INCOME & CAPITAL GAINS TAX

Section 1
General notes

1. Introduction

In South Africa income tax is levied in terms of the Income Tax Act Nr. 58 of 1962 (as amended). This Act contains provisions for the levying of four different types of tax, i.e. income tax, secondary tax on companies (STC), donations tax and capital gains tax. In these notes we will deal only with income tax and capital gains tax. These are taxes levied on all persons who have a taxable income and/or capital gains. The word "person" in this context does not only refer to natural persons, but also to companies, close corporations, estates of deceased persons, clubs, trusts and any other legal entity subject to tax. In these notes the focus is on the normal tax payable by a natural person and, more specifically, the employed person earning a salary.

2. Residence-based tax

A “residence minus” tax system became effective on 1 January 2001 and South African residents are now taxed on their world-wide income. To avoid double taxation all foreign taxes paid by these residents will, however, be allowed as a credit against the South African tax liability. Certain categories of income and activities undertaken outside South Africa will be exempt from South African tax. All non-residents will be taxed on their South African sourced income.

Who is a resident?

Individuals

A resident will be defined as:

1. A person who is ordinarily resident (namely, whether that person’s permanent home in South Africa is the home to which he or she will return (This is the subjective part of the definition).

2. A person will be regarded as a resident if he or she was physically present in South Africa for more than 91 days per tax year for four consecutive tax years; and was physically present for 549 days in aggregate during the first 3 years of assessment (of the four year consecutive tax years). (This is a more objective part of the definition).

3. It should also be noted that where a person who is a resident, in terms of the above definition, is physically outside that for a continuous period of 330 full days, such a person shall be deemed not to be a SA resident from the day on which such a person left the RSA.

Companies

A company is a resident if it is incorporated, formed or established in South Africa, or has its place of effective management is in South Africa.

Certain specific exclusions

Foreign pensions

Foreign pensions received by or accrued to any resident are not at present taxable s.10(1)(gC).

Foreign employment income

Residents are now also taxed on their remuneration earned outside South Africa, irrespective of whether they work for a local or foreign employer. Where a resident has rendered services outside South Africa for a continuous period exceeding 60 full days and an aggregate period of 183 days or longer in a tax year, the income earned from the services so rendered will be exempt from tax (Section 10(1)(o)(ii)) .

How will the income of a controlled foreign entity (CFE) be taxed?

A CFE is a foreign entity which is controlled by South African residents as defined in Section 9D. Control means where South African residents hold more than 50 per cent of the participation rights or votes in the entity or control the entity.

Such income, whether active or passive, will be taxed in the hands of the residents controlling the CFE. Note that there are exceptions to this general principle.

How will foreign losses be treated?

Foreign losses of a CFE will be ring-fenced in the CFE and not taken into consideration in determining the tax liability of the South African resident controlling the CFE.

3. The taxpayer

The term "taxpayer" means any person chargeable with any tax levied in terms of the Act (s.1 "taxpayer").

All taxpayers (other than companies, close corporations and trusts) are taxed according to one tax table.

Note:

1. For income tax purposes, a minor is taxed in his/her own right unless the provisions of section 7 apply.
2. A deceased estate is regarded as a taxpayer (represented by the executor) and is taxed according to the tables applicable to natural persons. If the taxpayer dies during the year that he/she would have turned 65, the deduction of the secondary rebate is allowed s.6(1) and 6(2).

4. The steps in calculating the tax liability of a natural person

The following steps are used to determine the liability for normal tax of a natural person:

Determine gross income		
Less exemptions	=	Income
Less deductions		
Plus taxable capital gains tax	=	Taxable income
Apply normal tax rates	=	Tax per scale
Less rebates	=	Tax payable.

We will now look at each of these steps individually.

5. Gross income

5.1 General formula

Gross income means, in relation to any year or period of assessment, in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident and in the case of any

person other than a resident, the total amount in cash or otherwise received by or accrued to or in favour of such person from a source within or deemed to be within the Republic during such year of assessment, but excluding receipts or accruals of a capital nature.

Although the definition refers to amounts received by or accrued to the taxpayer, there are certain provisions which deem amounts received by persons other than the taxpayer, to have been received by the taxpayer. These include:

- income received in certain circumstances by a married person from his or her spouse (s.7(2));
- income received in certain circumstances by a minor child (s.7(3) and s.7(4));
- income flowing from a donation, settlement or other disposition (s.7(5), s.7(6) and s.7(7));
- lump sums payable by approved funds after the death of the taxpayer (Second Schedule par. 5(1));
- certain types of investment income (s.9D).

Trade income

Trade includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of any patent, design, trademark or copyright or any property which is of a similar nature (s.1 "trade").

5.2 Shares and the 5-year rule - s.9B

Any profit made on the realisation of affected shares (even by a taxpayer who is recognised as a share dealer) will be exempt from income tax, subject to the following conditions:

- The existing “rules” for the distinction between capital and revenue profits (in terms of established case law) will continue to apply, except where a sale takes place after the shares have been held for five years or more.
- Quoted shares acquired by way of exchange in terms of section 24A of the Income Tax Act will continue to be “trading stock” and will not be affected by this concession.

- Where quoted shares have been acquired “in the course of trade” (i.e. as trading stock) and deductions for interest and expenses incurred in the acquisition of the shares have been allowed as a deduction, the taxpayer will be liable for a “claw-back” (recoupment) of such interest and expenses (other than share losses) previously deducted.

- Taxpayers may elect to be subject to the section 9B provisions or not. A taxpayer who elects to be subject to the provision must, therefore, apply the same principles to all transactions in affected quoted shares which have been held by him/her for more than five years. Losses realised will, accordingly, not be deductible.

This section is aimed more specifically at taxpayers who acquired the shares originally as trading stock. Such taxpayers have been afraid to sell listed shares (even after holding them for many years) for fear that they will not be able to discharge the onus of proving that the gain was of a capital nature.

The “safe haven” does not apply to the sale of unlisted shares. The onus is on the taxpayer to prove that he/she has held the shares for five years.

Taxpayers, when completing annual income tax returns, are required to elect whether the shares disposed of in that tax year are to be regarded as affected shares. The election is binding on the taxpayer. Section 9B applies to the gain on the disposal of listed shares on or after 14 March 1990, which have been held for more than five years, provided of course the necessary election has been made.

Taxpayers must evaluate whether they will be better off under the “safe haven” provision or the other provisions in the Act before making the optional election.

5.3 Off-shore investment income

Section 9D

This section introduces certain anti-avoidance measures in relation to the income of controlled foreign entities (CFE), as well as investment income arising from certain donations, settlements or other dispositions.

The important definitions in section 9D are the following:

Controlled foreign company means a foreign company in which any resident/residents, individually or jointly, directly or indirectly, have more than 50 per cent of the participation rights or are entitled to exercise more than 50 per cent of the votes, i.e. control the entity.

Foreign company means any association, corporation, company arrangement or scheme (excluding a cc or public benefit organisation (PBO)) which is not a resident.

Participation rights means the right to participate directly or indirectly in the share capital, share premium, current or accumulated profits or reserves of the foreign company, whether of a capital nature or not.

There will be included in the income of affected residents a proportional amount of the net income of the foreign entity, which is attributable to the participation rights of the resident in such entity.

This provision will not apply to a resident who, together with connected persons, holds less than 10% (in aggregate at all times during the tax year) of participation rights and voting rights in the CFE.

Section 9D(9) sets out various amounts that are exempt from the provisions of section 9D, e.g. if the net income of the CFE is subject to income tax in South Africa, the provisions of section 9D will not be applicable.

5.4 Specific inclusions

The definition of gross income lists certain specific amounts that are included in gross income, e.g. annuities (including commuted annuities), rewards for services, lump-sum benefits, pension fund benefits, fringe benefits, dividends, restraint of trade payments, pension and provident fund surpluses and the proceeds of certain policies.

5.5 Fringe benefits

The cash equivalent of the value of all fringe benefits, as determined under the provisions of the Seventh Schedule, granted in respect of employment or to the holder of any office must be included in gross income. In terms of the Seventh Schedule the following perks give rise to a taxable benefit if they are provided to the employee or holder of office for consideration which is less than the actual value or cost:

- the acquisition of an asset;
- the right of use of any asset (other than residential accommodation and motor vehicles);
- private use of an employer-owned motor vehicle (company car);
- meals and refreshments or a voucher for such meals or refreshments;
- the use of residential accommodation;

- free or cheap services;
- interest-free or low-interest loans;
- housing loans or subsidies;
- payment of an employee's debt or release from obligation to pay a debt;
- contributions to a medical aid fund.

