

**CAPITAL GAINS TAX :
A BASE COST AND VALUATION APPRAISAL.**

**By
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Declaration

I, Darin Dempster declare that the work presented in this dissertation is my own and has not been submitted previously to any other university or technikon. Any work done by other persons has been duly acknowledged.

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Abstract

This study investigates the implications of the introduction of Capital Gains Tax that came into effect on the 1st October 2001 through the Income Tax Act.

The study poses two questions, the first being, whether to elect the actual value of an asset at 1 October 2001 for base cost purposes, or to accept the 'default' time apportionment method?

The second question posed raises the subject of whether an asset owner should delay doing a valuation exercise on the assets they presently own or proceed with a valuation exercise now?

A number of actual examples were obtained from accounting firms and analysed to see what values the different methods of determining the base cost gave and hence the amount of tax payable.

The results clearly show that the longer the asset has been owned by the business or individual prior to the implementation date, the bigger the impact the Time Apportionment Formula has on the answer. The reason for this is the Time Apportionment Formula that states the following “ the effect of the formula is to multiply the actual pre- valuation economic expense by a factor, which increases it in the ratio of the pre- valuation period to the whole period of ownership. When this amount is deducted from the actual proceeds, it gives the effect of the gain having arisen at an equal amount per annum over the whole period of ownership”.

The Market Value Method comes into play when the assets are less than two years old.

The results obtained also answer the second part of the question posed of whether to wait or do the valuation exercise now. A quote from the tax planning journal answers the question in the best possible way “ *to delay is to pay*”. In some of the cases presented

the difference between the two methods is substantial and the taxpayer would have had to pay the amount given by the Time Apportionment Formula due to the fact that the Market Value Method has a time restriction placed on it. The Act is quite explicit in the use of the Market Value Method and its cut off date.

The conclusion drawn from the study indicates that it is in the best interest of businesses and individuals to do a valuation exercise on all capital assets owned without delay. These valuation exercises will then help those businesses and individuals determine which base cost calculation method will be in their best interest.

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CHAPTER 1 : Introduction

1.1 Background

The principal reason given for the introduction of Capital Gains Tax (CGT) in South Africa, with effect from 1st October 2001, is that a gain realised on a capital asset is economically no different to any other source of income. It is not a tax on capital or wealth itself, because it is only gains and not the underlying capital base, which is taxed.

The debate as to whether it should be introduced or not was a much-contested issue with both sides giving reasons for and against.

The main arguments for the comprehensive income tax approach were eloquently summed up in the 1966 Report of the Canadian Carter Commission:

Adoption of the comprehensive tax base requires the taxation of not only income from property, but also capital gains on the disposition of property. Almost everyone is familiar, at least in a general way, with the difference between income and capital, even though the words seem to be incapable of precise definition. Capital is the source of income. By levying a tax on income, the distinction between the two concepts takes on great significance, for if the courts find a particular gain to be capital the transaction is not now taxable. There is an enormous incentive for the taxpayer to try to transform income gains into (untaxable) capital gains (tax arbitrage). However, it is impossible to draw an unambiguous distinction between capital gains and income gains and the attempt to do so necessarily results in great uncertainty for the taxpayer because a particular transaction may or may not be found by the courts to fall on one side of the line or the other. . . After the most careful and exhaustive consideration of this complex question, we have arrived at the conclusion that the present distinction between kinds of gain is inconsistent with our concept of what we believe

income is for purposes of determining the individual's capacity to pay real tax . . . A dollar gained through the sale of a share, bond or piece of real property bestows exactly the same economic power as a dollar gained through employment or operating a business . . . To tax the gain on the disposal of property more lightly than other kinds of gains or not at all would be grossly unfair . . . These radical reforms are advocated because (horizontal) equity can be achieved in no other way, because in our opinion there would be no adverse economic effects through their adoption when combined with our other proposed changes, and because they would simplify the tax system and reduce uncertainty.

