

# ABC of Capital Gains Tax for Companies

Issue 11



## Capital Gains Tax

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## Preface

This guide provides a basic introduction to capital gains tax (CGT) for “companies” as defined in section 1(1) of the Income Tax Act 58 of 1962 (the Act) and should not be used as a legal reference.

For more information, assistance and guidance you may –

- visit the **SARS website** to, amongst other things, consult the *Comprehensive Guide to Capital Gains Tax* or the *Tax Guide for Share Owners*;
- contact the SARS National Service Centre (between 8am and 4.30pm South African time except on Wednesdays when the service centre can be called between 9am and 4.30pm) –
  - if calling locally, on 0800 00 7277; or
  - if calling from abroad, on +27 11 602 2093;
- have a virtual consultation with a SARS consultant by making an appointment via the **SARS website**;
- visit your nearest SARS service centre, preferably after making an appointment via the **SARS website**; or
- contact your own tax advisor or tax practitioner.

Comments on this guide may be e-mailed to **policycomments@sars.gov.za**.

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**SOUTH AFRICAN REVENUE SERVICE**  
18 March 2025

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## **1. Introduction**

Capital gains tax (CGT) was introduced in South Africa with effect from 1 October 2001 and applies to the disposal of an asset on or after that date. South African residents are subject to CGT on the disposal of assets not only in South Africa, but anywhere in the world.

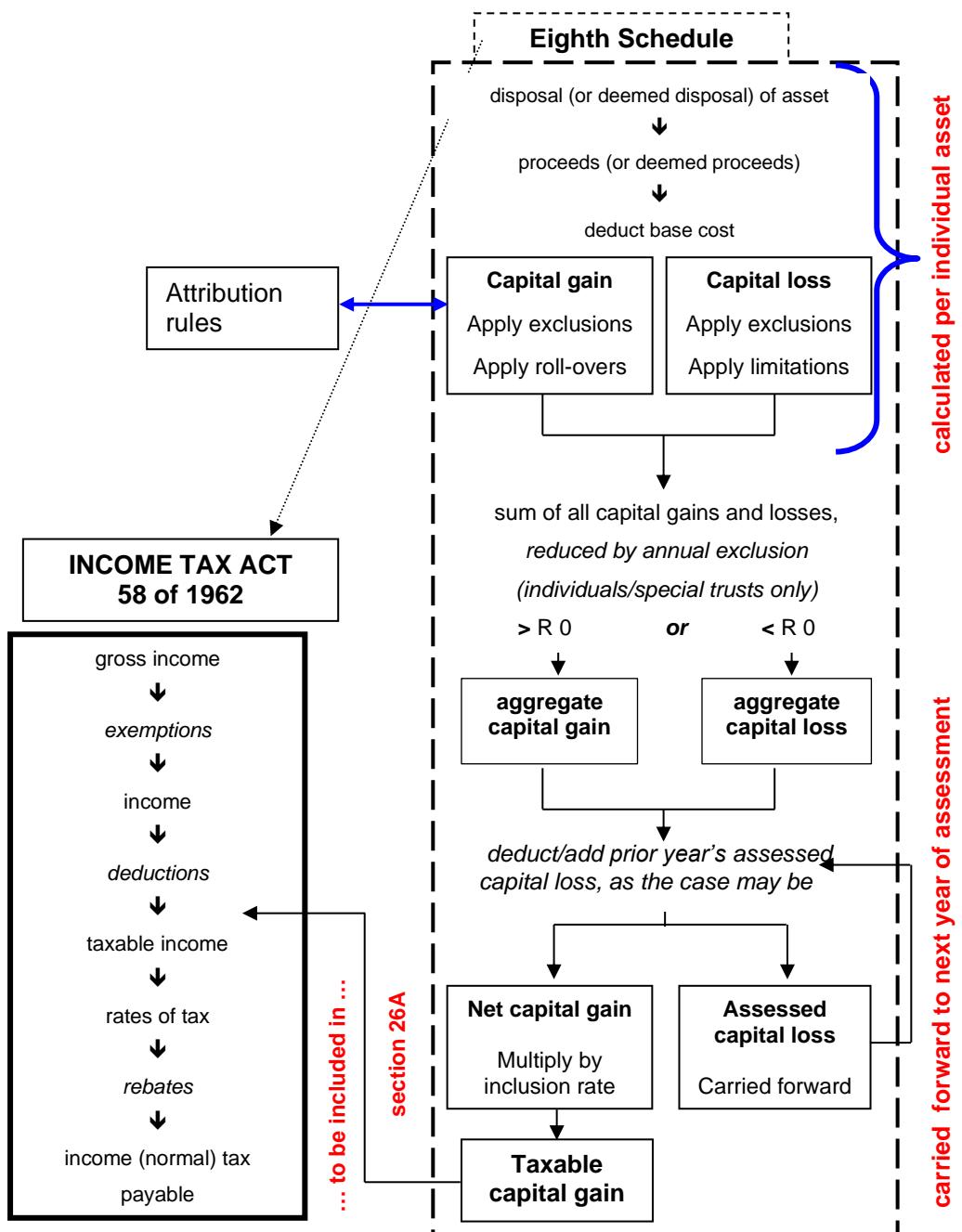
All capital gains and capital losses made on the disposal of assets are subject to CGT unless specifically excluded.