"Employee" in relation to any employer is defined in the Seventh Schedule as any person who is an employee in relation to such employer for purposes of the Fourth Schedule, i.e. for purposes of employees' tax (PAYE or SITE), including a director of a private company. Excluded from this definition (subject to certain exceptions) were persons who had retired from the employ of such employer by reason of superannuation (i.e. normal retirement), ill-health or other infirmity. This meant that, where these ex-employees continued to receive certain fringe benefits, e.g. a low-interest loan or housing subsidy, these amounts were not subject to tax in terms of the Seventh Schedule and could, therefore, only be taxed if they fell within the ambit of any other stipulation of the Act.

With effect from 1/3/92, any persons retiring after that date will continue to be regarded as an employee for purposes of the Seventh Schedule and any fringe benefits received by them will have to be included in their gross income.

This means that only people who retired **before** 1/3/92 will not be subject to the Seventh Schedule **provided** they do not fall into any of the other categories of ex-employees which under the existing legislation were already subject to the Seventh Schedule. Ex-employees who under the old legislation were already subject to the Seventh Schedule are:

(i) in relation to any company:

- any director of such company; and
- any person who was previously employed by or was a director of such company if such person is or was the sole or one of the controlling shareholders in the company, and

(ii) any person who has retired and who, after his/her retirement, is released by his/her employer from an obligation which arose before the employee's retirement to reimburse the employer for an amount paid by the employer on behalf of the employee or to pay any amount that became owing by the employee to the employer before the employee's retirement.

5.6 Subsistence allowances (section 8(1)(c))

A subsistence allowance is not regarded as taxable provided that it does not exceed a set daily rate.

(i) R173 per day, inside the RSA, US$190 per day outside the RSA (if the allowance is paid to defray cost of meals and other incidental subsistence expenses).

(ii) R53 per day, (applicable 01/01/2003 to 28/02/2003; R65 from 1/3/2002 - 31/12/2002) (if the allowance is paid to defray cost of incidental subsistence expenses).

(iii) The employee may be entitled to a larger allowance if he/she can prove that such larger amount was actually expended.

5.7 Travelling allowances (section 8(1)(b))

(i) Any portion of a travelling allowance received which is not expended on business travel is included in the employee's taxable income.

(ii) Travel between the employee's place of residence and his/her place of work **is not business travel**.

(iii) Where the taxpayer receives a travelling allowance, the amount of the deduction to be claimed for business travel may be based on the **actual cost incurred** or on a **kilometre rate** established in accordance with the tariffs set out in a notice published by the Minister of Finance in the Government Gazette. If no accurate log book has been kept of the kilometres travelled for business purposes, it will be assumed that 16 000 of the total kilometres travelled were in respect of private travelling. The assumption that the balance of the distance travelled represents business travel will only apply in respect of a total distance of 32 000 kilometres. Any claim for business travel which exceeds 16 000 kilometres must consequently be substantiated by accurate records.

Where a travel allowance has been given to an employee who has also been granted the use of an employer-owned vehicle, that portion of the travel allowance which is not subject to tax in the employee's hands is based on the employee's actual business traveling expenditure and not the deemed expenditure determined according to the statutory rate per kilometre scale.

The following formulae may be used in calculating the amount expended on business travel:

(a) $\frac{\text{actual business kilometres}}{\text{total kilometres travelled}} \times \frac{\text{actual costs}}{1}$

(b) actual business kilometre x kilometre rate

(c) business kilometres (max. 16 000) x kilometre rate

(d) $\frac{\text{business kilometres (max. 16 000)}}{\text{total kilometres travelled}} \times \frac{\text{actual costs}}{1}$

Methods (a) and (b) may only be used if an accurate log book has been kept.

(iv) In determining the rate per kilometre, a distinction is drawn between the fixed-cost element (which includes depreciation, licence fees, registration fees, etc.), the fuel element and the maintenance element. These elements are based on the determined value of the vehicle.

(v) Determined value in relation to a motor vehicle means:

- where the vehicle was acquired under a bona fide agreement of sale or exchange concluded by parties dealing at arm's length, the original cost thereof, including sales tax or VAT, but excluding any finance charges or interest payable; or

- where the vehicle is/was held under a financial lease the cost to the lessor or the selling price of the vehicle plus any sales tax or VAT paid; or

- in any other case the market value of the vehicle at the time when the taxpayer first obtained the vehicle or the right of use thereof plus any sales tax or VAT which would have been payable had it been purchased.

(vi) Where any motor vehicle which is owned or leased by an employee, his/her spouse or child, whether directly or indirectly, by virtue of an interest in a company or trust or otherwise, has been let to the employer or any associated institution in relation to the employer, the sum of the rental paid and any expenditure defrayed in respect of the vehicle, shall be deemed to be an allowance paid to the employee in respect of transport expenses.

(vii) The **fixed-cost element** (which includes depreciation, licence fees, registration fees, etc.) allowed in any year is a fixed amount ascertained according to the determined value of the vehicle in

accordance with the gazetted table.

(viii) The rate per kilometre will be the fixed amount divided by the total number of actual kilometres travelled, whether for business or private purposes.

(ix) A separate rate per kilometre is provided in respect of the **fuel element** and the **maintenance element**.

(x) The scale setting out the three components of the gazetted rate which may be used in determining the cost of business travel where actual costs are not used:

Where the value of the vehicle -	Fixed cost R	Fuel cost c	Maintenance cost c
exceeds R40 000 but not R60 000	19 869	36.2	22.4
exceeds R60 000 but not R80 000	25 068	36.2	22.4
exceeds R80 000 but not R100 000	30 893	40.7	27.8
exceeds R100 000 but not R120 000	35 578	40.7	27.8
exceeds R120 000 but not R140 000	40 732	40.7	27.8
exceeds R140 000 but not R160 000	46 157	45.0	37.7
exceeds R160 000 but not R180 000	51 930	45.0	37.7
exceeds R180 000 but not R200 000	57 332	51.1	41.6
exceeds R200 000 but not R220 000	63 287	51.1	41.6
exceeds R220 000 but not R240 000	68 697	51.1	41.6
exceeds R240 000 but not R260 000	74 287	51.1	41.6
exceeds R260 000 but not R280 000	78 992	53.9	49.8
exceeds R280 000 but not R300 000	83 744	53.9	49.8
exceeds R300 000 but not R320 000	88 854	53.9	49.8
exceeds R320 000 but not R340 000	94 322	53.9	49.8
exceeds R340 000 but not R360 000	99 240	59.8	65.5
exceeds R360 000	99 240	59.8	65.5

Where the allowance is based on the actual distance travelled on business or the recipient can prove the actual distance and the distance travelled in the vehicle for actual business purposes during the year of assessment does not exceed 8 000 kilometres, the rate per kilometre shall, at the option of the recipient, and provided that no other compensation in the form of an allowance or reimbursement is payable by the employer to the employee in respect of such vehicle, be determined in accordance with a scale of 238 cents per kilometre.

(xi) The steps in calculating the deductible travel expenses are as follows:

Total actual kilometres travelled = ...

Determined value	=	. . . .
Fixed cost		
$= \frac{\text{Fixed cost}}{\text{Total km}} \times \frac{y}{365}$	=	. . . . . cents per km
Fuel cost	=	. . . . . cents per km
Maintenance cost	=	. . . . . cents per km
Total cost	=	. . . . . cents per km
Deemed business travel	=	Total travel* - 16 000
(If accurate records have been kept use actual business travel)	=	. . . .
Deduction allowable against allowance	=	Business km x total cost per km ÷ 100
	=	.... x $\frac{\text{. . . . .}}{100}$
	=	R. . . . . . .

y If the motor vehicle was used for business purposes for less than 365 days, the fixed cost must be apportioned accordingly.

* Total travel is limited to 32 000 kilometres.

The deduction may not exceed the amount received as a travel allowance.

5.8 Private use of employer-owned motor vehicles (company cars) - Paragraph 7 of Seventh Schedule

(i) The value of the taxable benefit is calculated according to a scale based on the determined value of the vehicle. The monthly value of the benefit is calculated by multiplying the determined value of the vehicle by 1.8% (the deemed value of a company car will be increased from 1.8% per month to 2.5% from 1 March 2006).

Where more than one motor vehicle is provided to an employee for mainly private use, the value shall be the amount of 1,8% of the determined value of the motor vehicle with the highest determined value, and 4% of the determined value of every other such motor vehicle.