The counter argument was partly based on the following comment made by the Federal Reserve Chairman Alan Greenspan.

The point I made at the Budget Committee was that if the capital gains tax were eliminated, that we would presumably, over time, see increased economic growth which would raise revenues for the personal and corporate taxes as well as the other taxes we have. The crucial issue about the capital gains tax is not its revenue-raising capacity. I think it is a very poor tax for that purpose. Indeed, its major impact is to impede entrepreneurial activity and capital formation. While all taxes impede economic growth to one extent or another, the capital gains tax is at the far end of the scale. I argued that the appropriate capital gains tax rate was zero.
(Federal Reserve Chairman Alan Greenspan in testimony before the U.S. Senate Banking Committee on February 25, 1997.)

1.2 Commencement Date and Basic Principles

Once the debate was concluded the implementation of CGT became effective in respect of disposals which took place on or after 1 October 2001 (the "valuation" date). Where assets were acquired before 1 October 2001, valuation rules attempt to exclude

that part of the increment in the value of any asset, which took place up to that date. This ties to ensure that the tax is levied only on increments in realised value, which take place on or after that date.

The legislation giving effect to the tax is contained in the Eighth Schedule to the Income Tax Act and CGT therefore forms an integral part of that system. When a capital gain has been computed, a proportion of that gain (dependent on the identity of the taxpayer) is included in the taxable income of the taxpayer for the income tax year of assessment in which the gain is realised¹.

1.3 Statement of the Problem

The issue of CGT revolves around the four definitions of an 'asset', a 'disposal', the 'proceeds' and a 'base cost'.

The happening that triggers any CGT event is the disposal of an asset. Unless a disposal occurs, no gain or loss arises.

- An **asset** is defined as widely as possible and CGT applies to all assets of a person disposed of on or after valuation date, whether or not the asset was acquired by the person before, on, or after that date. However, only the gain accruing from the valuation date is subject to tax.
- The concept of **disposal** covers any event, act, forbearance or operation of law which results in a creation, variation, transfer or extinction of an asset. It also includes certain events treated as disposals, for example, emigration, immigration and the change in the use of an asset.
- Once an asset is disposed of it gives rise to **proceeds**. The amount which is received by or which accrues to the seller of the asset, constitutes the proceeds from the disposal.

¹ Section 26A

- The fourth important building block in the calculation of a capital gain or a capital loss is the *base cost* of an asset. The base cost of an asset, in essence, consists of three broad components, namely, costs directly incurred in respect of the
 - acquisition of an asset,
 - improvement of an asset, and
 - direct costs in respect of the acquisition and disposal of an asset.

The major issue of the four definitions is the determination of the *base cost*. This is the key factor in determining whether the asset will incur in a simplified situation a potential gain or a potential loss. The calculation of the *base cost* can be determined via a number of methods each with a number of conditions attached.

A further problem that has been added to the scenario was the tragic events that occurred on the 11 September 2001. This introduced a new set of economic implications into the world markets. These events certainly had a substantially negative impact on stock markets world wide and, therefore, also on the South African stock exchange.

1.4 Overview of the Research Methodology.

The research findings are presented in the way of a case study. The analysis will take on the format of a qualitative assessment rather than a quantitative assessment of the results.

A sample of share sales, business sales and property sales were chosen and reviewed with respect to the stipulations of the Act and why the particular method was chosen.

1.5 Scope and Limitations

The analysis in this dissertation is concerned with the responses of the business or individuals with respect to the *base cost* they obtained for their assets and why they chose the particular method they did. The dissertation does not deal with the sometimes-complex question of what constitutes a “capital” or “revenue” gain. The analysis in this study is subject to the usual caveats with respect to inferences regarding cause and effect that may be drawn from the results.

1.6 Contributions

The fact that the introduction of Capital Gains Tax is a new phenomenon in the South African context means that very little academic research has been undertaken regarding Capital Gains Tax in general. There has been no research to date regarding the manner of calculating the *base cost* of assets held by businesses or individuals in South Africa and why they have made the decision to use the valuation method they did.

