC 159.
[18] 1992 (4) SA 39 (A), 54 SATC 271.
[19] 1978 (2) SA 440 (A), 40 SATC 75.
[20] Above.

3.4.2 Shares acquired for dividend income

Shares bought for the dominant, main and overriding purpose of securing the highest dividend income possible will be of a capital nature when the profit motive is incidental (*CIR v Middelman*[21]).

3.4.3 Scale and frequency of transactions

The scale and frequency of your share transactions is of major importance, although not conclusive (*CIR v Nussbaum*[22]).

3.4.4 Forced sales shortly after purchase

The fact that an asset is sold for a substantial profit very soon after acquisition is, in most cases, an important one in considering whether a profit is of a revenue nature. However, it loses a great deal of its importance when an event occurs that was not previously contemplated (ITC 1185[23]). In the context of shares this principle may apply, for example, when a shareholder is forced to dispose of shares in order to facilitate a merger or acquisition.

3.4.5 Insufficient funds

It may be inferred that you bought your shares for the purpose of resale at a profit if you are forced to sell them because you had insufficient funds to enable you to hold them for the long term. For example, this could apply if you financed the purchase of your shares by means of an overdraft and were later forced to sell them because you could not afford the repayments (*CIR v Lydenburg Platinum Ltd;*[24] *Yates Investments (Pty) Ltd v CIR;*[25] *Ropty (Edms) Bpk v SBI*[26]*)*.

3.4.6 Low or nil return

The proceeds are more likely to be of a revenue nature when the type of share you have purchased does not produce dividends, or the business carried on by the company is highly risky. The sale of futures contracts is likely to be on revenue account, even if used as a hedge against losses on underlying shares held as capital assets (ITC 1756;[27] *Wisdom v Chamberlain (Inspector of Taxes)*[28]).

4. Income tax

4.1 Shares held as trading stock

The cost of shares acquired as trading stock is allowable as a deduction under section 11(*a*).

The cost price of shares held at the end of the year of assessment must be taken into account as closing stock in determining your taxable income.[29]

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[21] Above.
[22] Above.
[23] (1972) 35 SATC 122 (N).
[24] 1929 AD 137, 4 SATC 8.
[25] 1956 (1) SA 612 (A), 20 SATC 368.
[26] 1981 (A), 43 SATC 141.
[27] (1996) and (1997) 65 SATC 375 (C).
[28] (1969) (1 All ER 332 (CA).
[29] Section 22(1).

What happens if the market value of a share at the end of the year of assessment is less than what you paid for it? Is it permissible to include the lower market value in closing stock thereby effectively claiming a deduction for the difference? Companies have never been allowed to write down the value of closing stock of shares held as trading stock and their position remains unchanged. For individuals and trusts the position is as follows for shares held as trading stock:

- For the 2011 and earlier years of assessment an individual or trust was entitled to write down the value of closing stock of shares to their market value.
- For the 2012 year of assessment it is no longer possible for an individual or a trust to write down the value of closing stock of "financial instruments". This includes shares.[30]

The amount included in income as closing stock becomes deductible as opening stock for the following year of assessment.[31]

With the introduction of section 9C from 1 October 2007, the proceeds on disposal of South African shares (including JSE-listed shares in foreign companies) held as trading stock for longer than three years are treated as being of a capital nature. Any expenditure or losses claimed against income during the period that you held the shares will be recouped on disposal. For more on section 9C, see **5.2**. Despite this recoupment, in the case of listed shares one-third of any interest incurred on borrowings used to acquire the shares qualifies as an addition to the base cost of the shares in determining any capital gain or loss – see **5.6.2**.

Example 1 – Shares held as trading stock

Facts:

In November of year 1 L purchased 100 shares in XYZ Ltd at a cost of R1 per share for the purpose of resale at a profit. At the end of year 1 the market value of the shares had dropped to 80 cents per share. In July of year 2 L sold the shares for R1,20 per share. Determine the amounts to be deducted from or included in L's taxable income in years 1 and 2.

Result:

Assuming year 1 was the 2011 or an earlier year of assessment

Year 1

	R
Cost of shares allowable as a deduction	(100)
Less: Closing stock 80 cents x 100	80
Loss to be deducted in arriving at taxable income	(20)

Year 2

Proceeds included in gross income	120
Less: Opening stock	(80)
Net amount included in taxable income	40

[30] Paragraph (*a*) of the definition of a "financial instrument" in section 1 includes a share.
[31] Section 22(2).

Assuming year 1 was the 2012 year of assessment

Year 1

	R
Cost of shares allowable as a deduction	(100)
Less: Closing stock at cost price	100
Net amount deducted from or included in taxable income	Nil

Year 2

Proceeds included in gross income	120
Less: Opening stock	(100)
Net amount included in taxable income	20

4.2 Employee share incentive schemes

You may be subject to income tax when you acquire shares from your employer or from an employee share purchase trust set up by your employer. Any gain or loss on shares so acquired is determined in accordance with special rules contained in sections 8A, 8B and 8C. These rules are complex and a full discussion of them is beyond the scope of this guide. Your employer will usually determine the gain or loss and deduct the required amount of employees' tax (PAYE). The gain or loss will be reflected on your employees' tax certificate (IRP 5).

Set out below is a brief overview of sections 8A, 8B and 8C.

4.2.1 Shares or options acquired before 26 October 2004 (section 8A)

Section 8A applies to shares or options acquired by an employee (including a director) from his or her employer before 26 October 2004. Any revenue gain determined under section 8A will be included in your income. Such a gain usually arises when the employee exercises an option to acquire shares from his or her employer and the price paid for the shares is less than the market price at the time of acquisition. When your employer does not allow you to sell the shares before a certain date, you can elect to delay the taxation of the gain until that date.

Once you have been subject to income tax under section 8A on the shares acquired from your employer a further gain or loss may arise when you dispose of the share. The capital or revenue nature of this further gain or loss is determined in the normal way; that is, shares held as capital assets will be subject to CGT, while shares held as trading stock will be subject to income tax in full. For CGT purposes the base cost of the shares will be the market value that was taken into account in determining the section 8A gain.[32]

Example 2 – Shares acquired under section 8A

Facts:

On 1 October 2004, T was granted an option to acquire 1 000 shares in T's employer, ABC Ltd at a price of R1,00 per share when the market price was R1,50 per share. T paid 10 cents per share for the options. On 28 February 2009 T exercised the options when the market price was R5,00 per share, and on 30 June 2011 T sold the shares at R8,00 per share.

[32] Paragraph 20(1)(*h*)(i).

Result:

The following gains will arise in T's hands:

- *2009 year of assessment* – an ordinary income gain under section 8A
- 2012 year of assessment – a capital gain.

These gains will be determined as follows:

Section 8A gain

	R
Market value of shares at date option exercised (1 000 x R5)	5 000
Less: Cost of options 1 000 x 10 cents	(100)
Cost of shares 1 000 x R1,00	(1 000)
Section 8A gain included in income	3 900

Capital gain

Proceeds 1 000 x R8,00	8 000
Less: Base cost 1 000 x R5,00	(5 000)
Capital gain	3 000

Note: The actual cost of the shares comprises the option cost of R100 and the purchase price of the shares of R1 000. These amounts are excluded from base cost, since they have been taken into account in determining the section 8A gain. It is simply the market price of the shares that was taken into account in determining the section 8A gain that constitutes the base cost. The market value taken into account is the same as the actual cost R1 100 plus the section 8A gain (R3 900) = R5 000.

4.2.2 Broad-based employee share plans (section 8B)

Section 8B applies to qualifying broad-based employee share plans when at least 80% of the employees in the company are entitled to participate.[33] In order for an employee to qualify, the market value of the shares given to him or her in the current and immediately preceding four years of assessment must not exceed R50 000.[34] If you hold a share acquired under such a plan for at least five years, the gain on disposal will be of a capital nature and subject to CGT. But if you dispose of the share within five years, any gain will be taxed as income in your hands, and section 9C, which deems shares held for at least three years to be on capital account, will not apply. This serves as an encouragement for you to hold your shares for at least five years. The benefits of section 8B do not apply if you were a member of any other employee share incentive scheme at the time you received the shares. In that case you will be taxed under section 8C.

[33] Paragraph (*b*) of the definition of a "broad-based employee share plan" in section 8B(3).
[34] Definition of a "qualifying equity share" in section 8B(3).

Example 3 – Broad-based employee share incentive plan: Employee disposing of shares within five years

Facts:

On 5 January 2011, under a qualifying broad-based employee share incentive plan, Y received 2 500 shares in Y's employer, XYZ Ltd at no cost. The shares were trading at R1 each at the time they were awarded to Y. No restrictions apply to the shares, except that they may not be sold before 5 January 2014 unless an employee is retrenched or resigns. An employee who resigns or is retrenched must sell the 2 500 shares back to XYZ Ltd for the market value of the shares on the last day of employment. XYZ Ltd appointed a trust to administer the shares under the plan.

Y resigned from XYZ Ltd on 21 December 2011. Under the plan rules Y sold the shares back to XYZ Ltd (through the trust) on 21 December 2011 at market value of R3 750 (R1,50 per share).

Result:

Y is not subject to tax upon the granting of the shares in the 2011 year of assessment.[35] In the 2012 year of assessment R3 750 will be taxed as ordinary income in Y's hands when the shares are sold back to XYZ Ltd and the company will withhold the appropriate amount of employees' tax.

Example 4 – Broad-based employee share incentive plan: Employee disposing of shares after five years

Facts:

The facts are the same as in Example 3, except that Y left XYZ Ltd on 30 June 2016 and sold the shares on 31 January 2017 in the open market for R4 500.

Result:

Since the shares have been held for more than five years they are no longer subject to a potential income inclusion under section 8B(1) and any proceeds will be of a capital nature under section 9C(2) upon their disposal.

The disposal in 2017 will thus result in a capital gain of R4 500 (proceeds R4 500 less base cost of nil).

4.2.3 Shares and options acquired on or after 26 October 2004 (section 8C)

Section 8C replaced section 8A and applies to "equity instruments" (shares and options) acquired from an employer on or after 26 October 2004. A revenue gain or loss will arise when a share or option "vests" in you. Vesting will usually happen when you acquire the share with no restrictions, or when all restrictions are lifted. If you are restricted from disposing of the share, the revenue gain or loss will be determined at the time when the restriction is lifted. This differs from section 8A in which the revenue gain was frozen at the time of acquisition of a share and on election deferred until the restriction ended.