Section 26A of the Act provides that the taxable capital gain must be included in taxable income. Capital gains tax is therefore not a separate tax but forms part of income tax.

The CGT provisions are mostly contained in the Eighth Schedule to the Act, although some are in the main body of the Act, such as those dealing with change of residence, ceasing to be a controlled foreign company or becoming a headquarter company (section 9H), government grants (section 12P), international shipping (section 12Q) and the corporate restructuring rules (sections 41 to 47).

## **2. Overview of the core provisions of capital gains tax**

The **CGT Flowchart** below sets out the core steps in determining a taxable capital gain to be included in taxable income or an assessed capital loss to be carried forward to a subsequent year of assessment.



### **3. Determining a capital gain or capital loss**

The Eighth Schedule contains four key definitions (Asset, Disposal, Proceeds and Base Cost) which form the basic building blocks in determining a capital gain or capital loss.

A person's capital gain on disposal of an asset is the amount by which the proceeds exceed the base cost of that asset. A capital loss is equal to the amount by which the base cost of the asset exceeds the proceeds.

#### **Example 1 – Determination of a capital gain or capital loss**

	Gain R		Loss R
Proceeds	10 000	Proceeds	10 000
Less: Base cost	<u>(5 000)</u>	Less: Base cost	<u>(20 000)</u>
Capital gain	<u>5 000</u>	Capital loss	<u>(10 000)</u>

#### **3.1 Asset**

An "asset" is widely defined and includes property of whatever nature, whether movable or immovable, corporeal or incorporeal and any right to, or interest in, such property. Any currency is excluded from the definition of "asset", but any coin made mainly from gold or platinum is included. Capital gains tax applies to all assets disposed of on or after 1 October 2001 (valuation date), regardless of whether the asset was acquired before, on, or after that date.

Nevertheless, only the capital gain or capital loss attributable to the period on or after 1 October 2001 must be brought to account for CGT purposes.

#### **3.2 Disposal**

Capital gains tax is triggered by the disposal or deemed disposal of an asset. A wide meaning is given to the term "disposal". The Eighth Schedule provides for both disposals and deemed disposals. A disposal covers any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset or any event, act, forbearance or operation of law which is under the Act treated as the disposal of an asset. The following are some examples of events that are disposals or that are treated as disposals:

- Sale of an asset
- Donation of an asset
- Expropriation of an asset
- Loss or destruction of an asset
- Change in the use of an asset
- A company ceasing to be a controlled foreign company
- A person ceasing to be a resident
- A company becoming a headquarter company

The following are some examples of events that are not regarded as disposals:

- The transfer of an asset as security for a debt and the transfer of such asset back to the debtor upon the release of the security.
- The issue, cancellation or extinction of a share by a company. In the hands of the shareholder, however, a share-buy-back by a company constitutes a disposal.
- The issue of any debt by or to a person.
- The subdivision, consolidation or conversion of shares when the shareholder receives only replacement shares so that the participation rights and the interest of the person in the company remain unaltered.