(ii) **“Determined value”**

- original cost excluding finance charges, interest and sales tax or VAT where the vehicle is owned by the employer;
- cash value as defined in the Value Added Tax Act where the vehicle is held under a lease as defined in par. (b) of the definition of instalment credit agreement in the VAT Act;
- retail market value when first obtained under any other lease;
- the market value (excluding VAT) when first obtained by the employer in any other case.

(iii) The determined value shall be reduced by 15% for each completed year from the date on which the employer first obtained such vehicle to the date of first use by the employee.

(iv) Where the employee bears the cost of all fuel used for private purposes, the monthly value of private use according to the table is reduced by R120.

(v) Where the employee bears the cost of maintaining the vehicle (including the cost of repairs, servicing, lubrication and) the monthly value of private use is reduced by R85.

(vi) If the taxpayer can prove that the private distance travelled is less than 10 000 km per annum, the Commissioner may reduce the value placed on the private travel in terms of the table.

(vii) **Exemptions:**

“Pool vehicle”

- A vehicle available to and used by other employees; and
- the private use is of an infrequent nature or merely incidental to its business use; and
- the vehicle is not kept at or near the employee’s residence outside of business hours.

Restricted use

Where the nature of the employee’s duties requires the use of the vehicle out of business hours and the only private use permitted is travel between his/her residence and work.

5.9 Residential accommodation - Paragraph 9 of the Seventh Schedule

(i) The benefit is taxed on the basis of the employee's level of remuneration and not on the actual value of the housing provided.

(ii) The taxable benefit that is derived, may be the rental value of such accommodation calculated in terms of the formula in (iii) below, less any rental actually paid by the employee for the accommodation or any rental consideration paid by the employee for household goods supplied and any charge made to the employee by the employer in respect of power or fuel provided with the accommodation.

(iii) The rental value to be placed on any accommodation provided to an employee is calculated in terms of the formula:

$$(A - B) \times \frac{C}{100} \times \frac{D}{12}$$

"A" = the remuneration derived by the employee from his/her employer during the preceding year of assessment.

"Remuneration" includes directors' fees but excludes (amongst others):

- the benefit derived from residential accommodation;
- the benefit derived from the private use of any motor vehicle;

"B" = an abatement of R20 000.

The abatement is not available where:

- the employer is a private company and the employee or his/her spouse controls the company or is one of the persons controlling the company.
- the employee, his/her spouse or minor child owns or has some right to acquire the property.

"C" = a factor which determines the value to be placed on the accommodation and varies depending on the size of the accommodation and facilities supplied:

- 17, if less than four rooms, or more than four but unfurnished and without power;

- 18, if four or more rooms with either furnishing or power supplied;
- 19, if four or more rooms with both furnishing and power supplied.

"D" = the number of months in the year of assessment during which the employee was entitled to occupation of the accommodation.

(iv) No taxable benefit arises where the employee is provided with accommodation away from his/her normal place of residence for purposes of performing his/her duties.

(v) Where the employee is provided with two or more residential units the cash equivalent will be that of the unit with the highest rental value as determined in (ii) over the full period during which the employee was entitled to occupy more than one unit.

(vi) Where accommodation which is provided as a benefit to an employee is not owned by the employer or an associated person in relation to the employer, or where the employee has an interest in the particular accommodation, said employee will be taxed on the amount equal to the greater of:

(a) the value determined in (ii), or

(b) total amount of rentals and other expenditure paid by employer. Rental payable is not taxable in the hands of the employee or connected person in order to avoid double taxation.

An employee will be deemed to have an interest in the accommodation if:

- such accommodation is owned by the employee, his/her spouse or child, or by a company in which the employee, his/her spouse or child has a substantial shareholding, or by a trust in which the employee, his/her spouse or child is a beneficiary; or
- any increase in the value of the accommodation in any manner whatsoever, directly or indirectly, accrues for the benefit of the employee, his/her spouse or child; or
- such employee, or a connected person in relation to such employee, has a right to acquire the accommodation from the employer.

The formula in (iii) above will be used only when the employer or associated institution owns the accommodation and also when the employer or associated institution does not own the accommodation, provided all three of the following criteria apply:

- It is customary for an employer in the industry concerned to provide free or subsidised accommodation to its employees.
- It is necessary for the particular employer to provide free or subsidised accommodation to its employees:
  - (i) the proper performance of their duties
  - (ii) a result of the frequent movement of employees or
  - (iii) as a result of the lack of employer-owned accommodation

    and

  - benefit is provided solely for bona fide business purposes.

5.10 Subsidies - Paragraph 12 of the Seventh Schedule

(i) Taxable benefit arises when an employer pays a subsidy in respect of capital or interest payments due by the employee on any loan.

(ii) Cash equivalent of the taxable benefit in all cases is equal to the full amount of the subsidy.

(iii) Where a financial institution or other body grants a loan to an employee of any employer at a low rate of interest subject to an additional payment by the employer to compensate the financial institution for the consequent loss of interest income, the additional payment will be regarded as a taxable subsidy in the hands of the employee, if the payment by the employer exceeds the amount calculated using the official rate of interest. If it does not exceed this amount, the benefit will be taxed as a low-interest loan.

5.11 Housing and other loans - Paragraph 11 of the Seventh Schedule

(i) A low or no-interest loan to an employee gives rise to a taxable benefit calculated with reference to the difference between the interest charged at the official rate (8.5% with effect 1 September 2004) and the interest which the employee actually pays.

(ii) The value of the taxable benefit is the difference between the amount of interest which would be payable on the loan at the official rate of interest and the amount of interest actually paid by the employee on the loan.

(iii) No taxable benefit arises from:

(a) any casual loans which in aggregate do not exceed R3 000.

(b) a loan granted to enable an employee to further his own studies.

5.12 Payment of employee’s debt or release from obligation to pay a debt - Paragraph 13 of the Seventh Schedule

(i) Where an employer pays any amount owing by the employee or releases him/her from the obligation to repay any debt, a taxable benefit accrues to the employee.

(ii) The employee will be taxed on the amount of the debt he/she is released from paying.

(iii) If an employer pays an employee’s subscriptions to a professional body, membership of which is a condition of employment, it is not regarded as a taxable benefit.

5.13 Free or cheap services - Paragraph 10 of the Seventh Schedule

Travel facility

(i) The general rule is that travel facilities paid for by an employer for an employee’s private use, will be taxable at the cost to the employer.

(ii) No taxable benefit is attached to a transport service rendered by an employer to convey employees from home to work.

(iii) In certain circumstances employees of airlines, railways, etc. will not be taxed on the benefit of free travel.

Other services

All other services are taxable at cost to the employer unless:

the services are rendered at the employer's place of work to enable employees to perform their services more effectively or (in the case of recreational facilities) are rendered at a place set aside for employee's recreation in general.

5.14 Contributions to a medical aid fund - Paragraph 2(i) and 12A of the Seventh Schedule

With effect from 1 April 1998, the amount by which an employer's medical aid contributions to a medical aid scheme exceeds two-thirds of the total contribution is taxed as an employee fringe benefit.

6. Exempt income

Gross income less exemptions equals income. Some of the more common exemptions are:

6.1 The basic interest and foreign dividend exemption - s.10(1)(i)(xv) and (xvi)

The first R15 000 of interest earned by taxpayers under the age of 65 and the first R22 000 of interest earned by taxpayers over the age of 65, which is not otherwise exempt from tax, received in the year of assessment is exempt from tax. This interest exemption is only available to natural persons. Foreign interest and dividends will only be exempt up to the first R2 000 of the total exemption. For purposes of the interest exemption dividends distributed by a fixed-property company and the interest portion of amounts distributed by a unit trust also qualify for the interest exemption.

6.2 The tax-free portion of voluntary purchase annuities - s.10A

The capital element of a voluntary purchase annuity is exempt from tax in the hands of the purchaser or his/her spouse or surviving spouse or deceased/insolvent estate of purchaser spouse. The capital element includes the capital element of a purchased annuity where the purchaser of the annuity has died or has been sequestrated and where the final payment under the annuity contract becomes payable to the purchaser's deceased or insolvent estate.

The following requirements must be met before this exemption applies:

- There must be an agreement between an insurer and a natural person.
- The annuity must be payable until the death of the annuitant or the expiry of a specified term.
- The annuity must be payable to the purchaser or his/her deceased or insolvent estate or spouse or surviving spouse.
- It must not be an annuity payable by the insurer under the rules of a pension, provident or retirement annuity fund.

The capital element of the annuity is determined in accordance with the following formula:

$$\text{Capital element} = \frac{A}{B} \times C,$$

where:

A = the amount of the total cash consideration given by the annuity purchaser.

B = the total expected return of all the annuities to be paid (where the annuity is a temporary life annuity the total expected return must be calculated using the life expectancy tables based on age last birthday).