[35] Paragraph 2(*a*)(iii) of the Seventh Schedule to the Act.

Once you have been subject to income tax under section 8C on the shares acquired from your employer a further gain or loss may arise when you dispose of them. The capital or revenue nature of this further gain or loss is determined in the normal way; that is, shares held as capital assets will be subject to CGT, while shares held as trading stock will be subject to income tax in full. For CGT purposes the base cost of the shares will be the market value that was taken into account in determining the section 8C gain.[36]

Example 5 – Section 8C gain and capital gain

Facts:

On 30 June 2006 B acquired an option from B's employer to purchase 100 shares in ABC Ltd at a price of R100 per share. B paid R10 for the option, which was exercisable before 30 June 2007. On 31 May 2007 B exercised the option at a time when the share price was R160 per share. Under the arrangement with the employer, B was not permitted to sell the shares before 30 June 2010 at which time the market price was R190 per share. B eventually sold the shares on 1 March 2011 for R210 per share. Determine B's section 8C gain and capital gain per share.

Result:

Section 8C gain

	R	R
Market value on date restriction lifted		190
Less: Cost of option	(10)	
Strike price	(100)	(110)
Section 8C gain included in income		80

Capital gain

B has held the shares for more than three years and the consideration received or accrued on their disposal will therefore be of a capital nature under section 9C (see **5.2**). Section 9C does not apply while the shares are restricted[37] but since they were unrestricted at the time of disposal this prohibition does not apply.

For CGT purposes the base cost of the shares will be the market value that was taken into account in determining the section 8C gain.

	R
Proceeds	210
Less: Deemed base cost	(190)
Capital gain	20

Returns of capital

Any return of capital or foreign return of capital you receive or which accrues to you while your shares are restricted must be included in your income in the year of assessment in which it is received or accrues. In other words, these returns of capital do not receive CGT treatment as discussed in **5.8**.[38] This rule does not apply to a return of capital or foreign return of capital in the form of a distribution of an equity instrument.

[36] Paragraph 20(1)(*h*)(i).
[37] Section 8C(1)(*a*) applies "notwithstanding" section 9C.
[38] Section 8C(1A).

4.3 Taxation of dividend income

4.3.1 Local dividends

Normal tax

Dividends from South African resident companies are exempt from normal tax under section 10(1)(*k*)(i).

Dividends tax

On or after 1 April 2012 dividends from resident companies and non-resident JSE-listed companies will be subject to dividends tax the provisions of which are contained in sections 64D to 64N.

Dividends tax is a stand-alone tax (that is, it is not part of normal tax). It is levied under section 64E at a rate of 15% on the amount of any dividend paid by any company other than a headquarter company. The tax is withheld by the company paying the dividend or by a regulated intermediary but the persons who are liable for the tax are –

- the beneficial owner of the dividend,[39] or
- in the case of a dividend *in specie*, the company paying the dividend. [40] A dividend *in specie* is a dividend that is paid otherwise than in cash, for example, when the company distributes shares in another company.

SARS therefore has the right to recover dividends tax from a beneficial owner of a dividend should the amount not have been withheld by the company or a regulated intermediary.[41] Dividends tax must be paid to SARS by the end of the month following the month in which the dividend was paid. Any such payment must be accompanied by the prescribed return.

There are a number of exemptions from dividends tax. For example, it is not imposed on dividends paid to –

- a resident company;
- a public benefit organisation approved by the Commissioner under section 30(3);
- various other tax-exempt persons such as the government and pension funds;
- a shareholder in a registered micro business to the extent that the sum of dividends paid during the year of assessment does not exceed R200 000; and
- a non-resident in respect of a dividend paid on a JSE-listed share in a non-resident company.

Non-resident shareholders may qualify for a lower rate of dividends tax under an applicable tax treaty. Whether you will be able to obtain the lower rate of dividends tax will depend on the terms of the particular tax treaty, but typically the lower rate only applies to corporate shareholders who have an interest in the company of between 10% and 25%. A summary of withholding tax rates under South Africa's tax treaties is available on the SARS website under Tax Types / Dividends tax. In order to qualify for the lower rate you must submit a declaration to the company or regulated intermediary.[42]

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[39] Section 64EA(*a*).
[40] Section 64EA(*b*).
[41] Section 64K(1)(*a*).
[42] Sections 64G(3) and 64H(3).

4.3.2 Foreign dividends

Dividends from non-resident companies must be included in your income unless they are exempt from tax (see below). Dividends received or accrued in a foreign currency must be translated into rands using the spot rate on the date of receipt or accrual[43] but individuals and non-trading trusts can elect to use the average exchange rate during the year of assessment.[44] The election must be applied consistently to all foreign income derived during the year of assessment.

2012 year of assessment

Section 10(1)(*k*)(ii)(*aa*) to (*dd*) exempts the following dividends from income tax:

- A foreign dividend to the extent that the amounts from which it is distributed –
  - are included in the taxable income of that person; or
  - arose directly or indirectly from any dividends declared by any company which is a resident.[45]
- A dividend from a non-resident company whose shares are listed on the JSE.[46] Some well-known examples include Anglo American plc, BHP Billiton plc, Investec plc, Old Mutual plc and SABMiller plc.
- A foreign dividend received by or accrued to a resident from a *CFC*.[47] This exemption is subject to a complex limitation which is beyond the scope of this guide. In simple terms the purpose of the exemption is to prevent double taxation which would be caused if the net income of a CFC (which is imputed to the resident shareholder under section 9D) as well as foreign dividends distributed out of that net income were to be taxed.
- A foreign dividend received by or accrued to a person will be exempt if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 20% of the total equity shares and voting rights in the company declaring the foreign dividend (the "participation exemption").[48]

Note: Section 10(1)(*k*)(ii) has been deleted –

- for individuals with effect from 1 March 2012, and
- for companies with effect from years of assessment commencing on or after 1 April 2012,

and thus does not apply to the 2013 year of assessment.

[43] Section 25D(1).
[44] Section 25D(3).
[45] Section 10(1)(*k*)(ii)(*aa*).
[46] Section 10(1)(*k*)(ii)(*bb*).
[47] Section 10(1)(*k*)(ii)(*cc*).
[48] Section 10(1)(*k*)(ii)(*dd*).

2013 year of assessment

A foreign dividend received by or accrued to a person will be exempt –

- if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10% of the total equity shares and voting rights in the company declaring the foreign dividend (the "participation exemption"). The holding requirement has been decreased from "at least 20%" to "at least 10%";[49]
- if that person is a company and the foreign dividend is paid or declared by another foreign company that is resident in the same country as that company (this is a new exemption);[50]
- if that foreign dividend is derived from a CFC.[51] This exemption is unchanged from the exemption that applied to the 2012 year of assessment (see above); and
- to the extent that the foreign dividend is received by or accrues to that person from a JSE-listed share and does not consist of a distribution of an asset *in specie*.[52] This exemption applies because dividends paid by non-resident JSE-listed companies are subject to dividends tax unless an exemption applies. But a dividend *in specie* distributed by such a company is subject to normal tax in the recipient's hands because it is not subject to dividends tax.[53]

Foreign dividend exemption

For the 2012 year of assessment the first R3 700 of foreign dividends and interest is exempt from tax under section 10(1)(*i*)(xv) (2011: R3 700; 2010: R3 500). The exempt amount is first applied against foreign dividends and then against foreign interest.

For the 2013 year of assessment the tax-exempt amount of R3 700 no longer applies and a new method of exempting a portion of foreign dividends has been introduced under section 10B(3). The exempt portion of the dividend is determined by multiplying the dividend that is not otherwise exempt under section 10B(2) by a factor so as to arrive at a maximum tax rate of 15% thus giving a result similar to that produced by the dividends tax. The following proportions of the foreign dividend are expected to be exempt from normal tax:[54]

25/40 Individuals, deceased estates, insolvent estates and trusts.[55]

13/28 Companies.

Example 6 – Taxation of foreign dividends in the 2013 year of assessment – individual

Facts:

M, a South African-resident individual, pays income tax at a marginal rate of 40%. M holds 2% of the total equity shares and voting rights in Foreign Company, a company that does not qualify as a CFC and is not listed on the JSE. Foreign Company pays a dividend of R1,2 million to M, which is subject to foreign withholding taxes of 8% (that is, R96 000).

[49] Section 10B(2)(*a*).
[50] Section 10B(2)(*b*).
[51] Section 10(B)(*2*)(*c*).
[52] Section 10B(2)(*d*).
[53] See the definition of a "dividend" in section 64D.
[54] These proportions are proposed in the Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2012. The existing proportions produce a maximum effective rate of 10% instead of 15%.
[55] The draft Taxation Laws Amendment Bill, 2012 proposes to apply the 25/40 proportion to trusts which have erroneously been allocated the same proportion as companies.

Result:

	R
Gross income – foreign dividend	1 200 000
Less: Exempt portion under section 10B(3) (R1 200 000 x 25/40)	(750 000)
Income / taxable income	450 000
Tax on taxable income at 40% (note 2)	180 000
Less: Rebate for foreign taxes under section 6*quat* [R96 000 – (R96 000 x 25/40)]	(36 000)
Normal tax payable	144 000

Notes:

1. The participation exemption and the exemption of dividends from a CFC do not apply.

2. The normal tax on taxable income at a rate of 40% translates to an effective rate of 15% on the gross dividend (15% x R1 200 000 = R180 000). The effective rate will be lower for persons who have a lower marginal tax rate than 40%.

3. Had Foreign Company been listed on the JSE the foreign dividend would have been exempt from normal tax under section 10B(2)(*d*) and the exemption under section 10B(3) would not have applied.

Example 7 – Taxation of foreign dividends in the 2013 year of assessment – company

Facts:

The facts are the same as in Example 6 except that M is a resident company.

Result:

	R
Gross income – foreign dividend	1 200 000
Less: Exempt portion under section 10B(3) (R1 200 000 x 13/28)	(557 143)
Income / taxable income	642 857
Tax on taxable income at 28% (note 2)	180 000
Less: Rebate for foreign taxes under section 6*quat* [R96 000 – (R96 000 x 13/28)]	(51 429)
Normal tax payable	128 571

Notes:

1. The participation exemption and the exemption of dividends from a CFC do not apply.

2. The normal tax on taxable income at a rate of 28% translates to an effective rate of 15% on the gross dividend (15% x R1 200 000 = R180 000).