This dissertation will provide a starting point from which further investigations into the complex matters of valuations with regard to the base costs of assets can be determined.

CHAPTER 2 : Literature Review

There have been numerous studies, reports, steering committees discussions and so forth, on the topic of Capital Gains Tax. The majority of these studies have been done in countries, which already have a Capital Gains Tax policy in place. The emphasis has been on why a reduction in the rate applied to their particular situation is required. A few have gone so far as to give reasons as to why Capital Gains Tax should be scrapped altogether.

The introduction of the Tax has brought with it the dilemma of determining the "value " or, as it is phrased in the literature the "base cost" of an asset as at the implementation date of 1st October 2001.

This now poses the question of whether to elect the actual value of an asset at 1 October for base cost purposes, or to accept the 'default' time apportionment method?

The second question that also needs to be answered by asset owners is whether they should delay doing a valuation exercise on the assets they presently own or proceed with a valuation exercise now?

Conducting a valuation of the assets a business owns in the window period offered by SARS may protect the business against large capital gains tax payouts further down the line, as the business will be in a position to calculate capital gains on a cost base method.

Determination of the "base cost" of assets

The Eighth Schedule sets out what may or may not form part of the base cost of certain types of assets. Although conventional costs such as those of acquisition and the creation of assets will be allowed in the base cost, certain irregular costs, such as a portion

of any donations tax paid, may also be included in the base cost. Expenses such as the borrowing costs, interest and raising fees of assets, however, will not be allowed in the base cost.

A number of different values is used to determine the base cost of assets. These values are either based on different categories of assets and/or the date on which assets were acquired.

The following briefly outlines the determination of base cost values:

(1) Assets held prior to the valuation date (1 October 2001).

The determination of the base cost of assets held prior to the valuation date (1 October 2001), comprises the "valuation date value" of the asset plus any expenditure incurred after that date.

There are two means of determining the "valuation date value" of these pre-valuation date assets;

(a) Where proceeds exceed expenditure, or where expenditure cannot be determined, the valuation date value of the asset will generally be determined as either: -

- the "market value" of the asset on the valuation date,
- 20% of the proceeds from disposal of the asset (after deducting allowable expenditure incurred after valuation date), or
- time-based apportionment base cost of asset.

(b) Where proceeds do not exceed expenditure, the valuation date value will generally be determined as;

- the time-based apportionment base cost of the asset (where the market value was not adopted on the valuation date); or
- the market value (where the market value was adopted on the valuation date).

(2) The "valuation date value".

The "valuation date value" for instruments will be the "adjusted initial amount" (as defined in section 24J) on 1 October 2001 or the

market value on 1 October 2001. The market value is the price that could have been obtained upon a sale of the instrument between a willing buyer and a willing seller dealing at arm's length in an open market.

(3) The "market value".

The "market value" referred to in (a) above, is one of the values that may be used to determine the base cost of assets. A taxpayer wishing to use the market value basis for determining the base cost of an asset must have the asset valued by no later than 30 September 2003. Taxpayers wishing to adopt the market value basis will be required to submit proof of the valuation to the Commissioner.

There are essentially two different "*market values*" – the market value for assets held on the valuation date *i.e.* "valuation date market value", and for those assets that are only acquired after the valuation date *i.e.* "market value".

(a) Market value on valuation date

The market value on valuation date differs for certain classes of assets. The South African Revenue Service Media Release Number 46 of 2001, dated the 28th September 2001, sets out the guidelines on the method of determining market value of financial instruments.

(i) Recognised exchanges in the Republic.

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

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

referred to as the volume weighted average price and will give an average price, which will be difficult to manipulate.

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

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

(ii) Recognised exchanges outside the Republic:

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

(iii) Ruling Price:

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

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

instrument at the close of business of the exchange must be used.