C = the amount of the annuity.

Example

A male aged 66 buys a temporary life annuity for R70 000. He receives an annuity of R8 000 per annum. His life expectancy is 13.131 years. The total expected return of all the annuities is R8 000 x 13.131 = R105 048.

Capital element:

$$\frac{R70\ 000}{R105\ 048} \times R8\ 000 = R5\ 331.$$

The taxable portion of the annuity:

R8 000 - R5 331 = R2 669.

If the annuitant is required to render a return, a copy must be attached to the tax return.

Commutation of voluntary purchase annuity - s.10A(3)(c)

The commuted value of a voluntary purchase annuity is now taxable as gross income less an exempt amount determined in accordance with the following formula:

$$X = A - D,$$

in which formula:

(i) X = the exempt amount;

(ii) A = the amount of the total cash consideration given by the purchaser under the annuity contract; and

(iii) D = the sum of the capital elements of all annuity amounts payable under the annuity contract prior to the commutation.

Example

A taxpayer purchases a temporary life annuity for R50 000. The annual annuity is R7 000 of which the capital element is R4 000. After three years the taxpayer commutes the annuity and receives a commuted value of R41 000. What amount will form part of gross income?

Exemption =	X	=	A - D
		=	R50 000 - R12 000
		=	R38 000.
Taxable portion		=	commuted value - exemption
		=	R41 000 - R38 000
		=	R3 000.

6.3 Dividends - s.10(1)(k)

South African dividends received by any person are exempt from tax.

Dividends distributed by a company of which the shares are “property shares” in terms of the Collective Investment Scheme Control Act are not exempt in terms of this section.

All dividends from foreign registered or incorporated companies will be included in the income of South African residents. This measure will apply to all foreign dividends:

- which accrue to or are received by residents on or after 23 February 2000;
- which accrued to a resident before 23 February 2000, but are received by the resident on/or after 23 February 2000.

Foreign dividends received or accrued from certain designated countries will not be taxable where the exemption in terms of section 9E(7) applies.

Note that this exemption has been amended, but the amendment only applies to tax years commencing on or after 1 June 2004. Please refer to the 2003 Revenue Laws Amendment Act.

6.4 Transfer costs - s.10(1)(nB)

Where an employer bears certain expenses of transfer of any employee:

- on taking up employment;
- on transfer from one place of employment to another;
- on termination of employment;

no taxable benefit accrues to the employee.

The exempt expenses are:

- transport of the employee, his/her household and his/her possessions;
- “settling-in” expenditure at the new place of residence;
- the hiring of temporary accommodation (up to a maximum of 183 days) pending the obtaining of permanent residential accommodation.

6.5 Share incentive schemes - s.10(1)(nE)

An amount (including any taxable fringe benefits) received by or accrued to an employee under a share incentive scheme operated for the benefit of employees which was derived -

- upon the cancellation of a transaction under which the employee purchased the shares under the scheme; or

- upon repurchase from the employee at a price not exceeding the selling price to him/her of the shares under the scheme,

is exempt from tax, if the employee does not receive compensation or a consideration in excess of the purchase price he/she actually paid for the shares.

6.6 Employment outside South Africa s.10(1)(o)

Income earned by a resident from employment outside South Africa will be exempt if services are rendered outside South Africa and the taxpayer was outside South Africa for periods exceeding 183 days (in aggregate) during any 12-month period commencing or ending during the year of assessment and for a continuous period exceeding 60 full days during such 12-month period. Such service must have been rendered during such periods.

6.7 Bursaries - s.10(1)(q)

Bona fide scholarships or bursaries granted to any person to enable or assist that person to study at a recognised educational or research institute are exempt from tax. If the scholarship or bursary is granted by an employer or any associated institution in relation to the employer to an employee or to a relative of an employee, the amount will be taxable in the following circumstances:

(i) if the bursary is received by means of a “salary sacrifice”; or

(ii) if the bursary is received by a relative of an employee who earns in excess of R60 000 per annum; and

(iii) so much of the bursary contemplated in (ii) above as in the case of any such relative exceeds R2 000 during the year of assessment.

6.8 Lump sum received on termination of service - s.10(1)(x)

An amount of up to R30 000 received by an employee or director because of the termination or impending termination of service may be exempt from tax if certain conditions are met. It is this exemption which is often utilised in deferred compensation schemes.

Where such an amount was received by a married woman and was exempt from tax in her husband's hands, the amount will be deemed to have been received by him when the tax-exempt status of subsequent amounts received by the husband or wife after 1/3/90 is determined.

(See also Business Assurance.)

7. Deductions

7.1 General formula - s.11(a) read with s.23(g)

The general formula allows the deduction of:

- expenditure and losses
- actually incurred
- during the year of assessment
- in the production of income
- not of a capital nature
- laid out or expended for the purposes of trade.

The general formula provides for the deduction of those expenses not covered in the list of special deductions. Included hereunder would be travelling expenses, recurring business expenses, advertising, legal costs, salaries, interest paid on money borrowed to produce income, etc.

The Income Tax Act specifies various special deductions allowable against income. These deductions are generally meant to expand the general deduction formula.

7.2 Entertainment expenditure

Self-employed taxpayers can deduct entertainment expenses under the general deduction formula, (sec.11(a) and sec.23(g)).

7.3 The deduction for medical expenses - s.18

All taxpayers who are over the age of 65 may claim their full medical expenses as a deduction. If the taxpayer is under 65 years of age and not handicapped, the deduction may only be claimed where the amount

exceeds 5% of the taxable income before the deduction in respect of medical expenses.

This deduction is available to the spouse who paid the medical expenses irrespective of whether it was to the taxpayer's own benefit or that of his/her spouse or children.

Where the taxpayer or his/her spouse, child or stepchild is a "handicapped person" and the taxpayer is under 65, any medical expenses exceeding R500 may be claimed as a deduction.

A "handicapped person" is defined as a blind person, a deaf person, a person requiring a wheelchair, calliper or crutch to assist him/her in moving or a person who requires an artificial limb, or a person who suffers from a mental illness as defined in section 1 of the Mental Health Act 18 of 1973.

7.4 Donations to public benefit organisations (PBO's) - s.18A

Bona fide donations to any approved public benefit organisation may be claimed as a deduction by a taxpayer. The deduction is limited to 5% of the taxpayer's taxable income before the deduction of a claim in respect of any donation or medical expenditure.

7.5 Deductions in respect of current and arrear pension fund contributions - s.11(k)

See Retirement Planning.

7.6 Deductions in respect of current and arrear retirement annuity fund contributions - s.11(n)

See Retirement Planning.

8. Calculating the tax liability

8.1 The tax tables

Difference income tax rates apply to natural persons, non-natural taxpayers and trusts. See section E for the tax rates applicable to trusts. The tables that follow contain the income tax rates applicable to natural persons for the current and previous years of assessment.

Income tax rates for natural persons			
Year of assessment ending 28.2.2005			
Taxable income			
Exceeds	But does not exceed		
R	R	R	R
-	74 000	18% of each R1	
74 001	110 000	13 320 + 25% of the amount over	74 000
115 001	155 000	23 570 + 30% of the amount over	115 000
155 001	195 000	35 570 + 35% of the amount over	155 000
195 001	180 000	49 570 + 38% of the amount over	195 000
270 001	270 000 and above	78 070 + 40% of the amount over	270 000

Income tax rates for natural persons			
Year of assessment ending 28.2.2006			
Taxable income		Rates of tax	
Exceeds	But does not exceed		
R	R	R	R
-	80 000	18% of each R1	
80 001	130 000	14 400 + 25% of the amount over	80 000
130 001	180 000	26 900 + 30% of the amount over	130 000
180 001	230 000	41 900 + 35% of the amount over	180 000
230 001	300 000	59 400 + 38% of the amount over	230 000
300 001	and above	86 000 + 40% of the amount over	300 000

Deceased estates, special trusts (set up for the benefit of persons suffering from mental or physical disabilities) and testamentary trusts established for the benefit of minor children, will also be taxed at these rates. All other trusts are taxed at a flat rate of 40%.

Trusts do not qualify for any rebates or for the exemption on interest granted to natural persons.

8.2 Tax rebates

Taxpayers who are natural persons are entitled to certain rebates. These rebates are determined by the age of the taxpayer (section 6).

The rebates are as follows:

Primary tax rebate

All taxpayers R6 300 (previously R5 800)

Secondary rebate

Taxpayers aged 65 and older R4 500 (previously R3 200).

The secondary rebate will also be available if the taxpayer dies during the tax year in which he/she would have turned 65.