Deductibility of interest incurred by individuals

2012 year of assessment

Under section 11C(1) you can deduct interest actually incurred in earning taxable foreign dividends. But the deduction is limited to the amount of the taxable foreign dividends. Should the interest expense exceed the taxable foreign dividends, the excess must be reduced by any exempt foreign dividends and carried forward to the next year of assessment when it will be treated as an expense actually incurred in the earning of foreign dividends [section 11C(2)].

For more information on section 11C see Interpretation Note 2 (Issue 3) dated 16 March 2009.[56]

2012 year of assessment for some companies and 2013 year of assessment for individuals

Section 11C has been deleted with effect from 1 April 2012.[57] In addition section 23(*q*) now prevents the deduction of any expenditure in the production of foreign dividends.[58]

Claiming of foreign taxes

You may be able to claim a rebate under section 6*quat* for foreign taxes withheld from your foreign dividend income. A detailed examination of section 6*quat* is beyond the scope of this guide but the following points are worth noting:

- You will not be able to claim a rebate for any portion of the foreign taxes that is attributable to the exempt portion of a foreign dividend. For example, in the 2012 year of assessment, if the sum of your foreign dividends amounted to R3 700 or less you would not be able to claim any portion of the foreign taxes as a rebate because the entire amount is exempt from normal tax under section 10(1)(*i*)(xv). To the extent that the foreign dividends exceed R3 700 you will be able to claim a portion of the foreign taxes attributable to the amount included in your income (Example 8).
- The rebate cannot exceed the South African tax payable on the total income from foreign sources (before taking rebates into account). Any portion of the foreign tax not qualifying for the rebate may be carried forward to the following year of assessment, but the carry-forward may not continue for more than seven years (Example 9).
- Foreign taxes payable on dividends included in your income during a year of assessment are translated into rands at the average exchange rate during that year of assessment.[59]

For a detailed explanation of the rebate for foreign taxes, see Interpretation Note 18 (Issue 2) dated 31 March 2009.[60]

Example 8 – Determination of qualifying foreign taxes

Facts:

X derived foreign dividend income during the 2012 year of assessment amounting to R5 000 from which R500 was withheld by way of foreign taxes. How much of the foreign withholding taxes will qualify for rebate purposes?

[56] Available from the SARS website (Legal & Policy / Interpretation Notes / Income Tax).
[57] Section 31 of the Taxation Laws Amendment Act 24 of 2011.
[58] Section 23(*q*) comes into operation on 1 March 2012 in so far as it applies to individuals, deceased and insolvent estates and special trusts and applies to the 2013 year of assessment. For other taxpayers it comes into operation on 1 April 2012 and applies to years of assessment commencing on or after that date.
[59] Section 6*quat*(4).
[60] Available from the SARS website (Legal & Policy / Interpretation Notes / Income Tax).

Result:

Since the first R3 700 of foreign dividend income is exempt from income tax, any foreign taxes relating to the exempt portion will not qualify for rebate purposes. The qualifying taxes amount to R130 [(R5 000 – R3 700)/R5 000 x R500]. The remaining foreign taxes of R500 – R130 = R370 are forfeited and will not be carried forward to the 2013 year of assessment.[61]

Example 9 – Rebate for foreign taxes

Facts:

Y derived foreign dividends of R20 000 during the 2012 year of assessment which were subject to foreign withholding taxes of R7 000 (35%).

Y's taxable income for the 2012 year of assessment (including the taxable portion of foreign dividends) amounted to R637 500. Determine the amount of Y's rebate for foreign taxes.

Result:

Step 1 – Determine qualifying taxes

Since the first R3 700 of foreign dividends is exempt from income tax, only the foreign taxes attributable to the taxable portion of the dividends will qualify for rebate purposes

	R
Gross foreign dividends	20 000
Less: Exempt portion	(3 700)
Dividends included in income	16 300
Qualifying taxes R16 300/R20 000 x R7 000	5 705

Step 2 – Apply the overall limitation formula

The rebate is limited to the South African tax on the foreign dividends.

The normal tax on a taxable income of R637 500 is R191 250[62] before rebates. This gives an average tax rate of 30% (R191 250/R637 500 x 100). Since the foreign taxes were withheld at a rate of 35% the rebate will be limited to a tax rate of 30% and 5/35 of the qualifying foreign taxes will be carried forward to the next year of assessment (5/35 X R5 705 = R815).

Put differently, the rebate may not exceed the amount determined by the following formula:

Taxable income from foreign sources/Taxable income from all sources x Normal tax before rebates

= R16 300/R637 500 x R191 250

= R4 890

Thus the section 6*quat* rebate will be R4 890 and the excess of R5 705 – R4 890 = R815 will be carried forward to the 2013 year of assessment.

[61] Foreign taxes on exempt foreign income do not qualify for rebate purposes since section 6*quat*(1) only applies the rebate to an amount of "income" (gross income less exempt income) included in taxable income.

[62] Tax on taxable income of R580 000 = R168 250. Tax on the taxable income in excess of R580 000 = R57 500 at 40% = R23 000. Normal tax before rebates = R168 250 + R23 000 = R191 250.

Controlled foreign companies

Special rules relate to the income generated by CFCs. These rules deem an amount equal to the foreign company's taxable income to be taxable income in the hands of the South African-resident shareholders, thereby effectively disregarding the company's separate legal existence. These rules, which are contained in section 9D, are outside the scope of this guide.

5. Capital gains tax

5.1 Shares held as capital assets

When you hold your shares otherwise than as trading stock, that is, as capital assets, any gain will be of a capital nature and is subject to CGT. Capital losses may only be set off against other capital gains and not against your ordinary income. For the 2012 year of assessment the first R20 000 (2011: R17 500) of the sum of all capital gains and losses is excluded in determining the amount that is subject to CGT. This excluded amount is known as the "annual exclusion". The annual exclusion increases to R200 000 in the year of death (2011: R120 000). When the sum of your capital gains and losses in a year of assessment is a loss, the portion of that loss which exceeds the annual exclusion, is carried forward to the following year of assessment as an assessed capital loss that may be used against future capital gains.

5.2 The three-year rule

Section 9C applies to the disposal of any "qualifying share" on or after 1 October 2007.[63] It applies to gains and losses and does not require an election. Its application is automatic and compulsory.

Under section 9C any gain or loss you make on disposal of a qualifying share is deemed to be of a capital nature and will thus give rise to a capital gain or loss. A "qualifying share" is an equity share that was owned by you for a continuous period of three years before you disposed of it.

The capital or revenue nature of any profit or loss on disposal of shares that you held for less than three years must be determined using the general capital versus revenue tests outlined in **3**. The profit or loss is not automatically deemed to be of a revenue nature.

Qualifying shares

A "qualifying share" includes –

- a share in a listed or unlisted resident company;
- a share in a non-resident company which is listed on the JSE;
- an interest in a close corporation; and
- a participatory interest in a collective investment scheme in securities.

A "qualifying share" does not include –

- a participatory interest in a collective investment scheme in property;
- a share in a share block company;
- a share in a non-resident company (other than a JSE-listed share);

[63] Section 9C replaced section 9B.

- a section 8E "hybrid equity instrument" (for example, a preference share redeemable within three years); and
- a share that is not an equity share (for example, a non-participating preference share).

Deduction of general share-dealing expenses

A person who carries on a business of share-dealing will typically claim general expenses as a deduction against income under section 11. Such expenses may include bank charges, interest on money borrowed to buy shares, technical analysis software and telephone charges. Once these shares have been held for three years it will no longer be possible to claim such expenses in relation to them under section 11 because their ultimate disposal can no longer produce gross income.

Recoupment of expenditure claimed under section 11

Expenses or losses you claimed on shares you held as trading stock will be included in your income as a recoupment when you dispose of the shares.[64]

Anti-avoidance measures

Section 9C contains a number of anti-avoidance measures that are beyond the scope of this guide.

First in, first out

The first-in-first-out method must be used to determine the length of time you held shares you have disposed of.[65] This method is merely for the purpose of applying section 9C and does not affect any identification method you have adopted for determining the base cost of your shares for CGT purposes. Thus if you adopted the weighted-average method for CGT purposes you must continue to use that method for determining the base cost of your shares. The first-in-first-out method will merely be used to determine whether any shares you sold were held for at least three years.

Roll-over of dates of acquisition

Should you surrender your existing shares in exchange for a greater or lesser number of shares in the same company as a result of a share split or consolidation, the dates of acquisition of the old shares will be carried across to the new shares.[66]

This rule does not apply if –

- the new shares carry different rights to the old shares, or
- you receive any other consideration as part of the share substitution (for example, a cash payment or shares in another company).

For a detailed review of section 9C see Interpretation Note 43 (Issue 3) dated 30 September 2011.[67]

[64] Section 9C(5).
[65] Section 9C(6)].
[66] Section 9C(8).
[67] Available from the SARS website (Legal & Policy / Interpretation Notes / Income Tax).

5.3 Determining a capital gain or loss

For CGT purposes a capital gain or loss is determined as follows:

Capital gain or loss = Proceeds on disposal *less* base cost

In determining a capital gain or loss, there are four key prerequisites.

Asset – In the context of this guide, this would be the shares or options being disposed of.

Disposal – This is the event that triggers a capital gain or loss (for example, a sale).

Proceeds – This is the amount received or accrued on the disposal.

Base cost - This is the amount that is allowed as a deduction in determining a capital gain or loss.

The concepts of disposal, proceeds and base cost are discussed in more detail in the paragraphs that follow.

5.4 Disposal

A capital gain or loss is triggered when you dispose of your shares. A **disposal** will normally occur when you sell your shares, but you will also be treated as having disposed of your shares if –

- you donate them;
- you cease to be a resident;
- the nature of your shares changes from capital assets to trading stock;
- you still own them at the time of your death and did not bequeath them to your surviving spouse or an approved public benefit organisation;
- the company whose shares you hold is liquidated or deregistered; or
- you receive a return of capital on or after 1 October 2007 but before 1 April 2012 (part-disposal).

For more on the return of capital see **5.8**.

5.5 Proceeds

The **proceeds** are normally equal to the amount that is received by or accrues to you on disposal of your shares.