The Eighth Schedule provides for situations when only a part of an asset is disposed of, for example, sub-division or disposal of part of land. In such a case only part of the base cost of the asset can be deducted from the proceeds derived from the part disposed of.

It is important to note that the Eighth Schedule specifies the time of disposal of an asset. The time of disposal is important, since it determines when the capital gain or capital loss must be accounted for. It also provides the corresponding date of acquisition by the acquirer of an asset.

The table below summarises the time of disposal rules under paragraph 13.

<b>Disposal</b>	<b>Time of disposal</b>
<i>Disposal of an asset by means of a change of ownership effected or to be effected from one person to another because of an event, act, forbearance or by operation of law such as:</i>	
Agreement subject to a suspensive condition	Date on which the condition is satisfied
Agreement not subject to a suspensive condition	Date on which agreement is concluded
The distribution of an asset of a trust by a trustee to a beneficiary to the extent that the beneficiary has a vested interest in the asset	Date on which the interest vests
The granting by a trust to a beneficiary of an equity instrument contemplated in s 8C.	Time when the equity instrument vests in the beneficiary as contemplated in s 8C
Donation of an asset	Date of compliance with all legal requirements for a valid donation
Expropriation of an asset	Date on which the person receives the full compensation agreed to or finally determined by a competent tribunal or court
Conversion of an asset	Date on which that asset is converted
Granting, renewal or extension of an option	Date on which the option is granted, renewed or extended

<b>Disposal</b>	<b>Time of disposal</b>
Exercise of an option	Date on which the option is exercised
Termination of an option to acquire a share, participatory interest or debenture of that company	Date on which that option terminates
Any other case	Date of change of ownership
Extinction of an asset including by way of forfeiture, termination, redemption, cancellation, surrender, discharge, relinquishment, release, waiver, renunciation, expiry or abandonment	Date of the extinction of the asset
Scrapping, loss or destruction of an asset	<p>Date</p> <ul style="list-style-type: none"> <li>• when the full compensation is received; or</li> <li>• if no compensation is payable, the later of the date when the scrapping, loss or destruction is discovered or the date on which it is established that no compensation will be payable</li> </ul>
Distribution of an asset by a company to a holder of shares	Date on which that asset is so distributed as contemplated in para 75
Decrease of a person's interest in a company, trust or partnership as a result of a 'value shifting arrangement'	Date on which the value of that person's interest decreases
Deemed disposals referred to in para 12	Date immediately before the day that the event occurs

### 3.3 Proceeds

The amount received by or accrued to the seller on disposal of an asset or any amount that is treated as having been received by or accrued to the taxpayer (deemed disposal) constitutes the proceeds. Assets disposed of by donation, for a consideration not measurable in money, or to a connected person at a non-arm's-length price are treated as being disposed of for an amount received or accrued equal to the market value of the asset.

Proceeds will also be treated as being at market value when specified deemed disposal events occur, such as –

- ceasing to be a resident;
- a company ceasing to be a controlled foreign company;
- a company becoming a headquarter company;
- the conversion of a capital asset to trading stock; and

- the distribution of an asset *in specie*.

Amounts included in income or gross income such as a recoupment of capital allowances or dividends constituting a share buy-back are excluded from proceeds.

### **3.4 Base cost**

Broadly the determination of the base cost of an asset depends on whether the asset was acquired –

- before 1 October 2001;
- on or after 1 October 2001;
- by donation, for a consideration not measurable in money or from a connected person at a non-arm's length price; or
- in consequence of a deemed disposal event such as a distribution *in specie*, ceasing to be a resident, a company ceasing to be a controlled foreign company, a company becoming a headquarter company or the conversion of a capital asset to trading stock.