(iv) Effect:

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

(v) Publication of market value list:

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

South African equity unit trusts and property unit trusts will be valued according to the average of the price at which a unit could be sold to the management company of the scheme for the last five trading days before valuation date.

(b) "Market Value"

The "market value" of assets is determined for a number of different purposes, such as the base cost of assets, death, donation, emigration and immigration. The following are a few examples:

- The market value for financial instruments listed on a recognised exchange will be the average of the listed buying and selling prices at close of business on the last trading day before disposal.
- The market value of assets generally will be the price based on a willing buyer and willing seller at arm's length in an open market.

(4) Time-based apportionment.

Time-based apportionment is one of the methods used to determine the base cost of assets held prior to the valuation date. Two formulae are proposed for determining the time-apportionment base cost of an asset. The first is used where an asset was acquired before the valuation date and where there were no additions or reductions to that asset in more than one year of assessment prior to the valuation date, before its disposal. The second is used where an asset was acquired before the valuation date and there were additions or reductions to that asset in more than one year of assessment prior to the valuation date, before its disposal.

The decision whether to elect an actual value at 1 October 2001 or to allow the default apportionment to apply, can and probably should, be made on an asset-by-asset basis.

When to elect to value assets

The simplest rule of thumb for determining whether a valuation should be elected or the default position accepted is to determine whether one believes that the asset concerned is likely to appreciate more quickly after the commencement date than it did before. If such accelerated appreciation is likely, then the time apportionment basis of calculation will provide a higher deemed cost (and smaller taxable gain) than would be achieved through a

valuation.

Conversely, if it is believed that appreciation will decelerate after the commencement date (particularly if a loss is anticipated) then, in general terms, it would be better to rely on the actual value since this will either decrease the taxable gain or increase the creditable loss. A valuation in this example would minimise one's exposure to CGT at a future point of sale.

But in any case, until an assessment of value is made and a view taken on likely future appreciation, it is impossible to make the choice – predicting likely values is an essential starting point of CGT management.

What do businesses stand to gain by conducting a valuation?

From a planning point of view, each business (whether a sole proprietor, partnership, trust, close corporation or company) will have to keep detailed records of all its capital assets. Consideration should be given to having all assets properly valued as at the introduction date of CGT. Failure to do so may expose a business to substantial amounts of CGT calculated on a simple time apportionment basis. In the event of assets held for many years, or where no original purchase price details are available, CGT will be payable on the eventual disposal of such assets, a tax expense which may be legitimately reduced.

- (1) Benefits of a valuation would therefore include:
- Evaluating the choice in method to be used by SARS when assessing CGT.
 - A clear understanding of which of your assets are affected by CGT.
 - The opportunity to minimise large tax payouts based on time-based rather than value-based calculations (and vice versa).
 - The opportunity to minimise exposure to a new form of tax.
 - New insight into the value of your business.

- It helps establish an asking price for a future disposal
- Without a market valuation and a time-apportionment base cost, the base cost is deemed to be 20% of the asset's disposal value, thus making the capital gain 80% of the disposal value.
- Although primary residences enjoy the R1 million capital gain exemption, by providing no evidence of the base cost, such as market valuation, results in the gain deemed to be 80% of disposal value which could result in a taxable capital gain.
- In relation to income-generating real estate and other capital assets, the two year window creates the opportunity to do an initial valuation based on projections and subsequently review and amend it in the light of achieved results.
- There is no guarantee that SARS might not change the requirements that all real estate valuations be submitted to them (not only properties over R10 million) prior to disposal and not in the tax year pursuant to disposal. If this happens it will be too late to obtain a valuation at valuation date.

(2) The assets that could benefit from having a valuation performed include:

- intellectual property (comprising trademarks, patents, technological know-how and research and development projects).
- goodwill.
- properties.
- share investments in private and unlisted public companies.
- business divisions, operating units and operations.

CHAPTER 3 : Methodology

References to Paragraphs are to the Eighth Schedule of the Income Tax Act and references to Sections are Sections of the Act, unless otherwise indicated.