In some circumstances the proceeds will be deemed to be equal to the market value of the shares at the time of the disposal event. This would happen, for example, if you –

- died and did not bequeath the shares to your surviving spouse;[68]
- donated the shares;[69]
- disposed of the shares to a connected person at a consideration that does not reflect an arm's length price;[70]

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[68] Paragraph 40(1).
[69] Paragraph 38.
[70] Paragraph 38.

- ceased to be a South African resident;[71] or
- changed the nature of your shares to trading stock.[72]

The proceeds are reduced by any portion thereof that is included in your gross income or which is otherwise taken into account in determining your taxable income. This would apply, for example, if a portion of the proceeds comprises a dividend as can occur when the company in which you have invested buys back its own shares – see **6.4**.

A return of capital will form part of proceeds depending on when it was received – see **5.8**.

5.6 Base cost

5.6.1 Identification methods

Before you can determine the base cost of your shares you need to adopt a method to identify the shares that you have disposed of. This becomes necessary when you dispose of some of, but not all, the shares you hold in a particular company. The three permissible identification methods are –[73]

- specific identification;
- first in, first out; and
- weighted average.

Example 10 – Identification methods

Facts:

J owns 1 000 shares in ABC Ltd, a company listed on the JSE, which J acquired on the following dates:

Date purchased	Number of shares	Cost R
1 March 2007	200	2 000
30 June 2008	100	1 100
30 November 2009	500	6 000
31 July 2010	200	1 800
Total	1 000	10 900

On 31 December 2011 J sold 200 shares. Determine which 200 shares J has sold using the specific-identification, first-in-first-out and weighted-average methods.

Result:

Specific identification

Under this method J can nominate the shares that are being sold, based on their date and cost. In the above example J would probably choose to sell 200 of the 500 shares acquired on 30 November 2009 since they have the highest base cost of R12 per share (R6 000/500). In order to use this method J will have to maintain detailed records of the dates and costs of acquisition of the shares.

[71] Section 9H with effect from 1 April 2012 but before that date paragraph 12(2)(*a*).
[72] Paragraph 12(2)(*c*).
[73] Paragraph 32.

First in, first out

Under this method J is deemed to have sold the oldest shares first, namely, the 200 shares acquired on 1 March 2007 for R2 000.

Weighted average

Under this method, J must first determine the average cost of all the shares – R10 900 / 1 000 = R10,90 per share. The base cost of the shares disposed of is therefore R10,90 x 200 = R2 180. The base cost of the remaining shares is thereafter determined by reducing the weighted-average base cost by the number of shares disposed of:

	No	R
Total before disposal (as above)	1 000	10 900
Less: Shares disposed of	(200)	(2 180)
Total after disposal	800	8 720

Note: The weighted-average method can only be used for shares listed on a recognised exchange (for example, the JSE, London Stock Exchange or New York Stock Exchange). It does not apply to shares in private companies. A list of recognised exchanges can be found on the SARS website (Legal & Policy / Regulations and government notices / Income Tax Act, 1962 / Archive).

Consistency

Once you have adopted an identification method for the first listed share disposed of on or after 1 October 2001 you must continue to use that method for your entire portfolio of listed shares. You will only be able to switch to a different method once all the shares in your portfolio have been disposed of.[74]

5.6.2 Amounts included in base cost

The base cost of a share includes –

- the cost of acquisition;
- securities transfer tax or similar tax or duty paid on acquisition of the share;
- the cost of any option exercised in acquiring or selling the shares (except shares taxed under section 8A or 8C);
- broker's fees (whether in buying or selling the shares); and
- in the case of a listed share or participatory interest in a portfolio of a collective investment scheme, one-third of the interest on any loan used to buy the share or participatory interest.

Fees paid to a portfolio manager to manage your share portfolio do not qualify as part of the base cost of a share.

[74] Paragraph 32(6).

A special rule exists when you acquired the shares from your employer under an employee share incentive scheme. In that case, the base cost of the shares will usually be the market value of the shares that was taken into account in determining any amount of the revenue gain to be included in your income under section 8A or 8C (see **4.2.1** and **4.2.3**).[75]

5.6.3 Pre-valuation date shares

Special rules exist for determining the base cost of shares that you acquired before 1 October 2001 (known as the "valuation date"). These rules are necessary to exclude the portion of capital gains or losses that arose before the introduction of CGT on 1 October 2001. This is a fairly complex area, and although an overview of the rules is presented below, a detailed explanation is beyond the scope of this guide. For more information, please consult the *Comprehensive Guide to Capital Gains Tax* (Issue 4) that is available on the SARS website (All Publications / Capital Gains Tax).

The base cost of a share acquired before the valuation date is equal to the valuation date value plus any further allowable expenditure incurred on or after 1 October 2001.

Four methods are available for determining the valuation date value:

- Time-apportionment base cost
- Market value on 1 October 2001
- 20% of proceeds after first deducting any post-valuation date expenditure
- Weighted average (listed shares only)

Freedom of choice to switch between methods

Your freedom to switch between the different methods is limited by –

- your choice of asset-identification method (specific identification, first in, first out or weighted average (see **5.6.1** for commentary on identification methods); and
- the kink tests (see **5.6.4**).

Once adopted, the weighted-average identification method will also serve as your base cost method. In this case, you must use the weighted-average method for your entire portfolio of listed shares, and you may not use the time apportionment, market value or "20% of proceeds" methods for any of your listed shares. The kink tests do not apply if you choose the weighted-average method.

But if you chose specific identification or first in, first out as your identification method, you can choose whichever method (time apportionment, market value or 20% of proceeds) gives you the best result. Despite this freedom of choice, the kink tests discussed in **5.6.4** may substitute a different valuation date value to the one produced by the method you have chosen. Generally, the kink tests will only apply under certain circumstances when you determine a capital loss.

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[75] Paragraph 20(1)(*h*)(i). In some cases the amount received or accrued on disposal of the share is taken into account under section 8C and in such event that amount will be added to the base cost of the share rather than the market value.

Example 11 – Freedom of choice between valuation methods

Facts:

K held the following listed shares on 1 October 2001:

100 A Ltd
500 B Ltd

The following sales of shares occurred:

A Ltd – sold 50 on 30 June 2010 and the remaining 50 on 28 February 2011.

B Ltd – sold 100 on 30 June 2010 and a further 100 on 30 June 2011.

All shares were sold above cost and no capital losses will result regardless of the base cost method K selects (that is, the kink tests do not apply). Which base cost methods can K use for the shares that have been sold?

Result:

If K chooses the weighted-average method, K must use that method for all the A and B shares that have been sold. K will also have to use it for the remaining 300 B shares when they are sold.

If K chooses either the specific-identification or first-in-first-out method, K has complete freedom of choice between the time apportionment, market-value and 20%-of-proceeds methods. K does not have to be consistent within the same shares, between different shares or within a year of assessment.

Time-apportionment base cost

This method determines the valuation date value by spreading the capital gain or loss evenly over the pre- and post-1 October 2001 periods. There are two formulae:

$P = R \times B/(A + B)$, and

$Y = B + [(P – B) \times N/(N + T)]$

in which

Y = Time-apportionment base cost

P = Proceeds used in the time-apportionment formula.

R = Amount received or accrued on disposal of the share.

A = Allowable expenditure incurred on or after the valuation date (for example, one-third of interest on funds borrowed to acquire listed shares).

B = Allowable expenditure incurred before the valuation date reduced by any returns of capital received or accrued before the valuation date.

N = Number of years before 1 October 2001.

T = Number of years after 1 October 2001.

For the purposes of determining "N" and "T", a part of a year is counted as a full year.

The proceeds formula applies when further expenditure has been incurred on or after 1 October 2001 on the share. With effect from the commencement of years of assessment

ending on or after 8 November 2005 (that is, for individuals this means on or after 1 March 2005), selling expenses such as broker's fees must be deducted from the consideration received on disposal of the share and will no longer form part of "A" in the formula. This means that selling costs of this nature will no longer trigger the proceeds formula. Assuming no other post-valuation date expenditure was incurred, the selling expenses must be deducted from "P" in the time-apportionment formula. If other post-valuation date expenditure was incurred (for example, interest incurred in buying the shares or the cost of obtaining a CGT valuation in respect of unlisted shares) the proceeds formula will still apply and any selling expenses must be deducted from "R" in the proceeds formula.

If all these calculations are too much for you, do not despair. SARS has published a time-apportionment calculator on its website (Tax Types / Capital Gains Tax (CGT) / TAB Calculator), based on a Microsoft Excel spreadsheet. Simply enter the required data in the "input" section and the calculator will determine the time-apportionment base cost as well as the capital gain or loss. It applies the kink tests and will tell you whether another method for determining the valuation date value of an asset will give a better result.

Example 12 – Time-apportionment method

Facts:

J bought 100 ABC Ltd shares on 30 June 1991 at a cost of R9 500 plus broker's fees and marketable securities tax of R500. J sold them on 30 November 2011 for R15 400 less broker's fees of R400. Determine the capital gain on disposal of J's shares.

Result:

Pre-valuation date expenditure ("B") = R9 500 + R500 = R10 000

Post-valuation date expenditure ("A") = Nil (selling expenses reduce proceeds)

P = R15 400 - R400 = R15 000

Y = B + [(P – B) x N/(N+T)]

= R10 000 + [(R15 000 – R10 000) x 11/(11+11)]

= R10 000 + R2 500

= R12 500

Capital gain = Proceeds – valuation date value – post-valuation date costs

= R15 400 – R12 500 – R400

= R2 500

Note: For the sake of simplicity it has been assumed that J incurred no expenditure apart from selling expenses on or after 1 October 2001, thereby avoiding the triggering of the proceeds formula.

Market value

SARS has published the market values as at 1 October 2001 of all shares listed on the JSE on its website (Tax Types / Capital Gains Tax (CGT) / Value of Assets on 1 October 2001 / JSE-listed Financial Instruments). Persons wishing to use the market-value method for their pre-valuation date shares must use these values.

Example 13 – Market value method

Facts:

Z acquired 1 000 SA Breweries (SAB) shares before 1 October 2001 at a cost of R25 000. Z disposed of them for R75 000 after the valuation date. Determine Z's capital gain or loss using the market-value method.

Result:

The market value of the SAB shares on valuation date according to the published values on the SARS website is R53.96 per share. Z's capital gain is therefore R75 000 (proceeds) less R53 960 (base cost of 1 000 shares at R53,96 per share) = R21 040

20% of proceeds

For most taxpayers the 20%-of-proceeds method is likely to be a method of last resort since the market value and time-apportionment methods will usually give a better result. The valuation date value of a share using this method is determined as follows:

20% x (proceeds less allowable post-1 October 2001 expenditure).