Where the period of assessment is less than 12 months, the rebate is reduced proportionately.

8.3 Small business: tax stimulus

Small and medium corporations with an annual turnover of less than R6 million (previously R5 million) will pay no tax on the first R35 000 of taxable income, 10% on income between R35 000 and R250 000 and 29% thereafter.

Income Tax Calculation Sheet

GROSS INCOME				
Salary		R		
Trade/business		R		
Commission		R		
Interest	Domestic	R		
Interest	Foreign	R		
Unit trust:	Interest - Domestic	R		
	Interest - Foreign	R		
	Dividends - Domestic	R		
	Dividends - Foreign	R		
Dividends - Domestic		R		
Dividends - Foreign		R		
Other	. . . .	R		
	. . . .	R		
	TOTAL	**R**		**R**
EXEMPTIONS				
Basic interest		R		
Dividends - Domestic		R		
Foreign employment income		R		
Other	. . . .	R		
	. . . .	R		
		R	-	**R**
		INCOME		**R**
DEDUCTIONS				
Expenses		R		
Travel funds		R		
Pension fund contributions		R		
Retirement annuities contributions		R		
Donations to PBO's		R		
Medical expenses		R		
Other		R		
Plus: Taxable Capital Gain		**R**		
		R	-	**R**
		TAXABLE INCOME		**R**
Tax on	R.			R
+ . . . . .% on	R.		+	R
		TAX PER SCALE		**R**
REBATES				
Primary		R		
65 +		R	-	**R**
TAX PAYABLE				**R**

Section 2

Provisions relating to persons who are married

1. Income deemed to have accrued to the spouse - s.7(2)

To prevent married taxpayers from splitting their income with the sole or main purpose of reducing or avoiding their liability for tax, the Income Tax Act contains certain anti-avoidance measures which deem the income of either spouse in certain circumstances to be the income of the other spouse.

The circumstances in which the section applies are as follows:

(a) Where income is derived by a spouse as a result of:

- a donation, settlement or other disposition made on or after 20 March 1991 by the other spouse; or
- a transaction, operation or scheme entered into or carried out by that other spouse on or after that date;
- AND the sole or main purpose of the donation, settlement or other disposition, transaction, operation or scheme was to reduce, postpone or avoid that other spouse's liability for tax.

(b) Where a spouse derives any income:

- from a trade carried on by that spouse in partnership with the other spouse or which is in any way connected with any trade carried on by the other spouse; or
- from any partnership of which the other spouse is a member or from any private company of which the other spouse is the sole or main shareholder or one of the principal shareholders; and
- the amount so earned is excessive having regard to the nature of the relevant trade, the extent of the spouse's services or participation in the trade or any other relevant factor.

2. Spouses married in community of property

In the case of spouses married in community, all rental income from fixed property and all other income derived other than from the carrying on of a trade will be deemed to have accrued to both spouses equally, irrespective of which spouse earned the income.

All income derived from the carrying on of a trade will be deemed to have accrued to the spouse who is carrying on that trade. Income derived by way of both voluntary and compulsory purchase annuities is regarded as income from trade.

3. Lump-sum payments received - section 10(1)(x) and the definition of "formula B" in the Second Schedule

Any such tax-free amount received by a married woman prior to 1 March 1991 will reduce the tax-free amounts available to her husband.

Section 3
SITE

1. Introduction

Tax is collected by way of employees' tax and provisional tax. Employees' tax refers to the tax deducted by an employer from remuneration paid or payable to any employee. This method of collecting tax is also referred to as the pay-as-you-earn system (PAYE). Provisional tax refers to the estimated amounts of tax that are paid at periodic intervals.

When any taxpayer's liability for normal tax for the year of assessment is calculated by the South African Revenue Service (SARS), these amounts of employees' tax and provisional tax payments are then set off against the taxpayer's final liability for tax. If the sum of the tax paid exceeds the taxpayer's total liability for tax, the excess is refunded, but if the amount of tax paid is insufficient, the taxpayer must pay in the shortfall.

In order to relieve some of the burden of administering these tax returns, assessments, payments and the record-keeping of certain taxpayers, and freeing these taxpayers of the task of completing returns, a standard income tax on employees was introduced as an integral part of the PAYE system. In terms of the SITE provisions, a taxpayer's final liability for tax is determined by his/her employer and this relieves the burden of issuing assessments at the end of the tax year. In certain circumstances SITE determines a taxpayer's minimum liability for tax.

In this section the normal tax collected by way of employees' tax and the SITE provisions are discussed. The SITE provisions are contained in paragraph 11B of the Fourth Schedule.

2. Employer and employee

Employer means any person who pays or is liable to pay to any person any amount by way of remuneration. This definition includes any person:

- acting in a fiduciary capacity; or
- in the capacity as trustee of an insolvent estate, an executor or an administrator of a benefit fund, pension fund, provident fund, retirement annuity fund or any other fund; or

- responsible for the payment of any amount by way of remuneration to any person under the provisions of any law or out of public funds or out of funds voted by parliament or a provincial council.

Employee means any person:

- (other than a company) who receives any remuneration or to whom any remuneration accrues;
- who receives any remuneration or to whom any remuneration accrues by reason of any services rendered by such person to or on behalf of a labour broker;
- who is a labour broker;
- in a class or category of person whom the Minister of Finance so declare;
- any personal service company;
- any personal service trust; and
- any director of a private company.

3. The impact of SITE

In determining an employee's liability for normal tax, it is very important to distinguish between those employees who are subject to SITE only, those only partially subject to SITE and those not subject to SITE at all. This distinction is important for the following reasons:

- If an employee is subject to SITE only, the amounts of SITE deducted will constitute the final liability for tax. Any deductions that he/she could have been entitled to will be limited to those in respect of pension fund contributions, retirement annuity fund contributions and, under certain circumstances, medical expenses. He/she will not be required to render an income tax return.
- If the employee is only partially subject to SITE, the amounts of SITE deducted will constitute his/her minimum liability for tax. The only deductions allowable against SITE remuneration, are those in respect of pension fund contributions, retirement annuity fund contributions and, under certain circumstances, medical expenses. All other deductions that may be claimed, can only be offset against non-SITE income. The employee will be required to render a return.

- If the employee is not subject to SITE, allowable deductions may be offset against the whole of his/her income. The employee will be required to render a return.

4. When does SITE apply?

SITE only applies to:

- so much of the annual equivalent of the **net remuneration** earned by an employee during the tax period as does not exceed R60 000;

  or

- where such **net remuneration** includes any annual payment, to so much of the sum of all such annual payments and the annual equivalent of all other net remuneration earned as does not exceed R60 000.

In order to be able to apply this definition, the meaning of various expressions used in this definition must be understood.

5. Net remuneration

Net remuneration means the balance of any **remuneration** as determined by an employer or the Commissioner after making certain deductions.

In order to calculate the amount of net remuneration, one must:

- identify those amounts earned by an employee that qualify as **remuneration**;
- exclude those amounts of **remuneration that are not subject to SITE**;
- determine the balance of remuneration, i.e. deduct the allowable pension and retirement annuity fund contributions (and medical expenses where applicable) from the remaining amounts of remuneration.

5.1 Remuneration - Paragraph 1 of the Fourth Schedule

Remuneration refers to those earnings from employment in respect of which the employer must deduct employees' tax in terms of the PAYE system and furnish the employee with an IRP5. In terms of paragraph 1 of the Fourth Schedule, remuneration means any amount of income payable to any person by way of salary, leave pay, allowance, wage, overtime,

bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, including:

- annuities;
- any amounts, including voluntary awards, in respect of services rendered or to be rendered;
- any amount received as compensation for any restraint of trade imposed;
- any amounts, including voluntary awards, received or accrued in respect of the relinquishment, termination, loss, repudiation, cancellation, etc., of any appointment to any office or employment;
- lump sums received from pension, provident or retirement annuity funds;
- the cash equivalent of any taxable benefit determined in terms of the Seventh Schedule;
- 50% of the amount of any travel or car allowance if such allowance is not based on actual business travel; and
- director's remuneration.

The following amounts are, however, excluded:

- common law independent contractors, but excluding independent contractors who are subject to the control or supervision of any person as to the manner in which their duties are performed or as to the hours of work **or** if the amounts paid or payable to them are payable at regular daily, week, monthly or other intervals;
- amounts payable to an employee in reimbursement of expenditure actually incurred by such employee in the course of his/her employment;
- any annuity paid under an order of divorce or separation; and
- any pension or allowance in terms of the Aged Pensions Act, Blind Persons Act, Disability Grants Act and Children's Act.