3.1 Valuation Methods

This chapter will set out the various methods available to determine the **base cost** of an asset. It will be the foundation from which the case study is constructed. The following are the methods available to a business from which to calculate the **base cost** along with all the conditions that apply to each method.

3.1.1 General Rules

It is the responsibility of a taxpayer to establish the base cost of an asset disposed of. In the event that this cannot be done, then the base cost will be nil or will be limited to so much of the base cost as can be established. It is therefore essential to develop a procedure for ensuring the retention of all documentation, which verifies the expenditure, incurred on assets as described below. While a statement of the historic cost of an asset in the audited financial statements of a company may be acceptable in most circumstances, it must be remembered that original evidence may be necessary in the case of a dispute in court and original documents are much preferred. Also, the cost, which is reflected in the financial statements, may not reflect the entire cost, which is allowable in terms of the rules, set out below.

3.1.1.1 Exclusions

Before listing those expenses, which constitute the base cost in respect of an asset, it is essential to highlight certain expenses, which although constituting part of the cost, may not be claimed. These are:

- Interest and raising fees² and any other "borrowing costs" in respect of non-business assets.
- Interest, raising fees and any other borrowing costs in relation to business assets if that interest etc was deductible for normal income tax purposes.

The net effect of the two preceding points is that interest etc is deductible for CGT purposes only when incurred *wholly and exclusively for business purposes but disallowable for normal income tax purposes*. For example where it relates to pre-production expenditure on the acquisition of land (as opposed to buildings) or where an asset has been sold before being commissioned³, or where the interest is incurred in acquiring assets that do not produce "income", such as shares in a company. (Note that special rules apply to interest incurred in the acquisition of listed shares and units in a unit trust (below)⁴).

- Expenditure on repairs, maintenance, protection (security), insurance, rates and taxes or similar costs of an asset, which is not used wholly and exclusively for business, purposes.
- Any amount which is allowable as a deduction for normal tax purposes

As a consequence of the preceding two points, where an asset is used partly for business and partly for non-business purposes, any repair, maintenance etc expenditure is not allowable as an element of base costs.

- Any element of base cost which has been recovered whether by way of refund or otherwise⁵.

² Interest includes premiums, discounts and any other amounts set out in section 24J.

³ See section 11 (bA).

⁴ Paragraph 20 (1)(g)(iii) and (2)(a), paragraph 20 (1)(g) as regards the requirement for use to be wholly and exclusively for business purposes.

⁵ Paragraph 20 (3)(b).

- Any amount, which would otherwise be included in base, cost but which has been paid by a person other than the taxpayer or in any event is not yet due and payable (and has not been paid)⁶. Both provisos are aimed at preventing amounts which the "payer has not actually borne from being taken into account as part of base cost until payment is made by him⁷

3.1.1.2 Inclusions

The make-up of the base cost of an asset is defined comprehensively and expenses not specified below, will not constitute part of base cost irrespective of how logical such an inclusion might seem⁸. The inclusions are:

- Expenditure actually incurred in respect of the acquisition of an asset⁹, being :
 - The direct cost of acquisitions¹⁰ Where the consideration paid is the extinction of a debt owed to the purchaser by the seller, the cost base to the purchaser (for use on eventual resale), is the market value of the asset acquired and not the face value of the debt discharged¹¹
 - The cost of any option obtained for purposes of acquiring the asset (except pre-valuation date options. Where the option was acquired before 1 October 2001, the value of that option as at that date is treated as expenditure actually incurred for this purpose")¹²
 - Transfer costs (for example conveyancing fees) as well as stamp, transfer or any similar duty.

⁶ Paragraph 20 (3)(b) and (c).

⁷ Paragraph 4 (b)(ii).

⁸ Paragraph 20 (1) states that the base cost is "the sum of ..", in contradistinction to the terminology of paragraph 35 (1) dealing with proceeds which "includes" certain amounts.