Example 14 – 20%-of-proceeds method

Facts:

J inherited 100 ABC Ltd shares in April 2001. On 1 October 2001 the market value of the shares was R50. J sold them on 30 June 2010 for R500. Determine J's capital gain or loss using the 20%-of-proceeds method.

Result:

J has a capital gain of R400 determined as follows:

	R
Proceeds	500
Less: Base cost (R500 x 20%)	(100)
Capital gain	400

Weighted-average method

The weighted-average method is available for shares listed on a recognised exchange. Once you adopt this method, you must use it for your entire listed share portfolio. This means that you will not be able to use the time-apportionment, market value or 20%-of-proceeds methods for any of your listed shares.

Shares held on 1 October 2001 are added to the base cost pool at market value on that date. For JSE-listed shares you must use the prices published on the SARS website. The market value of foreign-listed shares on valuation date is equal to the ruling price at close of business on the last business day before 1 October 2001. The "ruling price" is the last sale price unless there was a higher bid or lower offer, in which case the latter will prevail.

Further purchases of the same share are added at actual cost.

A return of capital received or accrued –

- between 1 October 2001 and 30 September 2007 (both dates included) must be deducted from the weighted-average base cost of your shares;
- on or after 1 October 2007 and before 1 April 2012 triggers a part-disposal of your shares and the portion of the base cost that has been disposed of must be deducted from the weighted-average base cost of your shares; and
- on or after 1 April 2012 must be deducted from the weighted-average base cost of your shares.

For more on returns of capital see **5.8**.

The weighted-average base cost per share is calculated immediately before disposal and this is used to determine the base cost of the shares disposed of. The base cost pool is then reduced by the shares disposed of. This method is illustrated in an example under **5.6.1**. The main advantage of this method is simplicity, since portfolio managers report share transactions to SARS (and usually to their clients) using this method. It also avoids the complex gain and loss limitation rules ("kink tests") that apply when you use the time-apportionment or market value methods.

5.6.4 Gain and loss limitation rules (the "kink tests")

Special rules contained in paragraphs 26(3) and 27, known as "kink tests", apply under certain circumstances when you use the time-apportionment and market value methods to determine the valuation date value of your shares. These rules are primarily aimed at preventing or limiting the claiming of losses when the market value on 1 October 2001 is used as the base cost. In other cases, the kink tests will prevent the use of time-apportionment to determine the valuation date value and will substitute another value such as market value or proceeds less post-valuation date expenditure.

It is beyond the scope of this guide to explore these rules in detail, but some examples of the more common situations in which the kink tests apply are set out in the table below. These rules do not apply when you use the weighted-average method.

Table 1 – Examples of application of gain and loss limitation rules

Cost **R**	**Market value on 1 October 2001** **R**	**Proceeds** **R**	**Valuation date value prescribed by kink test**
100	150	120	120
100	50	70	70 (time-apportionment method not permitted)
100	50	20	50 (time-apportionment method not permitted)
100	150	50	Time-apportionment base cost

For the purpose of the above examples, post-valuation date expenditure has been ignored.

5.6.5 Base cost of shares in foreign-listed companies

Paragraph 43(4) contains special rules for the determination of the capital gain or loss on disposal of foreign-listed shares. These rules tell you how to translate the base cost and proceeds into rands when you incur expenditure and receive proceeds from the disposal of those shares in a foreign currency.

The proceeds on disposal must be translated into rands using either –

- the average exchange rate during the year of assessment in which the share was disposed of; or
- the spot rate on the date of disposal.

The expenditure on the share must be translated into rands using either –

- the average exchange rate during the year of assessment in which the expenditure was incurred; or
- the spot rate on the date on which the expenditure was incurred.

A list of average exchange rates for a year of assessment can be found on the SARS website (Tax Types / Income Tax (IT) / Average Exchange Rates for a Year of Assessment).

Any market value determined on 1 October 2001 must be translated into rands at the spot rate on that date.[76] A list of exchange rates as at 1 October 2001 can be found on the SARS website (Tax Types / Capital Gains Tax (CGT) / Value of Assets on 1 October 2001 / Exchange Rates as at 1 October 2001).

5.7 Determining a taxable capital gain or assessed capital loss

5.7.1 The basic computation

A taxable capital gain (which will be included in your taxable income) or an assessed capital loss (which will be carried forward to the following year of assessment for set-off against future capital gains) is determined as follows:

Sum of capital gains and losses during the year of assessment

Less: Annual exclusion

= Aggregate capital gain or loss

Less / add: Assessed capital loss brought forward from previous year of assessment

= Net capital gain or assessed capital loss

Multiply a net capital gain by the inclusion rate (25% for individuals and special trusts; 50% for companies and trusts)

= Taxable capital gain to be included in taxable income.

Any resulting assessed capital loss will be carried forward to the following year of assessment.

[76] Paragraph 43(6)(*a*).

5.7.2 Annual exclusion

The first R20 000 (known as the "annual exclusion") of the sum of an individual's capital gains and losses in the 2012 year of assessment is disregarded (2011: R17 500).[77] To the extent that the annual exclusion is not used, it may not be carried forward to the next year of assessment. For the 2012 year of assessment the annual exclusion is increased to R200 000 in the year of assessment in which a person dies (2011: R120 000).

5.7.3 Assessed capital loss

An aggregate capital gain will result if the sum of the capital gains and losses during the year of assessment produces a positive figure and there is still a balance remaining after reducing that sum by the annual exclusion.

An aggregate capital loss will result if the sum of the capital gains and losses during the year of assessment is a negative figure and there is still a balance remaining after reducing that sum by the annual exclusion.

An assessed capital loss for the year of assessment results when –

- an assessed capital loss brought forward from the previous year of assessment exceeds an aggregate capital gain for the year of assessment; or
- there is an aggregate capital loss for the year of assessment, in which case the assessed capital loss is equal to the aggregate capital loss plus any assessed capital loss brought forward from the previous year of assessment.

The assessed capital loss is carried forward to the next year of assessment in which it will be used in the manner described above. An assessed capital loss can only reduce your liability for CGT and cannot be set off against your ordinary income.

Once it is established, an assessed capital loss is not again reduced by the annual exclusion in future years.

Example 15 – Determination of taxable capital gain

Facts:

B made the following capital gains and losses during the 2012 year of assessment:

	R
Capital gain on ABC Ltd shares	5 000
Capital gain on XYZ Ltd shares	30 000
Capital loss on DEF Ltd shares	(3 000)

At the end of the 2011 year of assessment B had an assessed capital loss of R2 000.

Determine the amount to be included in B's taxable income.

[77] The annual exclusion also applies to a special trust referred to in paragraph (*a*) of the definition of a "special trust" in section 1. This is a special trust created for a person having a mental illness or serious physical disability, which incapacitates the person from earning sufficient income for the maintenance of the person or from managing the person's own financial affairs.

Result:

	R
Capital gain on ABC Ltd shares	5 000
Capital gain on XYZ Ltd shares	30 000
Capital loss on DEF Ltd shares	(3 000)
Sum of capital gains and losses during the year of assessment	32 000
Less: Annual exclusion	(20 000)
Aggregate capital gain	12 000
Less: Assessed capital loss brought forward from previous year of assessment	(2 000)
Net capital gain	10 000
Inclusion rate (25% for an individual)	
Taxable capital gain – to be included in taxable income	2 500

5.8 Return of capital

There have been a number of significant changes to the Act which affect the treatment of a return of capital by way of a distribution of cash or an asset *in specie* for CGT purposes. Most of these changes were introduced on 1 January 2011 and include the following:

- The definition of a "dividend" in section 1 was substituted with effect from 1 January 2011 with a much-simplified definition which is no longer dependent on the concept of profits. The simplified definition has undergone further modification with effect from 1 April 2012 and in general a dividend is now anything transferred or applied by a resident company for the benefit or on behalf of any person in respect of any share in the company, which does not comprise "contributed tax capital".
- The definition of the term "contributed tax capital" was introduced into section 1 at the same time as the simplified definition of a "dividend" from 1 January 2011. This definition has also undergone further modification with effect from 1 April 2012. At a basic level contributed tax capital represents the consideration a company receives in return for the issue of a class of shares less those amounts transferred for the benefit of the persons holding those shares.
- The term "capital distribution" has been deleted from paragraph 74 with effect from 1 April 2012 and replaced by the terms "return of capital" and "foreign return of capital" which are defined in section 1.
- Section 64B(5)(*c*) has been deleted. This section used to exempt from STC distributions made in anticipation or in the course of the liquidation or deregistration of a company out of pre-1993 profits and pre-1 October 2001 capital profits. Such STC-exempt distributions were a return of capital for CGT purposes. On or after 1 January 2011 these distributions are subject to STC and are no longer treated as a return of capital but instead comprise a dividend. On or after 1 April 2012 these distributions are subject to dividends tax.
- With effect from 1 April 2012 a return of capital will no longer trigger a part-disposal of a share. Instead, it will be treated as a reduction of the base cost of the share.

A return of capital for CGT purposes has been treated in three different ways since 1 October 2001. An understanding of these changes is necessary in order to appreciate the current treatment of these distributions.

1 October 2001 to 30 September 2007

During this period the CGT consequences of a return of capital were deferred until the related shares were disposed of. If you adopted the specific-identification or first-in-first-out methods, a return of capital received or accrued on or after 1 October 2001 was treated as proceeds on disposal of a share, while under the weighted-average method it was deducted from the base cost of your shares.

1 October 2007 to 31 March 2012

A return of capital received or accrued on or after 1 October 2007 but before 1 April 2012 triggered a part-disposal of the share in your hands, regardless of the identification method adopted (specific identification, first in, first out or weighted average).

Any returns of capital accumulated between 1 October 2001 and 30 September 2007 continued to be treated as proceeds on a full disposal of the share provided you dispose of it before 1 April 2012. This only applies to the specific identification and first-in-first-out methods because under the weighted-average method you would already have deducted the returns of capital from the base cost of your shares at the time of receipt or accrual.