5.2 Amounts of remuneration specifically excluded from the definition of net remuneration - Paragraph 11B(1) of the Fourth Schedule

SITE does not apply to all income that qualifies as remuneration. Certain amounts of remuneration have been specifically excluded in the definition of net remuneration.

They are:

- any amounts which are taxable at the taxpayer's average rate of tax in terms of the rating formula, e.g. the taxable portion of the lump-sum benefit from a pension fund, in terms of s.5(10);
- remuneration in the production of which the taxpayer has incurred deductible expenses or is entitled to a wear-and-tear or depreciation allowance which exceeds 1% of the remuneration in question, e.g. commission earned by a representative who pays his/her own motor expenses;
- remuneration derived by any person which is under the provisions of s.7(2) deemed to be income accrued to such person's spouse;
- any remuneration **not** derived from standard employment;
- any remuneration derived by way of an annuity which is **not** payable by a pension, provident or benefit fund, e.g. a voluntary purchase annuity;

  (From 1 March 1993 annuities payable by retirement annuity funds are excluded from the SITE system. Such annuities will be subject to the deduction of PAYE only and the recipient will be required to submit a return of income for assessment.)
- remuneration paid to a director of a company for services rendered to the company ;
- any travel allowance which qualifies as remuneration; and
- remuneration derived by the taxpayer in respect of which he/she is entitled to set off an assessed loss in terms of section 20(1).

Standard employment

Standard employment is defined as follows:

(a) Any employment in terms of which an employee is required to render service to any one employer for a period of at least 22 hours in every full week falling within the period of such employment. For the purposes of this paragraph no regard shall be had to:

  (i) periods of temporary absence of an employee due to leave or exceptional circumstances; or

  (ii) any temporary reduction in working hours imposed by the employer; or

(b) the employment of any employee with an employer if such employee declares in writing that he/she does not and will not during the period in which he/she holds such employment render services (other than casual services as determined by the Commissioner) to any other employer; or

(c) where any employer conducts business in such a manner that employees are regularly or frequently employed for such periods as may be required by the employer, the employment of any such employee if the Commissioner, after consultation with the employer or with any body or association representing any group of employers, so directs.

5.3 After the allowable deductions have been taken into account - Paragraph 11B(1) and Paragraph 2(4) of the Fourth Schedule

The final step in determining net remuneration is to deduct from SITE remuneration certain defined deductions to which the taxpayer would normally be entitled in determining the liability for tax.

Here we must distinguish between the deductions which an employer may take into account and the deductions which the Commissioner may take into account.

The deductions the employer may take into account are:

- the permissible current pension fund contributions;

- the permissible current retirement annuity fund contributions;

- provided the taxpayer will be over the age of 65 at the end of the year of assessment, contributions to any medical scheme registered under the provisions of the Medical Schemes Act.

(For the deductions that may be taken into account by the Commissioner, see paragraph 10 below - Redetermination of SITE by the Receiver of Revenue.)

6. Taxpayers subject to SITE only

Where the taxable income of any person for the year of assessment was derived solely from net remuneration and the annual equivalent of such net remuneration received during the tax period does not exceed R60 000, the taxpayer's liability for normal tax will be equal to the amount of SITE paid. The employee will qualify as a SITE-only taxpayer and will not be required to render a return.

The requirements to qualify as a SITE-only taxpayer in this category can be set out as follows:

- the employee must earn remuneration;
- the annual equivalent of the net remuneration paid during the tax period may not exceed R60 000; and
- the employee has no other taxable income.

(i) Annual equivalent not exceeding R60 000

The annual equivalent must only be determined if the tax period is less than a full year. The annual equivalent refers to the amount of net remuneration the employee would have received had he/she been employed for the full year. For example, if a taxpayer worked only for eight months of the tax year and earned R6 000 per month, the annual equivalent of net remuneration is R6 000 x 12, i.e. R72 000. Although the actual remuneration is less than R60 000, the annualised equivalent exceeds R60 000 and the taxpayer will, therefore, not be a SITE-only taxpayer and will have to render a return for the tax year.

(ii) Tax period

Tax period in relation to any employee, means:

- any unbroken period in the year of assessment during which the employee was employed in the Republic in standard employment by

any one employer or during which any annuity was paid or became payable to him/her by any one employer; or

- where the Commissioner has in relation to the employment of any employee issued a directive as contemplated in the definition of standard employment, such period as the Commissioner considers appropriate in the circumstances.

(iii) No other taxable income

If a taxpayer earns net remuneration not exceeding R60 000 but has other taxable income, for example a voluntary purchase annuity, the taxpayer will not qualify as a SITE-only taxpayer and will be required to render a return. The liability for normal tax will be calculated on the total amount of taxable income received, but the amounts of SITE paid will constitute the minimum liability for tax. If the taxpayer receives any amounts that do not qualify as income or taxable income, for example interest from tax-free investments or the first R15 000 (R22 000 for taxpayers age 65 and over) interest that is exempt of tax, the status as SITE-only taxpayer will not be affected.

7. The steps in calculating SITE tax

The steps in calculating the tax liability of a SITE-only taxpayer are as follows:

Determine: Remuneration

Deduct: The amounts of remuneration specifically excluded in the definition of net remuneration

Deduct: The permissible contributions to pension and retirement annuity funds and medical aids

= net remuneration.

Apply: Normal tax rates on net remuneration

= tax per scale.

Deduct: Tax rebates

= SITE payable.

8. Return of personal particulars - Paragraph 11B(6)

For the purposes of determining the amount of SITE required to be deducted from any net remuneration paid or payable by an employer to an employee, the employer shall not allow the deduction of the secondary rebate unless he/she is in possession of a written declaration by the employee that he/she would be over the age of 65 years on the last day of the year of assessment. If such written declaration is not furnished, and the amount of SITE is greater than it would have been had such written declaration been furnished, the employer is deemed to have correctly determined the SITE. Where the employee fails to furnish such a declaration in sufficient time to enable the employer to take account thereof for the purposes of determining the employee's SITE liability, the employee is deemed to have failed to render such written declaration.

9. Refunds of PAYE by employers - Paragraph 11B(5) and Paragraph 11B(2A) of the Fourth Schedule

The Fourth Schedule provides that, if at the end of a tax period it is found that an employee is liable for SITE only, i.e. the net remuneration of the employee does not exceed the applicable limit of R60 000 and the total PAYE deducted by the employer exceeds the amount of SITE payable, the overpayment must be refunded to the employee by the employer. Any shortfall must be recovered from the employee. Where the amount of SITE actually deducted is within R5 of the actual SITE liability determinable in accordance with the statutory rates, the employer need not make any adjustment.

10. Redetermination of SITE by the Receiver of Revenue - Paragraph 11B(4) of the Fourth Schedule

Where an employee has made an allowable contribution to a pension or retirement annuity fund which was not taken into account by the employer in the determination of SITE or has incurred deductible medical expenditure, the taxpayer may apply to the Commissioner for a redetermination of SITE. The application for a redetermination must be addressed to the local Receiver of Revenue who will authorise the necessary refund.

11. Amounts of net remuneration from different sources

Where a taxpayer's income consists solely of amounts of net remuneration, the sum of the amounts of SITE deducted on each of these amounts will be the final liability for normal tax. If, for example, a taxpayer's only income consists of a salary of R14 000 for the full year and a pension of R12 000 for the full year, both such amounts being subject to SITE only, the final liability for normal tax will be the sum of SITE deducted. The two amounts will not be combined for income tax purposes. Should the taxpayer, however, be in receipt of other taxable income, e.g. business income, which does not constitute net remuneration or if one of the amounts of net remuneration exceeds the annual rate of R60 000, all the income, including the net remuneration which does not exceed the annual rate of R60 000, will be combined to determine the liability for normal tax.

12. Calculating SITE on a lump sum where the tax period is less than a full year - Paragraph 11B(3)(b) of the Fourth Schedule

Special provision is made for the determination of SITE in cases where the tax period is less than a full year and the employee has received an annual payment, i.e. an amount of remuneration which is payable once annually or which is determined without reference to any period, for example a 13th cheque. In these circumstances SITE is calculated in accordance with the formula:

$$S = T1 - T2.$$

S represents the amount of SITE to be determined.

The steps are as follows:

Step 1: Determine the annual tax on an amount (not exceeding R60 000) equal to the sum of the bonus or similar payment plus the annual equivalent of all the other net remuneration earned by the employee (T1).

Step 2: Determine the annual tax on an amount (not exceeding R60 000) equal to the said annual equivalent (T2).

Step 3: Deduct T2 from T1. The result is the amount of SITE payable on the bonus or similar payment.