⁹ Paragraph 20 (1)(a)(c)i, ii, iii, v, vi, ix, (e).

¹⁰ Paragraph 20 (1)(a)

¹¹ Paragraph 34

¹² Paragraph 20 (1)(f).

- Professional costs in relation to the acquisition¹³.
 - The costs of installation (including foundations and supporting structures) and the cost of moving the asset from one location to another (if for purposes of its acquisition or disposal)
 - The cost of effecting a physical improvement or enhancement in value of the asset provided it is still reflected in the asset at the time of disposal. Typically, this would cover the cost of physical improvements or extensions and also the legal costs of obtaining a valuable rezoning for the use of the property. If those improvements have been demolished or the rezoning has been reversed or has lapsed at the date of disposal, then the cost is excluded from base cost. Any such demolition or lapse might, of course, itself trigger a capital loss at the time.
- Expenditure actually incurred in establishing or defending legal title¹⁴.
 - In the case of assets used wholly and exclusively for business purposes, the cost actually incurred in maintaining, repairing, protecting and insuring the asset, and on rates and taxes (in the case of immovable property) and on interest incurred on money borrowed to finance the costs referred to above (and to finance any donations tax involved in the acquisition - see below). In all cases, however, these costs will not be allowed if they were deductible for normal income tax purposes¹⁵ Note that the cost of maintenance, repair, rates and taxes, and interest on acquisition costs, is *not* part

¹³ Specifically, the services of surveyors, valuers, auctioneers, accountants, brokers, agents, consultants and legal advisors.

¹⁴ Paragraph 20 (1)(d)

¹⁵ Paragraph 20 (1)(g)

of base cost in the case of a domestic or other private (non-business) property.

- In the case of shares listed on a recognised stock exchange or units in an equity (not property) unit trust, one-third of interest incurred on loan finance is deductible, irrespective of whether these assets are business or private in nature (but provided always that the interest has not been deducted for normal income tax purposes)¹⁶. Note that this provision does not apparently apply to interest incurred in acquiring *foreign* unit trust or mutual fund investments. Interest on borrowings to acquire property unit trusts cannot be part of base cost.

Example

During January 2002, Mr F Lucre, an industrialist, signed an agreement to purchase a factory and associated buildings, from an unrelated party, for R2 million, subject to a suspensive condition in relation to a rezoning. His intention was to move a number of his production lines into it from an existing facility. Rezoning was approved in early February and costs of modification to accept particularly large machinery, and of special effluent requirements, amounted to R 1 million during February and March 2002. Transfer of the property took place late in April 2002 at which time the purchase price was paid.

During July 2002 a warehouse on the site was demolished, an inspection having revealed that it was structurally unsound. The warehouse had been valued (for insurance and replacement purposes) at R300 000 at the time of the acquisition, but for technical reasons, Mr Lucre's insurers refused to pay compensation. Mr Lucre claimed and obtained R150 000 compensation from the seller in a court case, which was eventually settled in August 2003. But before that, in December 2002, Mr

¹⁶ Paragraph 20 (1)(g)(iii)

Lucre realised that the production facilities were still too cramped for his requirements and put the property on the market, intending to build a completely new replacement facility in the following calendar year. He found a purchaser almost immediately and in February 2003 concluded an unconditional sale with occupation and transfer to be given on 1 August 2003, at which time his new facility was expected to be ready for occupation. The sale price was R3 250 000.

What amounts were brought to account in Mr Lucre's hands in the tax years ended February 2002 - 2003 and 2004? (ignore income tax allowances on the buildings and improvements).

Tax year to Feb 2002

- Purchase and modifications made, but no asset disposed of, therefore a non-CGT event.