The assets described in the last two bullet points above are generally treated as having been acquired at a cost equal to their market value.

#### *Assets acquired on or after 1 October 2001*

The base cost of an asset acquired on or after 1 October 2001 generally comprises the actual expenditure incurred on the asset. In order to qualify for inclusion in base cost, such expenditure must qualify under paragraph 20 of the Eighth Schedule. Some of the main costs that qualify to be part of the base cost of an asset include –

- the costs of acquisition or creation of the asset;
- the cost of valuing the asset for the purpose of determining a capital gain or capital loss;
- the following amounts actually incurred as expenditure directly related to the acquisition or disposal of the asset, namely –
  - the remuneration of a surveyor, valuer, auctioneer, accountant, broker, agent, consultant or legal advisor, for services rendered;
  - transfer costs;
  - securities transfer tax, transfer duty or similar tax or duty;
  - advertising costs to find a seller or to find a buyer;
  - the cost of moving the asset from one location to another;
  - installation costs including foundations and supporting structures;
  - donations tax limited by a formula;
  - cost of an option used to acquire or dispose of the asset;
- cost of establishing, maintaining or defending a legal title to or right in the asset;
- cost of effecting an improvement to or enhancement of the value of the asset; and
- value-added tax incurred on an asset and not claimed as an input tax credit for value-added tax purposes.

### *Holding costs*

Holding costs generally do not form part of the base cost of an asset. Expenditure on repairs, maintenance, protection, insurance, rates and taxes, or similar expenditure is specifically excluded. Borrowing costs (including bond registration costs, bond cancellation costs and raising fees) are also generally excluded with one exception. Under that exception a person is entitled to add to base cost one-third of the interest incurred on borrowings used to acquire listed shares and participatory interests in collective investment schemes. One-third of the interest incurred on borrowings used to refinance such investments may also be included. However, interest on borrowings used to finance the acquisition of shares in an operating company contemplated in section 24O may possibly not be included in the base cost of those shares since such interest may be deductible against the borrowing company's income under that section.

### *Reduction of base cost*

Any expenditure referred to above which is allowable against a company's income must be reduced in arriving at the base cost of an asset. For example, capital allowances claimed as a deduction will reduce the expenditure incurred in acquiring an asset.

## **4. Base cost of assets acquired before 1 October 2001**

In order to exclude the portion of the capital gain relating to the period before 1 October 2001, the base cost of the asset as at that date must be determined according to any one of the following methods:

- “20% of proceeds”
- Market value on 1 October 2001
- Time-apportionment base cost

### **4.1 “20% of proceeds” method**

Under this method the valuation date value of the asset is equal to 20% of the proceeds after first deducting from the proceeds any allowable expenditure incurred on or after 1 October 2001. This method would typically be used when no record of pre-valuation date expenditure exists and no valuation was obtained at 1 October 2001.

### **4.2 Market-value method**

Under the market-value method, the market value of the asset on 1 October 2001 must be determined. Various requirements apply before the market-value method can be used.

#### *Time limit for performing valuations*

All valuations must have been completed by 30 September 2004. If a company failed to perform a valuation by this date, it will not be permitted to use the market-value method. Valuations must be performed as if done on 1 October 2001. The prices on 1 October 2001 of specified financial instruments such as South African-listed shares and participatory interests in South African collective investment schemes were determined by SARS and published in the *Government Gazette*. A company is required to use these

prices and therefore does not need to determine its own values for these assets. The prices are also available on the SARS website.<sup>1</sup>

#### *Onus of substantiating a valuation*

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

#### *Methods to be adopted in valuing specified assets*

In general the Act does not specify the methods to be used in performing valuations, though there are some exceptions which are summarised in the table below.