Section 4
Capital gains tax

The implementation date for capital gains tax (CGT) was 1 October 2001 (the effective date) and only capital gains arising after the effective date will be subject to CGT. Capital gains are determined and then a portion thereof is included in the taxable income of a taxpayer. Capital gains are thereofe included in the determination of normal tax and incorporated as part of the Income Tax Act.

Who is liable for CGT?

1. Residents

All South African residents are liable for CGT, on the disposal of any asset whether the disposal is made in the Republic or beyond its borders.

2. Non-residents

A non-resident will be subject to CGT on the disposal of –

- any immovable property or any interest or right in immovable property situated in the Republic, and
- any asset of a permanent establishment through which a trade is carried on in the Republic.

What is capital gain?

A capital gain is the proceeds (or deemed proceeds) from the disposal (or deemed disposal) of an asset less the base cost. The proceeds from the disposal will generally be the price at which the asset is sold. In certain cases, when it is not possible to determine the selling price of the asset (for example in the case of death, donations, disposal of an asset at less than market value, emigration or immigrations), the market value of the asset will be the price that could have been obtained upon the sale of the asset between a willing buyer and a willing seller dealing at arm's length in the open market. The base cost of the asset is deducted from the proceeds to arrive at the capital gain. The capital gain is then multiplied by the inclusion rate to determine the taxable gain.

Assets

The term "asset" is defined as widely as possible and basically includes any property of whatever nature and any interest in such property. It will therefore include the following:

- Shares; unit trusts; land; property and rights to property; large boats (more than 10 m) and aircraft (more than 450 kg); plant and machinery; mineral rights; coins made mainly from gold or platinum, e.g. Krugerrands and all other assets except those specifically excluded.

The definition of "asset" specifically excludes any currency and the distribution of money can therefore never be subject to CGT.

CGT applies to all assets disposed of after 1 October 2001, whether or not the asset was acquired before, on, or after that date.

Disposals

A disposal for capital gains tax purposes is regarded as any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset. It is a very wide definition that covers almost every situation where there is a change of ownership of an asset.

The following events, amongst others, would fall within the definition of disposal:

- A sale, donation or cession; expiry or abandonment of an asset; the scrapping, loss or destruction of an asset; the vesting of an interest in an asset of a trust in the hands of a beneficiary; the distribution of an asset by a company to a shareholder; the granting, renewal, extinction or exercise of an option; the decrease in value of a person's interest in a company, trust or partnership as a result of a value shifting arrangement.

In addition to the list above, there are a number of events that are to be treated as disposals for the purposes of CGT (i.e. deemed disposals). The legislation deems that the asset(s) are disposed of a day before the event and reacquired immediately at market value. Some of these events are the following:

- When a person ceases to be a resident (par 12(2)), all that person's assets are deemed to be disposed of except immovable property or rights in immovable property situated in the Republic, and assets of a permanent establishment through which that person carries on a trade in the Republic during the year of assessment.

- The assets of a person who is not a resident, which becomes an asset of that person's permanent establishment in the Republic other than by way of acquisition, and is withdrawn from the permanent establishment for personal or other use.

- An asset of a person that is not held as trading stock, which becomes trading stock.

- A personal use asset held by a natural person, which ceases to be a personal use asset of that person without being disposed of.

- An asset which is not held as a personal use asset, which commences to be held as that person's personal use asset.

- Where a person becomes a South African resident (this provision does not apply to immovable property in the RSA or any asset of a permanent establishment in the Republic).

- When a person dies, all that person's assets are deemed to be disposed of, the day the person dies, at market value, par 40(d).

In determining when the capital gain or loss accrues to a person the timing of the disposal becomes important. In most cases the disposal will take place on transfer of ownership of the asset.

Exclusions from capital gains tax

The list below contains some of the pertinent CGT exclusions.

Annual exclusion

The first R10,000 of a natural person and a special trust's capital gains are excluded in each year of assessment. Where a person dies during a year of assessment, such person's annual exclusion for that year of assessment is R50,000.

Primary Residence Exclusion

The general principle is that capital gains will be taxable on the disposal of primary residences, with the first R1,000,000 of a capital gain or loss being disregarded. Capital gains in excess of R1,000,000 will, therefore, be subject to CGT.

The size of the residential property will also be subject to certain exclusions. A primary residence includes the land upon which it is actually situated and may include land adjacent to it that is used mainly for domestic purposes. The total of all the land must not exceed two hectares in order to fall out of the CGT net. If the size of the property exceeds two hectares, a reasonable apportionment would have to be made. If the property is not mainly used for domestic purposes, that portion will not qualify for the exclusion.

Absence from primary residence for certain periods

Where a natural person or a special trust disposes of an interest in a primary residence, but was not ordinarily resident in such residence for the whole period prior to the disposal date, the exclusion will be determined with reference to the period(s) during which the person, beneficiary or spouse was actually ordinarily resident. Even if a person, beneficiary or spouse was not ordinarily resident in the residence for a maximum period of 2 years, he or she will still be deemed to be a resident, if the absence was due to the following reasons:

- The residence was being put up for sale and vacated with the intention to acquire a new primary residence.
- The residence was in the process of being built on land acquired for purposes of building a primary residence.
- The residence was accidentally rendered uninhabitable, for example, as a result of flood or fire.
- The death of that person.

Personal use assets

Personal use assets are also not subject to CGT. Examples of personal use assets are cars, furniture and garden appliances.

The following are not regarded as personal use assets:

- A coin made mainly from gold or platinum, e.g. Krugerrands; immovable property; an aircraft exceeding 450 kg; a boat exceeding 10 m in length; all financial instruments; a fiduciary, usufructuary or other like interest, the value of which decreases over time, a right or interest in any of the aforementioned assets and certain policy contracts.

Lump sums from your pensions, provident or retirement annuity funds

Lump sums from local retirement funds or from foreign funds of a similar nature are not subject to CGT.

The proceeds of a long-term insurance policy

Insurance policies are not subject to CGT in the hands of the owner provided that such owner is the owner of first instance or his/her spouse, dependant or beneficiary.

Prizes from a South African source (gambling, games and competitions)

A gain of up to R500,000 on the sale of assets of small business on retirement

"Small business" means a business of which the market value of all its assets, as at the date of disposal of the asset or interest does not exceed R5,000,000.

The person must have, at the time of disposal, held for his/her own benefit that active business asset, interest in the partnership, or interest in the company for a continuous period of at least 5 years prior to disposal and must have been substantially involved in the operations of that small business during that period. The person must have attained the age of 55 years or the disposal must be in consequence of ill-health, other infirmity, superannuation or death.

The sum of the amounts to be disregarded may not exceed R500,000 during that person's lifetime.

Determining the base cost

Capital gains or losses are the difference between the base cost of the asset and the sum received on its sale or disposal. The base cost is calculated by adding up the following expenses:

- Acquisition costs; costs associated with the acquisition and disposal of the asset (for example legal fees, agent's commission, stamp duty, advertising costs, broker's fees and transfer duty); VAT; improvement costs and any legal costs incurred (for example, the legal costs incurred in defending a right to an asset owned by the taxpayer).

- Business assets: All current expenses incurred in respect of business assets can be included in the base cost.

- Shares and unit trusts: Up to one third of any interest incurred on a loan taken to purchase shares or unit trusts will form part of the base cost.

Assets acquired after to 1 October 2001

As mentioned earlier, CGT only applies to gains made after 1 October 2001. The base cost of an asset purchased after that date is simply the purchase price plus any allowable expenses (as discussed above).

Assets acquired before 1 October 2001

Before the base cost can be determined, the valuation date value (value of the asset as at 1 October 2001) has to be determined. Once this value has been determined, any allowable expenses incurred after 1 October 2001 must be added to determine the base cost.

Market value

The market value of the asset at 1 October 2001 can be used as the valuation date value.

Taxpayers had until 30 September 2004 to obtain the market value of the asset. Even though the valuation may occur subsequent to 1 October 2001, the valuation must be the value as at 1 October 2001.

For shares, bonds and other securities traded on the open market, the market value will be calculated by taking the average closing price of the asset for the five trading days before 1 October 2001.

Time apportionment method

This method involves looking at the total capital gain made over the period during which the asset was owned and then determining the gain made after 1 October 2001.

The 20% rule

In terms of this rule 20% of the proceeds received by the seller will be deemed to be the base cost in the event that an asset held before 1 October 2001 is sold thereafter. Allowable expenditure incurred after 1 October 2001 must be deducted from the proceeds before the 20% rule is calculated.

