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CAPITAL GAINS TAX ON A PRIMARY RESIDENCE

Capital Gains tax came into effect in South Africa on the 1 October 2001. Does it have any impact on you as an individual? Let's first look at a definition for capital gain: it is the profit you make when you sell a possession. A capital loss will take place should you sell the possession for less than what it had cost you.

Capital Gains tax (CGT) forms part of the tax systems of most countries in the world. The happening that triggers any CGT event—as the transaction is called—is the disposal of an asset. Unless such a disposal occurs, no gain or loss arises.

Once your taxable capital gain has been determined, it is included in the taxable income for that year of assessment in terms of section 26A of the Income tax Act. If you sustain an assessed capital loss for the year, that loss cannot be set-off against your taxable income, but it is carried forward to subsequent years, for set off against any future taxable capital gains.

In South Africa individuals as well as companies, close corporations and trust are subject to CGT. It includes any capital sales you make in or outside South Africa. Non-residents who sell property or at least 20% of the share capital of a company where 80% or more of the net asset value of the company is attributable to immoveable property in South Africa are also liable to pay CGT.

Certain assets have been excluded from CGT, you therefore do not have to pay CGT on the profit when you sell them; for now we are only going to look at your primary residence.

The first R1.5 million profit you make if you sell your primary residence is excluded from CGT. Individuals are also exempt from CGT on the first R20 000 of capital gains per year, and this figure increases to R200 000.00 in the year in which an individual dies. The South African Revenue Service has a sophisticated computer system, which interfaces with systems in the Deeds Registry, Motor Vehicle Registry, JSE and financial institutions, so you cannot hide that capital gain!

LET'S EXPLAIN THE TERM PRIMARY RESIDENCE:

1. The house must be individually owned (in your name), not by a trust, close corporation or company.

2. The owner, or spouse of the owner, must reside in the house and use it as an ordinary residence. If part of the house is used for business, there will be a pro-rata inclusion for CGT calculations. Where more than one person holds an interest in a primary residence (eg: spouses married to each other out of community of property), the exclusion will be in proportion to the interest held by each party in the residence.

WHEN WILL CAPITAL GAINS TAX BE PAYABLE ON THE SALE OF A PRIVATE RESIDENCE?

1. After deduction of the first R1,5 million profit, the balance will be subject to tax, BUT only on primary residences with a gross value that exceeds R 2 million. In other words a property that qualifies as a "primary residence" that has a gross value of R 2 million or less is exempt from the payment of CGT and there after the first R 1.5 million of "profit" is further exempt from CGT.
2. Where the property is larger than 2 hectares – the first 2 hectares will be exempt and the balance subject to CGT.
3. The part of the house that was used for business purposes.

THE CALCULATION OF CAPITAL GAINS TAX ON A PRIMARY RESIDENCE

We said that a capital gain is the profit you make on selling your house. The selling price is deducted from the base cost. The base cost is calculated by taking the price you paid for the property and adding to that: costs for buying and selling the property and extensions to the property (not maintenance.) Costs you can include are: transfer costs, advertising, vat and estate agency commission.

CGT must be paid in the year you sell the property. For individuals, it is calculated by adding 25% of the capital gain to your income for the year and taxed at the individual's marginal rate of income tax. The present maximum marginal rate of income tax for individuals is 40% and therefore individuals will pay a maximum of 10% of the capital gain.

If a property is owned by a company, a close corporation or an ordinary Trust, 50% of the capital gain must be included in their taxable income. The income tax rate for a company or close corporation is 28% and these entities will therefore pay 14% of the capital gain in CGT, while Trusts, whose income tax rate is 40%, will pay 20% of the capital gain.

CGT is only payable from the 1 October 2001. You can use the following methods to calculate CGT:

1. The fair market value of the property as at 1 Oct 2001, called the valuation date. The valuation must have been carried out before the 30 September 2004 and the property valued according to its condition and in terms of prevailing market and economic conditions as at 1 October 2001. This would then constitute the base cost and be deducted from the eventual selling price of the property to determine the profit for the purposes of the CGT calculation.
2. Where no fair market valuation was obtained and submitted and no accurate records maintained, the value as at 1 October 2001 (base cost) will be deemed to be 20% of the proceeds when sold.

If you have a second, or more properties, be it for holiday or investment purposes, you will be liable for CGT when selling the property.

Before the implementation of CGT we were only taxed on income earned from assets, now we are also taxed on the profits should we sell the asset. The rationale was to broaden the tax base as companies and wealthy individuals could build up a large capital base that was never taxed.

Like it or not, Capital Gains Tax is here to stay.