**Table 1 – Market value of assets on 1 October 2001**

Type of asset	Valuation method
General rule	Market value = price based on willing buyer, willing seller acting at arm's length in an open market
South African-listed securities	Volume weighted average price for the five business days preceding 1 October 2001 <sup>2</sup>
Foreign listed securities	The ruling price (usually the last sell price) on the last business day before 1 October 2001
Participation rights and "property shares" in South African collective investment schemes	Average "sell to management company" price for the last five trading days before 1 October 2001 <sup>3</sup>
Participation rights in foreign collective investment schemes	Same as for South African collective investment schemes, except based on last trading day before 1 October 2001
Controlling interest in listed company	The listed price at 1 October 2001 must be adjusted by the control premium or discount at the time of sale
South African second-hand endowment policies	Greater of – <ul style="list-style-type: none"> <li>• Surrender value</li> <li>• Insurer's market value (assume policy runs to maturity)</li> </ul>
Farm land	Market value less 30% (under specified circumstances) or price based on willing buyer, willing seller acting at arm's length in an open market.

<sup>1</sup> Prices supplied in *Government Gazette* 23037 of 25 January 2002 and on SARS website under Types of Tax / Capital Gains Tax / Market Values.

<sup>2</sup> See above.

<sup>3</sup> See above.

### *Submission requirements*

Generally, proof of any valuation performed within the prescribed period must be retained for five years after the date of submission of the return reflecting the disposal of the asset.<sup>4</sup> However, with the high-value assets described in the table below, the valuation forms were required to be lodged with the first return of income submitted after 30 September 2004. If the value form was not thus submitted, the person disposing of the asset will not be permitted to use the market-value method for these assets.

**Table 2 – Assets subject to early valuation submission requirements**

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

### *Limitation of losses*

The Eighth Schedule contains loss-limitation rules which apply when the market value of an asset on 1 October 2001 has been determined, or has been published in the *Government Gazette* (the latter would apply, for example, to South African-listed shares). Under specified circumstances a person's ability to choose a method for determining the valuation date value of an asset will be restricted by these rules which are beyond the scope of this guide.<sup>5</sup>

### **4.3 Time-apportionment base cost method**

The time-apportionment base cost method may be used when a company has a record of the date of acquisition and cost of an asset. The following formula is used to determine the time-apportionment base cost of an asset:

$$Y = B + [(P - B) \times N / (N + T)]$$

In which –

Y = The amount to be determined

B = Allowable expenditure incurred before 1 October 2001

P = Proceeds on disposal of the asset

N = Number of years or part of a year before 1 October 2001

T = Number of years or part of a year on or after 1 October 2001

<sup>4</sup> Section 29(3)(a) of the Tax Administration Act 28 of 2011 read with paragraph 29(6) of the Eighth Schedule.

<sup>5</sup> See the *Comprehensive Guide to Capital Gains Tax* for commentary in this regard.

For purposes of this formula the following should be borne in mind:

- Improvements or additions made before 1 October 2001 are deemed to have taken place when the asset was acquired.
- A part of a year is treated as a full year.
- The period before 1 October 2001 is limited to 20 years when –  
improvements have been made to an asset in more than one year of assessment before 1 October 2001; and  
the asset was acquired before 1 October 1981.
- The 20-year limit does not apply when no additions or improvements have taken place before valuation date.
- The following adjustments must be made when capital allowances have been claimed on an asset for normal tax purposes:  
Proceeds must be reduced by the amount of any recoupments.  
Expenditure must be reduced by the amount of any capital allowances claimed as a deduction.

The following additional formula must be used to determine the value of "P" (proceeds) when improvements to an asset occurred on or after 1 October 2001:

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

In which –

R = Amount received or accrued on disposal of the asset

B = Allowable expenditure incurred before 1 October 2001

A = Allowable expenditure incurred on or after 1 October 2001

A special "depreciable assets" formula applies when –

- capital allowances have been claimed on an asset;
- additions to the asset have occurred on or after 1 October 2001; and
- the proceeds from the disposal of the asset exceed all the allowable expenditure on the asset.

The use of the special depreciable assets formula is illustrated in **Example 3**.

Selling expenses (for example, estate agent's commission) are treated as a reduction in proceeds for the purpose of determining the time-apportionment base cost. This aspect is not illustrated in the examples which follow.