On or after 1 April 2012

On or after 1 April 2012 a return of capital must be deducted from the base cost of your shares.[78]

If the base cost becomes negative as a result of the deduction of the return of capital the excess is treated as a capital gain.[79]

Special rules apply when you receive a return of capital on or after 1 April 2012 on a share you acquired before 1 October 2001. These rules are necessary because the base cost reduction method needs to reduce expenditure. With pre-valuation date shares you have a "valuation date value" (as opposed to expenditure). The problem is that a valuation date value can only be established under the time-apportionment and 20%-of-proceeds methods once you have disposed of your share and it is therefore not possible to perform the base cost reduction at the time of the return of capital. In order to address this problem the rule converts your pre-valuation date share into a post-valuation date share with a re-established base cost comprising post-valuation date expenditure. It does this by deeming the share to be disposed of and reacquired at market value immediately before the return of capital. Any capital gain will be deducted from the reacquisition cost while any capital loss is added to it.[80] Should the base cost become negative in this process, a capital gain will be triggered to the extent of the negative amount. Once this base cost adjustment has been done any further returns of capital will simply reduce base cost in the normal way.

Another special rule deems the accumulated pre-1 October 2007 returns of capital in respect of shares held on 1 April 2012, which were previously dealt with as proceeds on a full disposal of the share to be distributed on that day.[81] You must deduct this deemed distribution from the base cost of your shares on 1 April 2012 (but not if you have adopted the weighted-average method you would already have done so at the time of actual receipt or accrual of the return of capital). For pre-valuation date shares for which you have adopted first in, first out or specific identification the deemed distribution on 1 April 2012 will trigger the deemed disposal and reacquisition described in the previous paragraph in order to re-

[78] Paragraph 76B(2).
[79] Paragraph 76B(3).
[80] Paragraph 76B(1).
[81] Paragraph 76A(1A).

establish a base cost for the share. If you adopted the weighted-average method and the base cost is negative at the end of 31 March 2012 the negative amount is treated as a capital gain on 31 March 2012.[82]

The part-disposal method (1 October 2007 to 31 March 2012)

The formula for determining the portion of the base cost of your shares to be allocated to the part-disposal is as follows:

$$A = \frac{B}{C} \times D$$

in which

A = The portion of the cost of the shares, market value on 1 October 2001 or weighted average base cost to be allocated to the part-disposal.

B = The market value of the return of capital received or accrued.

C = The market value of your shares immediately before the return of capital is received by or accrues to you.

D = The cost of the shares, market value on 1 October 2001 or weighted-average base cost immediately before the part-disposal.

The table below summarises the CGT consequences of returns of capital.

Table 1 – Treatment of returns of capital

When return of capital received or accrued	Identification method adopted	Treatment
Before 1 October 2001	Specific identification or first in, first out	Reduce pre-1 October 2001 expenditure in respect of the share (but not below nil). This applies if you use the time-apportionment method to determine the base cost.
	Weighted average	Not relevant (ignore).
On or after 1 October 2001 but before 1 October 2007	Specific identification or first in, first out	• If you dispose of your shares before 1 April 2012, the return of capital is treated as proceeds on disposal. • If you still hold the shares on 1 April 2012, the return of capital is deemed to be distributed to you on 1 April 2012. This deemed distribution means that you must deduct the return of

[82] Paragraph 76A(2).

		capital from the base cost of the share. Any negative amount resulting from the deduction must be brought to account as a capital gain. The base cost of a pre-valuation date share must be re-established on 31 March 2012.
	Weighted average	• A return of capital received or accrued on or after 1 October 2001 but before 1 October 2007 must be deducted from base cost as and when received or accrued. • If you have disposed of the shares before 1 April 2012 you must calculate the capital gain in the normal way (proceeds less base cost). • If you still hold the shares on 1 April 2012 and the base cost is negative as at the end of 31 March 2012, the negative amount is treated as a capital gain on 31 March 2012 and the base cost as at the end of 31 March 2012 reset to nil.
On or after 1 October 2007 but before 1 April 2012	Specific identification, first in, first out or weighted average	Treat as proceeds on a deemed part-disposal.
On or after 1 April 2012	Specific identification, first in, first out or weighted average	• Deduct from base cost. • Re-establish base cost for pre-valuation date shares (specific identification and first in, first out only).

Example 16 – Return of capital triggering part-disposal on or after 1 October 2007 but before 1 April 2012

Facts:

T acquired a share in 2002 at a cost of R120. On 31 January 2012 T received a return of capital of R20 in cash. The market value of the share at the close of business on 30 January 2012 was R200.

Result:

The return of capital triggers a part-disposal. Ten percent of the base cost of R120 is allocated to the part-disposal (R20 return of capital divided by R200 market value). T will therefore have a capital gain of R8 (R20 proceeds less R12 allocable base cost). The base cost of the share going forward is R120 – R12 = R108.

Example 17 – Return of capital and the weighted-average method

Facts:

V has adopted the weighted-average method for base cost and identification purposes for V's listed shares. The following is a summary of V's weighted average base cost for shares in ABC Ltd, a JSE-listed company:

	No of shares	Price per share R	Base cost R
01.10.2001 Opening balance	200	1,00	200,00
30.06.2004 Buy	100	1,50	150,00
28.02.2007 Return of capital	___		(20,00)
Subtotal	300	1,10	330,00
31.07.2007 Sell	(100)	1,10	(110,00)
Subtotal	200	1,10	220,00
31.12.2007 Buy	300	2,00	600,00
Subtotal	500	1,64	820,00
30.06.2011 Sell	(100)	1,64	(164,00)
Subtotal	400	1,64	656,00

The shares sold on 31 July 2007 realised R1,80 per share.

The shares sold on 30 June 2011 realised R3,00 per share.

On 31 December 2011 V received a return of capital of R60 on the 400 shares held at the time. The market value of the shares at close of business on 30 December 2011 is R3,00 per share.

On 31 May 2012 V received a return of capital of R70.

Determine the capital gain or loss arising from the various sales and returns of capital and the base cost after the last transaction.

Result:

Return of capital – 28 February 2007

No capital gain or loss arises on the receipt of this return of capital. Since the amount was received before 1 October 2007, it is deducted from the base cost of the shares.

Sale – 31 July 2007

	R
Proceeds 100 x R1,80	180,00
Less: Base cost	(110,00)
Capital gain	70,00

Sale – 30 June 2011

	R
Proceeds 100 x R3,00	300,00
Less: Base cost	(164,00)
Capital gain	136,00

Return of capital– 31 December 2011

The market value of the 400 shares held on 30 December 2011 was R1 200 (400 x R3 per share). This figure is used in the denominator of the part-disposal formula in paragraph 33(1).

	R
Proceeds	60,00
Less: Base cost R60/R1 200 x R656	(32,80)
Capital gain	27,20

Return of capital – 31 May 2012

The return of capital of R70 is deducted from the base cost of the shares under paragraph 76B(2).

The base cost of V's shares after the last two returns of capital is as follows:

	No of shares	Price per share R	Base cost R
Subtotal	400	1,64	656,00
31.12.2011 Return of capital			(32,80)
Subtotal	400	1.56	623,20
31.05.2012 Return of capital			(70,00)
Total	400		553,20

Example 18 – Return of capital on or after 1 April 2012 on post-valuation date shares

Facts:

B acquired all the shares in Company X on 1 March 2003 at a base cost of R150. What are the CGT implications if Company X makes a return of capital to B on 30 April 2012 of –

- R100; or
- R400?

Result:

The amount distributed to B must first be applied in reduction of the base cost with any excess being treated as a capital gain.

Return of capital of R100

	R
Base cost	150
Less: Return of capital	(100)
Base cost going forward	50

Return of capital of R400

	R
Base cost	150
Less: Return of capital	(400)
Capital gain	250

The base cost of the shares going forward will be nil.

Example 19 – Return of capital on or after 1 April 2012 on pre-valuation date shares

Facts:

On 1 June 1991 C acquired 100 shares in ABC Ltd, a JSE-listed company, at a cost of R100. C uses the first-in-first-out method to identify listed shares that have been disposed of. The market value of the shares on 1 October 2001 was R350 and on 15 May 2012 was R500. On 16 May 2012 C received a return of capital of R40 and on 30 October 2012 a further return of capital of R30. What are the CGT implications for C?

Result:

The receipt of the return of capital triggers a re-establishment of the base cost of the ABC Ltd shares. For this purpose C is deemed to have disposed of the shares for proceeds of R500 (market value of the shares immediately before the return of capital) and to have reacquired the shares at a cost of R500. Any capital gain must be deducted from the deemed expenditure of R500 while any capital loss must be added to that amount.

C can use any method to determine the capital gain or loss (time apportionment, market value on 1 October 2001 or 20% of proceeds).

Time apportionment

Y = B + [(P – B) x N/(N + T)]
= R100 + [(R500 – R100) x 11/(11 + 11)]
= R100 + R200
= R300

20%-of-proceeds

	R
Proceeds	500
Base cost (20% x R500)	100

The market value method gives the highest base cost, namely, R350. C therefore chooses this method since it will give the best result.

The capital gain is determined as follows:

	R
Proceeds	500
Less: Base cost using market value on 1 October 2001	(350)
Capital gain	150

Re-established base cost

	R
Deemed reacquisition cost	500
Less: Capital gain determined above	(150)
Re-established base cost	350
Less: Return of capital – 16 May 2012	(40)
Base cost after first return of capital	310
Less: Return of capital – 30 October 2012	(30)
Base cost going forward	280

Example 20 – Pre-1 October 2007 return of capital with post-valuation date shares still held on 1 April 2012

Facts:

D acquired 100 shares in XYZ Ltd on 1 March 2002 at a cost of R100. On 30 June 2007 D received a return of capital of R40 on the shares. The shares are still held by D on 1 April 2012. D uses the specific-identification method to identify shares that have been disposed of.

Result:

The return of capital of R40 must be deducted from the base cost of the shares. The base cost of the shares on 1 April 2012 is thus R100 – R40 = R60.

Note: Had D acquired the shares before the valuation date it would first be necessary to re-establish their base cost on 31 March 2012 as in Example 19.

5.9 Anti-loss rules

The Eighth Schedule contains two anti-avoidance rules in paragraphs 19 (extraordinary dividens) and 42 (short-term disposal and reacquisition) which limit capital losses on the disposal of shares under certain circumstances.

5.9.1 Losses arising from extraordinary dividends

The position before 1 April 2012

You must disregard any capital loss on disposal of your shares under paragraph 19 to the extent that it is equal to or less than any extraordinary dividends received by or accrued to you within the two years before or as part of the disposal.