Tax year to Feb 2003

- July 2002 building demolished:

$$\begin{aligned} \text{Capital gain/loss} &= \text{proceeds} - \text{base cost} \\ &= 0 - 300\,000 \end{aligned}$$

$$\text{Capital loss} = (300\,000)$$

- December 2002 - unconditional sale of property:

$$\begin{aligned} \text{Capital gain/loss} &= \text{proceeds} - \text{base cost} \\ &= 3,25 \text{ mil} - (2 \text{ mil (s20(1)(a))} + 1 \text{ mil (s20(l)(e))} - 300\text{k(s20(3)(b))}) \\ &= 3,25 \text{ mil} - 2,7 \text{ mil} \end{aligned}$$

$$\text{Capital gain} = 550\,000$$

$$\text{Net capital gain} = 250\,000$$

Tax year to Feb 2004

- August 2003 compensation from court settlement:

$$\text{Capital gain} = 150\,000(\text{s3(b)(ii)})$$

- Net capital gain = 150 000

Note that in arriving at the solution above the following points were taken into account:

- The suspensive condition is irrelevant to the purchaser but would have been relevant to the seller if it had been fulfilled after 28 February since the proceeds would then have accrued in a later year. The date of transfer is a red herring.
- The compensation for the defect in the warehouse did not accrue until the court case was settled.
- It is presumed that the insured value of the warehouse is satisfactory as a direct attribution of base cost.
- The unconditional sale is a trigger for CGT and the proceeds accrue in that year even though transfer is in the subsequent year.

3.1.1.3 Assets owned pre-October 2001

General overview

As indicated previously, CGT is intended to apply only to those increments in the value of an asset which arise on or after 1 October 2001 and accordingly a method of valuing assets at that date is required. This paragraph deals with those mechanisms, which fall into a variety of general and special categories. The general category provides (broadly) for an election to be made between the use of the actual market value of the asset and the so called "time apportionment" value, in which the value at 1 October is escalated to result in an apportioning of the total capital gain proportionately between the time prior to and after the valuation date. However, a number of limitations exist in respect of that election where "artificial" losses might otherwise result. These rules and other special rules, which deal with specific types of assets, are dealt with in detail below. It must be stressed at this point, however, that:

- A separate election (and limitation can apply to every asset. It is therefore necessary to consider the points below in relation to, for example:
 - Each company owned (as regards the value of shares held);
 - Every asset within every business division and especially goodwill and intellectual property;
 - Every separate erf or building owned directly;
 - Every sole proprietor or partnership business;
 - Every other asset of significant value.

- The election whether to use market value, time apportionment or some other method (subject to various limitations) needs only be made at the time the gain is to be computed (i.e. the year of disposal), but
- If a person intends to be able to elect market value, he must have had the asset valued by 30 September 2003¹⁷ There is no requirement that such a valuation must be done by any particular person but, obviously, to the extent that it is done by someone unqualified it must be expected that the Revenue will be more inclined to challenge the valuation, and
- Where the market value on an asset (including the total value of shares held in any unlisted company) as at 1 October exceeds R 10 million, or in the case of an intangible asset (excluding financial instruments) its value exceeds R 1 million, then proof of that valuation must be submitted with the tax return for the period, which covers 29 September 2003¹⁸.
- Proof of valuation must in every other circumstance, be furnished with the tax return in which that valuation is used for the computation of a gain or a loss¹⁹.

¹⁷ Paragraph 29(4). The Minister can extend the date by notice in the Gazette – paragraph 29(8).

¹⁸ Paragraph 29(5).

¹⁹ Paragraph 29(6).

- Aside from special rules dealt with in paragraph 4.4.6, market value at the transition date must be determined on the basis of a willing buyer/willing seller at arms length in an open market.

The Commissioner is entitled to request further information or documents relating to valuations and if dissatisfied with the amount, can adjust the value accordingly. Any such adjustment is subject to objection and appeal²⁰.

Logically, the value of an asset at valuation date as determined below must be increased by any other base cost expenditure, which is incurred between then, and the time of disposal²¹.

3.1.2 Valuation Date Value

Proceeds exceed expenditure or expenditure in respect of an asset cannot be determined.