A taxpayer need only inform the Commissioner of the South African Revenue Service of the option chosen once the asset is disposed of.

However, where a taxpayer opts for the market value as the valuation method, proof of the valuation must be submitted with the first tax return submitted after 30 September 2004 in the following instances:

Type of asset	Applies	Where market value exceeds
Intangible assets	Per asset	R1 million
Unlisted shares	All shares held by the shareholder in the company	R10 million
All other assets	Per asset	R10 million

Roll-overs

The CGT legislation provides for the roll-over of certain capital gains. In such cases a CGT liability does not arise upon disposal or transfer of ownership, but is rather deferred until a subsequent CGT event. In all cases the “pre-exchange” base cost is rolled over. Some pertinent roll-overs are listed below.

Involuntary disposals - in the case of expropriation, loss or destruction of an asset

If an amount equal to the proceeds has or will be used in replacing the asset; a contract is entered into for the replacement, reconstruction or rectification within one year; and the replacement asset has or will be brought into use within 3 years of the disposal of that asset, the roll-over may be applied. The Commissioner may extend these periods by no more than 6 months if all reasonable steps were taken by the taxpayer. In the event that this time frame is not adhered to, the gain will be taxed at the applicable rate for the year in which the asset was originally disposed of, plus interest at the prescribed rate.

Reinvestments in replacement assets where capital gains arise on the disposal of assets that qualify for capital allowances or deductions

This is the case where an asset utilised in the production of income is disposed of and the proceeds are reinvested in a similar asset, provided that the base cost is no less than that of the asset disposed of. Tax on the capital gains on such assets may be deferred and paid in annual instalment as per the prescribed formula.

Where the asset disposed of is a depreciable asset, the roll-over only applies to the capital gain or loss and not to any recoupment required in terms of normal income tax provisions.

Transfers of assets between spouses

The base cost of an asset is transferred to a person's spouse where the asset is transferred to that person's spouse during that person's lifetime. The base cost will also be rolled over to that person's spouse as a result of that person's death, or as a consequence of a divorce order/agreement of division of assets that has been made an order of court.

Attribution of capital gains

In certain instances capital gains will be attributed to entities other than those that have disposed of the assets. The following are examples of where capital gains will be attributed to entities other than those that made the disposal:

- Attribution of capital gains to spouses
- Attribution of capital gains to parents of minor children
- Attribution of capital gains subject to conditional vesting
- Attribution of capital gains subject to revocable vesting
- Attribution of capital vesting in a person who is not a resident
- Attribution of income, as well as capital gain

(These CGT attribution rules are similar to the income tax provisions contained in section 7 of the Income Tax Act.)

Rate at which the capital gains is included in taxable income (inclusion rate)

Once a net capital gain for the year of assessment is determined, such amount is multiplied by the inclusion rate to determine the individual or entity's taxable gain.

Inclusion rate x statutory tax rate = effective rate.

Type of Taxpayer	Inclusion Rate	Statutory Tax Rate	Effective Tax Rate
Individuals	25%	0 - 40%	0 - 10%
Unit Trusts	N/A	N/A	N/A
Other (local) Trusts	50%	40%	20%
Special Trusts	25%	0 - 40%	0 - 10%
Life Assurance			
Individual Policyholders	25%	30%	7.5%
Corporate Policyholders	50%	29%	14.5%
Company Policyholders	50%	29%	14.5%
Untaxed Retirement	N/A	18%	N/A
Untaxed: Other	0	0	0
Companies	50%	29%	14.5%

Aggregate capital gain or aggregate capital loss

A capital gain or loss is first determined separately for each asset disposed of by a taxpayer during a year of assessment.

In determining a person's aggregate capital gain or loss, two steps need to be followed:

- First of all a person's capital gains and/or losses are added together; and
- Thereafter, the total amount of such capital gains and/or losses is reduced by the annual exclusion, i.e. R10 000 in the case of a natural person.

Determination of a net capital gain or assessed capital loss

After determining a person's aggregate capital gain or aggregate capital loss, the person's assessed capital loss for the previous year of assessment, if any, must be deducted from the aggregate capital gain or added to the aggregate capital loss to determine the net capital gain or assessed capital loss for the current year of assessment. There is no limit as to the length of time that a capital loss can be carried forward.

Capital losses

Capital gains must be included in taxable income, but capital losses can only be offset against capital gains. It is not possible to offset capital losses against income.

The limitation of capital losses

Although capital losses may generally be offset against capital gains, capital losses made on the disposal of certain assets must be disregarded. These include losses made on the disposal of personal use aircraft, boats, as well as certain intangible assets acquired prior to valuation date from connected persons.

The capital loss on the sale of shares will be disregarded if the share has not been held for more than 2 years before resale.

The limitation above will exclude distributions from unit trusts, foreign dividends and the dividends between group companies.

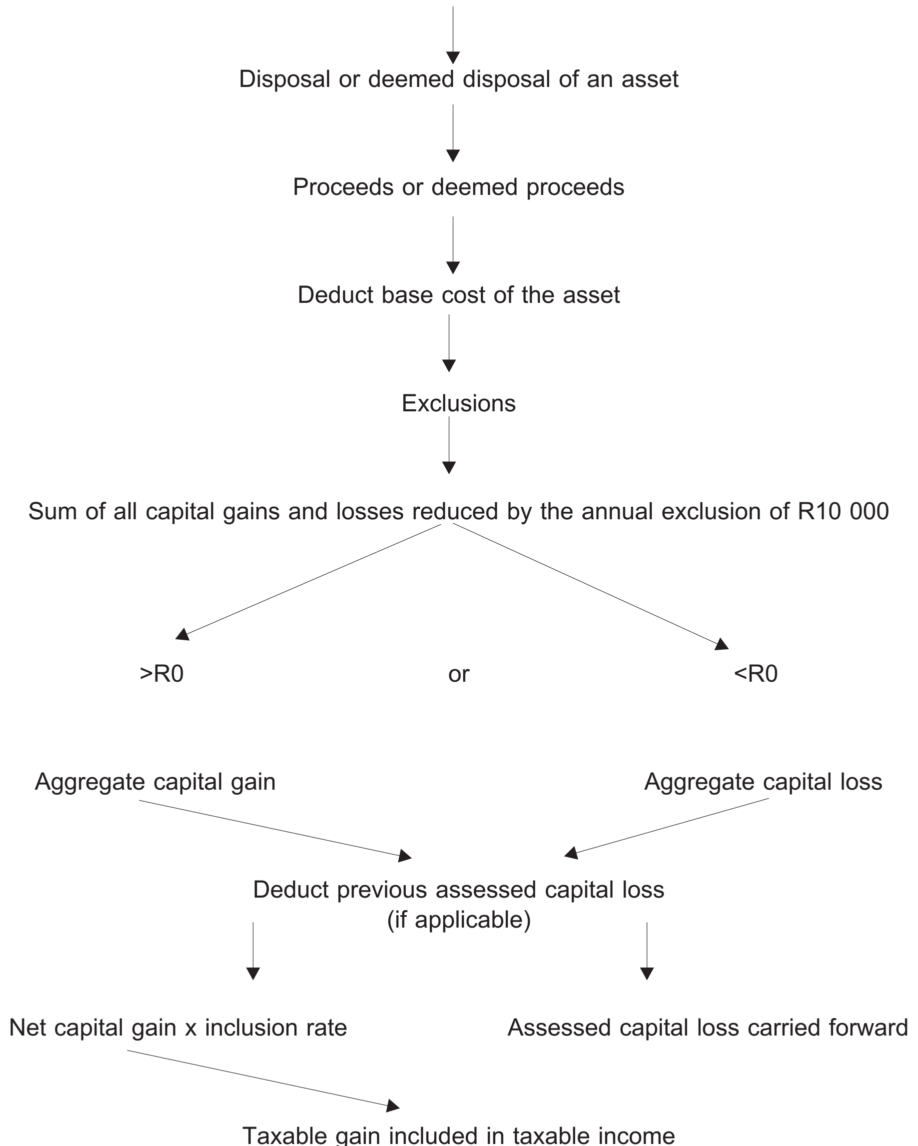
Record-keeping

It is the taxpayer's responsibility to supply proof of the base cost of an asset. As a minimum, the following records should be kept:

- The date the asset is acquired
- The price paid
- Any money spent on the purchase (transfer fees)
- Any money spent improving the asset
- The date the asset was disposed of
- The profit or loss made on the disposal

When an asset is disposed of, the records pertaining to the asset must be kept for at least four years after the Commissioner acknowledges receipt of the disposal.

Summary of capital gains tax liability calculation (Income Tax Act 8th Schedule)



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