To assist taxpayers, SARS has made available a time-apportionment base cost calculator ("TAB calculator") on its website which uses an Excel spreadsheet. The TAB calculator does not apply when the special depreciable assets formulae are applicable. More advanced examples can be found in the *Comprehensive Guide to Capital Gains Tax*.

**Example 2 – Determination of time-apportionment base cost (expenditure incurred before 1 October 2001) and a capital gain**

*Facts:*

Company A's financial year ends on the last day of February. It purchased a machine for R100 000 on 1 September 1999 and sold it for R150 000 on 29 February 2024. At the date of sale, capital allowances of R100 000 had been claimed on the machine.

*Result:*

- (a) Exclude recoupment from the amount received or accrued and capital allowances from cost

	R
Consideration received or accrued	150 000
Less: Recoupment	<u>(100 000)</u>
Proceeds for CGT purposes	<u>50 000</u>
Cost	100 000
Less: Capital allowances	<u>(100 000)</u>
Cost for CGT purposes	<u>0</u>

- (b) Determine time-apportionment base cost

Period 1 September 1999 – 30 September 2001	=	3 years
Period 1 October 2001 – 29 February 2024	=	23 years
Total period 1 September 1999 – 29 February 2024	=	26 years

$$\begin{aligned}
 Y &= B + [(P - B) \times N / (N + T)] \\
 &= R_0 + [(R50\ 000 - R_0) \times 3 / 26] \\
 &= R_0 + R5\ 769 \\
 &= R5\ 769
 \end{aligned}$$

- (c) Determine capital gain

	R
Proceeds	50 000
Less: Base cost	<u>(5 769)</u>
Capital gain	<u>44 231</u>

**Example 3 – Determination of time-apportionment base cost (expenditure incurred before and after 1 October 2001) and a capital gain**

*Facts:*

Company B's financial year ends on the last day of February. It purchased a machine for R100 000 on 1 September 1999. The machine was upgraded on 1 July 2021 at a cost of R10 000.

The machine was sold for R150 000 on 29 February 2024. At the date of sale, capital allowances of R100 000 had been claimed on the original cost of the machine while allowances of R6 000 had been claimed on the cost of improvements.

*Result:*

(a) Exclude recoupments from proceeds

	R
Consideration received or accrued	150 000
Less: Recoupment (R100 000 + R6 000)	<u>(106 000)</u>
Proceeds for CGT purposes	<u>44 000</u>

(b) Exclude capital allowances from cost

	Before 1 October 2001	After 1 October 2001	Total
	R	R	R
Cost	100 000 ( <b>B1</b> )	10 000 ( <b>A1</b> )	110 000
Less: Capital allowances	<u>(100 000)</u>	<u>(6 000)</u>	<u>(106 000)</u>
Cost for CGT purposes	<u>0 (<b>B</b>)</u>	<u>4 000 (<b>A</b>)</u>	<u>4 000</u>

(c) Determine portion of proceeds relating to period before valuation date

$$\begin{aligned} P_1 &= R_1 \times B_1 / (A_1 + B_1) \\ &= R150\ 000 \times R100\ 000 / R110\ 000 \\ &= R136\ 364 \end{aligned}$$

(d) Determine time-apportionment base cost

$$\begin{aligned} Y &= B + [(P_1 - B_1) \times N / (N + T)] \\ &= R0 + [(R136\ 364 - R100\ 000) \times 3 / 26] \\ &= R0 + R4\ 196 \\ &= R4\ 196 \end{aligned}$$

(e) Determine capital gain

	R
Proceeds	44 000
Less: Valuation date value (time-apportionment base cost)	(4 196)
Cost after valuation date	<u>(4 000)</u>
Capital gain	<u>35 804</u>

## 5. Exclusions

Capital gains and / or capital losses on the disposal of specified assets are excluded from CGT, if specified requirements are met, and are disregarded when calculating the aggregate capital gain or aggregate capital loss. Some of the most common exclusions include the following:

- Disposal by a creditor of debt owed by a connected person.
- A “registered micro business” as defined under the Sixth Schedule must disregard for CGT purposes, any capital gain or capital loss on disposal of any asset used mainly for business purposes.
- A capital loss determined on the disposal relating to prizes or winnings from gambling, games or competitions.
- A donation or bequest of an asset to an approved public benefit organisation.
- Specified disposals of an interest of at least 10% in a foreign company.
- Land or the right to land donated under land reform measures.

