

Method of Determining Market Value of Listed Financial Instruments On 1 October 2001 For CGT Purposes

The method of determining the market value of financial instruments (i.e. shares, warrants and derivatives) listed on an exchange recognised by the Minister of Finance on valuation date (1 October 2001) is set out in paragraph 29(1)(a) of the Eighth Schedule to the Income Tax Act, 1962.

Method of determination

In the case of recognised exchanges in the Republic, the paragraph provides that the market value of a financial instrument will be the average of the last price quoted in respect of that financial instrument on the exchange at close of business on each of the five days preceding the valuation date. These calculations are to be done by SARS and it is the intention to publish these values on SARS' website as well, as is required by law, in the Government Gazette.

In the case of recognised exchanges outside the Republic, the paragraph provides that the market value of a financial instrument will be the last price quoted in respect of that financial instrument on that exchange on the last trading date before valuation date.

Consultation

In the course of consultation on the implementation of CGT a number of concerned persons and organisations have expressed the view that the proposed method of determining the market value (the average of the last price quoted on the last five days before valuation date) will create anomalies and in certain circumstances will not be workable. There is also a risk of manipulation with instruments which are thinly traded.

Proposal

In view of this it is the intention of the Minister of Finance to propose to Parliament that a new method of determination of the market value on valuation date be applied to financial instruments on recognised exchanges (other than loan stock which is dealt with separately in paragraph 28 of the Eighth Schedule). Separate proposals will be made for exchanges in the Republic and those outside the Republic.

Recognised exchanges in the Republic

- Stock exchanges licensed under the Stock Exchange Control Act, 1985

This is a stock exchange where shares, warrants, etc are traded. The proposal will be that the aggregate transaction value (i.e. total selling price) of each financial instrument be determined for the last five business days preceding valuation date and that it be divided by the total quantity of that instrument traded during the same period to arrive at the market value. This method is referred to as the volume weighted average price and will give an average price which will be difficult to manipulate.

- Financial exchanges licensed under the Financial Markets Control Act, 1989

This is a financial exchange where futures contracts, option contracts and other types of derivatives are traded. It will be proposed that the market value be the average mark to market price for the five last business days before valuation date of that financial instrument on the exchange.

Determination of market value by the Commissioner

It will also be proposed that the Commissioner of SARS be given the power to determine the market value of these financial instruments listed in the Republic, after consultation with the relevant recognised exchange in the Republic and the Financial Service Board, in certain limited circumstances.

Where—

- an instrument is not traded during the last five business days preceding valuation date;
- an instrument is suspended for any period during September 2001; or
- the market value of the instrument for the five days preceding valuation date, as determined using the method described in the previous paragraph, exceeds the average of the ruling price of that instrument determined for the first fourteen business days of September 2001 by five per cent or more,

it will be proposed that the Commissioner be given the power to determine the actual market value of that instrument. It will be proposed that the Commissioner in determining the actual market value must have regard to the value of the instrument, and if suspended, the reason for the suspension. If there has been an increase in value above five per cent, the Commissioner must consider the reason for the increase.

Any decision of the Commissioner in this regard would be subject to objection and appeal.

Recognised exchanges outside the Republic

Persons owning shares listed on recognised exchanges outside the Republic which use the same method to determine the market value as will be prescribed for exchanges in the Republic, will also be able to use this method to determine the market value of financial instruments. If the exchanges do not use these methods the persons can still use the last price quoted at close of business on the exchange in respect of that financial instrument.

Ruling Price

In the proposed provisions above the term "ruling price" is used. It is proposed that a definition of "ruling price" be introduced.

The proposed definition will provide that the ruling price of a listed financial instrument on a recognised exchange in the Republic, is the last sale price of that instrument at close of business of the exchange, unless there is a higher buying bid or a lower selling offer on that day subsequent to the last sale, in which case the higher bid or lower offer will prevail. This is the method used by the JSE Securities Exchange SA.

In the case of financial instruments listed on a recognised exchange outside the Republic, it will be proposed that the ruling price be the same as described above if the exchange calculates the price in this manner. If the price is not calculated on this basis, the last price quoted in respect of the financial instrument at the close of business of the exchange must be used.

Effect

The effect of the proposals will be that the average "ruling price" of a financial instrument listed on an exchange in the Republic for the first fourteen business days of September 2001 will be compared, depending on the nature of the exchange, to the volume weighted average price for the last five business days of the month; or the average mark to market price quoted at close of business for the same five days. If there is an increase of more than five percent in the price of the instrument the reason for the increase will be determined and if it is purely through normal open market forces the price will be accepted. If not, after consultation with the relevant exchange and the Financial Services Board, a new price will be determined.

Publication of market value list

The market prices will be determined by SARS and a provisional list will be published on the Website and the prices of instruments, which require further investigation, will be indicated on the list. A final list will be published as soon as possible thereafter in the Government Gazette.

ISSUED BY: The Commissioner for the South African Revenue Service

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