"Extraordinary dividends" are dividends –

- received or accrued within the two years before you dispose of your shares or which form part of the disposal; and
- which in total exceed 15% of the proceeds on disposal of your shares.

An extraordinary dividend will form part of the disposal, for example, when the company in which you have invested buys back its own shares and part of the consideration you receive consists of a dividend. You may also receive an extraordinary dividend upon the winding up or deregistration of a company since the company will typically distribute an amount in excess of its contributed tax capital in that process. You can also receive extraordinary dividends as part of a normal distribution by a company although this will tend to happen less frequently.

Example 21 – Extraordinary dividends before 1 April 2012

Facts:

K bought all the shares in ABC (Pty) Ltd at a cost of R1 million in 2002. On 1 March 2011 the company was placed into voluntary liquidation. On 1 May 2011 K received a dividend of R1,5 million. On 15 October 2011 K received a return of capital of R10 000 at which point the company was finally dissolved.

Result:

Were it not for paragraph 19, K would have a capital loss on 15 October 2011 determined as follows:

	R
Proceeds	10 000
Less: Base cost	(1 000 000)
Capital loss before applying paragraph 19	(990 000)

Under paragraph 19(1) ABC (Pty) Ltd has distributed an extraordinary dividend within two years of the disposal of the shares. Accordingly, the capital loss of R990 000 must be disregarded to the extent of the extraordinary dividend.

	R
Dividend	1 500 000
Less: 15% of R10 000 (proceeds)	(1 500)
Extraordinary dividend [paragraph 19(3)(*c*)]	1 498 500

Since the capital loss of R990 000 does not exceed the extraordinary dividend, it must be fully disregarded.

The position on or after 1 April 2012

With effect from 1 April 2012 paragraph 19 has undergone some significant changes to account for the introduction of dividends tax and the revised method of taxing foreign dividends. The terms "exempt dividend" and "extraordinary exempt dividends" are now defined as follows in paragraph 19(3)(*b*) and (*c*) respectively:

An "exempt dividend" is any dividend or foreign dividend –

- to the extent that it is not subject to dividends tax; and
- is exempt from normal tax under section 10(1)(*k*)(i) (exempt local dividend), section 10B(2)(*a*) (foreign dividend exempt because the person (whether alone or

together with any other company forming part of the same group of companies as that person) holds at least 10% of the total equity shares and voting rights in the company), or section 10B(2)(*b*) (foreign dividend exempt because it is paid or declared by a foreign company to another foreign company resident in the same country).

The term "extraordinary exempt dividends" means so much of the amount of the aggregate of any exempt dividends received or accrued within the period of 18 months before or as part of the disposal of the shares as exceeds 15% of the proceeds received or accrued from their disposal.

The amended paragraph 19 now applies to exempt dividends derived during the 18-month period before or as part of the disposal of the shares, down from the previous two-year period.

Different rules apply when a person disposes of shares at a capital loss –

- as a result of a share buy-back or as part of the liquidation, winding up or deregistration of the company; and
- in circumstances other than those described in the above bullet point.

Under the first bullet point the person must disregard so much of the capital loss that does not exceed any exempt dividends.

Under the second bullet point the person must disregard so much of the capital loss as does not exceed any extraordinary exempt dividends.

The practical effect of these changes is that paragraph 19 will not apply to an individual holding shares in a resident company or non-resident JSE-listed company because dividends from these companies are subject to the dividends tax. It will, however, apply to resident companies receiving dividends from such companies because such dividends are exempt from dividends tax under section 64F(*a*).

In the case of foreign dividends paragraph 19 will apply to –

- an individual who enjoys the participation exemption in section 10B(2)(*a*); and
- a company that enjoys the participation exemption in section 10B(2)(*a*) or the same country exemption in section 10B(2)(*b*).

Example 22 – Disregarding of capital loss on buy-back of resident company shares from company

Facts:

Resident Company A owns shares in JSE-listed Company B which it acquired for R100 000 on 1 March 2005. On 31 May 2012 Company B buys back 10% of its shares from all its shareholders and advises them that 75% of the consideration is a dividend while the remaining 25% is a return of capital. Company A receives R20 000 as consideration for the buy-back.

Result:

Company B has engaged in a pro rata repurchase of its shares from all its shareholders (as opposed to a "general repurchase" on the open market through a stockbroker). It is accordingly necessary for Company A to split the consideration it received for the disposal of the Company B shares between the dividend and return of capital elements.

	R
Proceeds (return of capital R20 000 x 25%)	5 000
Less: Base cost R100 000 x 10%	(10 000)
Capital loss before applying paragraph 19(1)(*a*)	(5 000)

Portion of capital loss to be disregarded:

The dividend portion of the consideration of R15 000 (R20 000 x 75%) is an exempt dividend because it is not subject to normal tax or dividends tax. Under paragraph 19(1)(*a*) the company must disregard the portion of the capital loss that does not exceed the exempt dividends received as a result of the share buy-back. Since the exempt dividend of R15 000 exceeds the capital loss of R5 000, the full capital loss of R5 000 must be disregarded.

Note: Had Company A been a resident individual no portion of the capital loss would be disregarded under paragraph 19(1)(*a*) because the dividend of R15 000 is subject to dividends tax at 15% and is therefore not an exempt dividend as defined in paragraph 19(3)(*b*).

Example 23 – Disregarding of a capital loss as a result of the receipt or accrual of an extraordinary exempt dividend

Facts:

Company A owns shares in ABC Ltd, a resident JSE-listed company which it acquired at a cost of R100 000 on 1 March 2009. On 31 May 2012 ABC Ltd declared a dividend of R30 000 to Company A. On 31 December 2012 Company A sold its shares for R80 000.

Result:

The dividend of R30 000 is an exempt dividend referred to in paragraph 19(3)(*b*) because it is exempt from dividends tax[83] and normal tax.[84]

	R
Proceeds	80 000
Less: Base cost	(100 000)
Capital loss before applying paragraph 19(1)(*b*)	(20 000)

Extraordinary exempt dividend:

Dividend	30 000
Less: 15% of proceeds (R80 000 x 15%)	(12 000)
Extraordinary exempt dividend	18 000

Portion of capital loss to be disregarded:

Capital loss before applying paragraph 19(1)(*b*)	20 000
Less: Extraordinary exempt dividend	(18 000)
Allowable capital loss	(2 000)

[83] Section 64F(*a*) exempts a resident company from the dividends tax.
[84] Section 10(1)(*k*)(i).

Note: Had Company A been a resident individual no part of the capital loss of R20 000 would have been disregarded because the dividend of R30 000 would have been subject to dividends tax at a rate of 15% and would therefore not comprise an exempt dividend as defined in paragraph 19(3)(*b*). Since it would not comprise an exempt dividend it would also not comprise an extraordinary exempt dividend under paragraph 19(3)(*c*).

5.9.2 "Bed and breakfast" sales

Paragraph 42 deals with a CGT avoidance scheme known as "bed and breakfasting". In a literal sense the term refers to a sale of shares on one day ("before bed"), and a repurchase of those same shares the next day ("at breakfast"). The purpose of such a short-term disposal and acquisition is to generate a capital loss for set-off against other capital gains in the year of assessment. Typically one might find "bed and breakfasting" occurring at the end of a year of assessment. The purpose of reacquiring the shares is simply to restore the portfolio to its pre-sale position.

Under paragraph 42 if you dispose of shares at a capital loss and buy back those shares within a 45-day period on either side of the disposal, you must disregard the capital loss. The capital loss is not forfeited, but is added to the base cost of the replacement shares. In this way the use of the capital loss is deferred until you sell the replacement shares without reacquiring them in the short term.

6. Corporate restructuring events

Although not covered in detail by this guide, you should be aware that special rules exist for determining a capital gain or loss when certain corporate restructuring transactions occur. Some of these are mentioned below.

6.1 Unbundling transactions

When a company distributes shares it holds in another company to you as shareholder under an "unbundling transaction" contemplated in section 46, you will need to allocate a portion of the expenditure and any market value on 1 October 2001 of your existing shares to the new shares received.[85] Similarly, if you have adopted the weighted-average method you must allocate part of the base cost of the existing shares to the new shares. The allocation must be done in accordance with the following formula:

$$\frac{\text{Market value of new shares at end of day after unbundling}}{\text{Market value of old and new shares at end of day after unbundling}} \times \text{Cost of old shares}$$

Any market value on 1 October 2001 or weighted-average base cost in respect of the old shares must be allocated to the new shares on the same basis.

The amount allocated to the new shares in accordance with the above formula must be deducted from the expenditure, market value or weighted-average base cost relating to the old shares.

[85] Section 46(3).

Example 24 – Unbundling transaction

Facts:

J held 100 shares in A Ltd on 1 October 2001 that had been acquired in 1995 at a cost of R100. Their market value on 1 October 2001 was R120. On 30 June 2011 A Ltd distributed all its shares in B Ltd to its shareholders as part of an unbundling transaction. J received 20 B Ltd shares, which had a market value of R20 at close of business on 1 July 2011. The market value of J's A Ltd shares at close of business on 1 July 2011 was R140.

Determine the market value on 1 October 2001 and expenditure attributable to J's A Ltd and B Ltd shares.

Result:

Expenditure attributable to B Ltd shares:

= R100 x R20/(R20 + R140)
= R100 x R20/R160
= R12,50

Expenditure attributable to A Ltd shares:

= R100 – R12,50
= R87,50

Market value attributable to B Ltd shares:

= R120 x R20/(R20 + R140)
= R120 x R20/R160
= R15

Market value attributable to A Ltd shares:

= R120 – R15
= R105

6.2 Asset-for-share transactions

When you receive equity shares in a new company in exchange for your existing shares in another company under an "asset-for-share transaction" contemplated in section 42, you may qualify for roll-over relief under which –

- your existing shares will be deemed to be disposed of at their base cost thus giving rise to neither a capital gain or loss; and
- the base cost of your shares in the new company will be the same as the base cost of the old shares that you disposed of.[86]

You will only be entitled to roll-over relief for gain or break even shares. Thus the roll-over relief will not apply if you would have made a loss on exchange of the shares. In a loss situation you will simply claim the loss, and acquire the new shares at a cost equal to the market value of the shares you have disposed of at the time of the asset-for-share transaction.

[86] Section 42(2).