## **6. Roll-over of capital gain or capital loss**

In some cases capital gains or capital losses are “rolled over”, that is, they are deferred to a future year of assessment. Some examples include –

- involuntary disposal of an asset by operation of law, theft or destruction (does not apply to financial instruments and is made at the election of the taxpayer; the capital gain will be recognised when the replacement asset is sold, or if the replacement asset is a depreciable asset, over the period that the capital allowances are claimed on the replacement asset);
- replacement of depreciable assets used for the purposes of trade (made at the election of a taxpayer); and
- certain corporate actions (asset-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and liquidation distributions).

## **7. Aggregate capital gain or aggregate capital loss**

A company’s aggregate capital gain or aggregate capital loss is determined by adding the capital gains and capital losses on individual assets together for a specific year of assessment.

## **8. Net capital gain or assessed capital loss**

A company’s net capital gain or assessed capital loss is determined by deducting any assessed capital loss brought forward from the previous year of assessment from the aggregate capital gain or aggregate capital loss. An assessed capital loss may be deducted only from capital gains and added to capital losses. It may not reduce taxable income.

## **9. Inclusion rate and taxable capital gain**

The taxable capital gain of a company is determined by multiplying the net capital gain by the inclusion rate. For years of assessment commencing on or after 1 March 2016 the inclusion rate for a company is generally 80% (see **Table 3**).

## **10. Effective rates of capital gains tax**

The effective rate of CGT is determined by multiplying the inclusion rate by the statutory rate of income tax applicable to the company.

**Table 3 – Inclusion, statutory and effective rates of tax (effective for years of assessment ending on or after 31 March 2024)**

Type of company	Inclusion rate	Statutory rate	Effective rate
	%	%	%
Company & Close corporation	80	27	21,6
Small business corporation	80	0 – 7 – 21 – 27	0 – 5,6 – 16,8 – 21,6
Micro business <sup>6</sup>	50	0 – 1 – 2 – 3	0 – 0,5 – 1 – 1,5
Taxable income derived by company in special economic zone	80	15	12
Life Assurer – individual policyholder fund	40	30	12
Life Assurer – company policyholder fund	80	27	21,6
Life Assurer – untaxed policyholder fund	0	0	0
Life Assurer – corporate fund	80	27	21,6
Life Assurer – Risk policy fund	80	27	21,6

**Example 4 – Determination of a taxable capital gain and the effective rate of CGT**

*Facts:*

Company C declared the following capital gains and capital losses for its year of assessment ending on 31 March 2024:

	R
Disposal of vacant land	50 000
Disposal of a trade mark	25 000
Loan waived	(5 000)
Disposal of shares	<u>(10 000)</u>
Aggregate capital gain	<u>60 000</u>

Company C does not have an assessed capital loss brought forward from the previous year of assessment.

<sup>6</sup> Under paragraph 57A of the Eighth Schedule a micro business's assets are not subject to CGT. However, under paragraph 6 of the Sixth Schedule 50% of the receipts of a capital nature from the disposal of micro business assets are included in taxable turnover.

*Result:*

	R
Aggregate capital gain	60 000
Less: Assessed capital loss brought forward	<u>(0)</u>
Net capital gain	<u>60 000</u>
Taxable capital gain ( $60\ 000 \times 80\%$ inclusion rate)	<u>48 000</u>

The taxable capital gain is included in taxable income and taxed at the statutory income tax rate of 27%, that is,  $R48\ 000 \times 27\% = R12\ 960$ .

The effective rate of CGT on the sum of the capital gains and capital losses (the net capital gain) is 21,6% ( $R12\ 960 / R60\ 000 \times 100$ ).