Example 25 – Asset-for-share transaction

Facts:

L acquired 100 shares in Target Ltd on 1 March 1995 at a cost of R100. The market value of the Target Ltd shares on 1 October 2001 was R150. On 30 June 2011 L received a circular advising that Acquiring Ltd, a listed company, would be taking over L's shares under a section 42 asset-for-share transaction. In return L would receive 50 shares in Acquiring Ltd. The market value of the Acquiring Ltd shares at the time of the take-over was R500.

Determine the CGT consequences for L of the disposal of the Target Ltd shares and the acquisition of the Acquiring Ltd shares.

Result:

Step 1: Determine whether L qualifies for roll-over relief under section 42

L will qualify for roll-over relief because –

- an asset-for-share transaction has occurred under section 42; and
- L would have made a capital gain on disposal of the Target Ltd shares had section 42 not applied, that is, R500 (proceeds equal to market value of Acquiring Ltd shares) less R150 (base cost of Target Ltd shares assuming the use of market value as the valuation date value) = R350 (capital gain).

Step 2: Apply the roll-over relief

L is deemed to have sold the Target Ltd shares for an amount equal to their base cost, which results in a tax-free disposal.

L is deemed to have acquired the Acquiring Ltd shares on 1 March 1995 at a cost of R100. The market value of the Acquiring Ltd shares on 1 October 2001 is deemed to be R150.

6.3 Amalgamation transactions

An amalgamation transaction occurs under section 44 when a company (A) transfers all its assets to another company (B) in return for shares in B. Company A then distributes the B shares to its shareholders and is thereafter liquidated or deregistered. Thus, if you were a shareholder of Company A, your A shares will be disposed of and you will receive Company B shares as a replacement. This rule works on a similar basis to the asset-for-share transaction rule described under **6.2**. Any capital gain or loss on disposal of your A shares is disregarded and the attributes of your A shares are carried across to your B shares, namely –[87]

- dates of acquisition and incurral of expenditure;
- any expenditure incurred; and
- any market value determined on 1 October 2001.

Simply put, the B shares step into the shoes of the A shares.

[87] Section 44(6).

6.4 Share buy-backs

A disposal will occur when a company buys back its own shares from you.

For CGT purposes the proceeds received by you exclude any portion of the consideration that constitutes a dividend.[88]

You are not required to split the consideration you receive from a JSE-listed company which buys back your listed shares on the open market (in any event you would be unlikely to know that it was the company that had repurchased your shares hence the need for this rule).[89] In these circumstances the full consideration you receive will accordingly comprise the proceeds.

The latter situation must be distinguished from one in which a JSE-listed company buys back its shares from all its shareholders on a pro rata basis. In such event it will be necessary to split the consideration between the dividend and non-dividend elements. The company should provide you with this information.[90]

6.5 Roll-over relief for forced sale of listed shares

Paragraph 42A enables you to defer a capital gain when you are forced to sell some of your shares as a result of a court order under section 311 of the Companies Act 61 of 1973. Section 311 of the Companies Act, 1973 has been repealed with effect from 1 May 2011 and paragraph 42A has not yet been amended to reflect the equivalent provision under the Companies Act 71 of 2008, namely, s 114. Clause 42 of the draft Taxation Laws Amendment Bill, 2012 proposes to insert a reference in paragraph 42A to section 114 of the Companies Act with effect from 1 May 2011.

A compulsory disposal of this nature could occur, for example, because the company needs the shares in order to facilitate a Black Economic Empowerment deal. The deferral relief will only be granted if you replace the shares with shares of the same kind in the same company within 90 days of the forced sale. The relief is provided as follows:

- You are treated as having disposed of your old shares at an amount equal to their base cost (that is, there will be no capital gain on the forced sale).
- You must reduce the expenditure on your replacement shares by the amount of the deferred capital gain that arose on the forced sale of your old shares (this is the base cost of your replacement shares going forward).
- If the capital gain exceeds the expenditure on the replacement shares, the excess is treated as a capital gain on disposal of the old shares and the replacement shares are treated as having a base cost of nil going forward.
- You are treated as having acquired the replacement shares on the same date as the old shares (this is relevant for the purposes of the three-year holding rule under section 9C).

[88] Under paragraph 35(3)(*a*) the proceeds must be reduced by any amount thereof that is included in your gross income. A dividend or foreign dividend is specifically included in gross income by paragraph (*k*) of the definition of the term "gross income" in section 1.

[89] Paragraph (iii) of the definition of a "dividend" in section 1 excludes as a dividend the amount given by a company to its shareholders under a "general repurchase" of its own listed shares. A "general repurchase" refers to an open market buy-back. Typically in such a situation the company would instruct its stockbroker to purchase a certain number of shares on the market.

[90] Paragraph 76(4) read with the definition of "contributed tax capital" in section 1.

Example 26 – Forced sale of listed shares followed by reacquisition of shares of the same kind

Facts:

K owns 2 000 ordinary shares in XYZ Ltd, a company listed on the JSE. Under section 114 of the Companies Act 71 of 2008 K is forced to sell 25% (that is, 500) of those shares to XYZ Ltd in return for a cash payment of R110 000. The company notifies K that this amount comprises a return of capital since it has been paid out of its contributed tax capital. The shares sold have a base cost of R90 000.

Within 40 days of the buy-back, K repurchases 500 of XYZ Ltd's ordinary shares for R135 000 on the open market.

Result:

Were it not for paragraph 42A, K would have had a capital gain of R20 000 (R110 000 – R90 000) on the forced sale of the 500 ordinary shares. Paragraph 42A treats K as having disposed of the 500 shares at their base cost of R90 000 and hence no capital gain arises on the disposal. This is because –

- K was forced to sell the shares under section 114 of the Companies Act, 2008;
- the shares are listed;
- the sale would have given rise to a capital gain; and
- the repurchase occurred within 90 days.

The base cost of the newly repurchased shares is determined as follows:

	R
Cost of replacement shares	135 000
Less: Deferred capital gain on disposal of old shares	(20 000)
Base cost	115 000

Example 27 – Gain on old "forced sale" shares exceeds expenditure on new shares

Facts:

The facts are the same as Example 26, except that K acquires the 500 replacement ordinary shares in XYZ Ltd for R15 000.

Result:

The capital gain on disposal of the old shares (R20 000) exceeds the expenditure on the new shares (R15 000) by R5 000. As a result

- the base cost of K's new shares is reduced to nil, and
- the excess of R5 000 is treated as a capital gain.

6.6 Capitalisation shares

Companies often issue "capitalisation shares"[91] to their shareholders instead of paying dividends.[92] This may be done to retain the funds in the company for further expansion of its operations. Capitalisation shares, which are acquired for no consideration are deemed to have a cost of nil.[93] However, if you acquired such shares before 1 October 2001 you would be entitled to use the market value to determine their base cost on 1 October 2001.

6.7 Share splits / consolidations

Sometimes companies increase the number of their shares in issue by subdividing the existing shares into a greater number of shares (a share split). For example, you may be asked to surrender your present holding of 100 ABC Ltd shares and will receive 200 new ABC Ltd shares in return. In these cases the base cost of your old ABC Ltd shares will simply be allocated between the new shares. The same would apply when you are asked to surrender your old shares for a lesser number of new shares – known as a consolidation. In this case you will simply allocate the base cost of the old shares across the lesser number of new replacement shares.[94]

6.8 Nil paid letters

Companies sometimes raise additional capital on the securities exchange by means of a rights issue. Under such an arrangement, the company offers its existing shareholders the right to take up its shares at a certain price (usually below the prevailing market price) at a certain date. The rights that shareholders receive are known as "renounceable nil paid letters of allocation" or more simply as "nil paid letters" (NPLs). These NPLs are listed temporarily for a few weeks on the securities exchange until the close of the offer. Should you accept the offer, you will simply acquire the shares offered to you for the stipulated price. Should you decide not to accept the offer, you may sell the NPLs on the securities exchange. From a CGT perspective, an NPL is an asset that has a nil base cost.[95] The capital or revenue nature of the amount you derive on disposal of an NPL must be determined with reference to the normal capital v revenue principles laid down by case law.

The cost of an NPL you have purchased on the open market must be added to the base cost of the relevant shares when you acquire them by exercising the right to take up the shares.[96] Should you decide not to take up the shares the NPL will be disposed of[97] at a loss equal to the cost of the NPL.The capital or revenue character of such a loss will be determined by applying the normal capital v revenue principles.

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[91] Section 47 of the Companies Act 71 of 2008.

[92] Capitalisation shares are not a dividend since paragraph (ii) of the definition of a "dividend" in section 1 excludes an amount transferred or applied by a company that constitutes shares in the company.

[93] Section 40C.

[94] The share-substitution rule was contained in paragraph 78(2) but was inadvertently deleted by section 123(1)(*a*) of the Taxation Laws Amendment Act 24 of 2011 with effect from 1 January 2011. Clause 49(1)(*b*) of the draft Taxation Laws Amendment Bill, 2012 proposes to reinstate paragraph 78(2) with effect from 1 January 2011.

[95] Section 40C.

[96] Paragraph 58 read with paragraph 20(1)(*f*).

[97] Paragraph 11(1)(*b*).

6.9 Demutualisation shares

When Old Mutual and Sanlam demutualised before 1 October 2001 and became listed companies, they issued ordinary shares free of charge to their policyholders. If you acquired demutualisation shares in these companies, you need to note the following when determining the base cost of your shares:

- "B" in the time-apportionment and proceeds formulae will be nil since you incurred no expenditure before valuation date in acquiring the shares.
- Should you adopt the market value or weighted-average method you will be able to use the relevant prices published on the SARS website to establish a base cost.

7. Changes proposed in the 2012 Budget

The following are some of the changes proposed in the Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2012 that will affect the taxation of shares and dividends:

- The CGT inclusion rate has been increased for individuals and special trusts from 25% to 33,3% and for companies and other trusts from 50% to 66,6%. The effect of this change is that an individual with a 40% marginal tax rate will now pay CGT at 13,32% (previously 10%) while a company will pay 18,65% (previously 14%). The change applies to years of assessment commencing on or after 1 March 2012.
- The annual exclusion for the 2013 year of assessment for individuals and certain special trusts is increased to R30 000 (previously R20 000) while this figure increases to R300 000 in the year of assessment in which a person dies (previously R200 000).
- Dividends tax is to be imposed at a rate of 15% from 1 April 2012, up from 10%.
- The effective rate of normal tax on foreign dividends is to be a maximum of 15%, up from 10%. The change comes into operation on 1 April 2012.