Paragraph 26(1) provides the method to determine the valuation date value of an asset disposed of, after the valuation date where

- the asset was acquired before the valuation date,
- proceeds exceed expenditure, allowable in terms of paragraph 20, incurred both before and after the valuation date, and
- the asset is not an instrument as defined in section 24J of the Act. (These assets are dealt with in terms of paragraph 28 (see below).)

Where the total proceeds from disposal exceed the total expenditure allowable for base cost purposes over the entire period of holding, the taxpayer can adopt whichever of the following alternatives produces the best result from a CGT perspective²².

Note that there is no reference in this calculation to the dates of

²⁰ Paragraph 29(7).

²¹ Paragraph 25.

accrual or of payment of proceeds and expenditure, so that the election appears to depend upon the cumulative economic result and not the amounts which might be brought to account in any one year (see paragraph 4.3):

- The market value of the asset on the valuation date as contemplated in paragraph 29 (see below).
- An amount equal to 20% of the proceeds from disposal of the asset, after deducting from the proceeds the expenditure allowable in terms of paragraph 20 incurred after the valuation date. For example, if base cost pre-transition date were 100, base cost post-transition date were 25 and proceeds were 160, the base cost would be $(160 - 20) \times 20\% = 28$.
- The time-apportionment base cost of the asset, as contemplated in paragraphs 30 (see below).

If a person has used the weighted average method of determining the base cost of the asset in terms of paragraph 32(5) (see below), the person may not adopt the time-apportionment base cost of the asset.

In terms of paragraph 26(2) where neither the person who disposed of an asset nor the Commissioner can determine the expenditure incurred before the valuation date, the person must determine the valuation date value of the asset by adopting any of the following as the valuation date value of the asset:

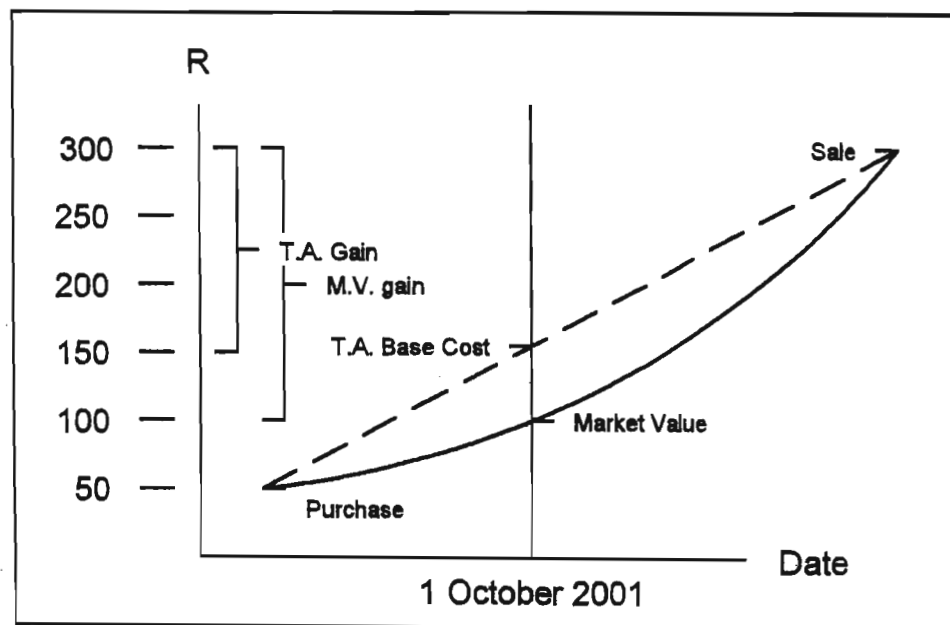
- The market value of the asset on the valuation date as contemplated in paragraph 29.
- An amount equal to 20% of the proceeds from disposal of the asset, after deducting from the proceeds the expenditure allowable in terms of paragraph 20 incurred after the valuation date.

²² Paragraph 25 and 26 (1).

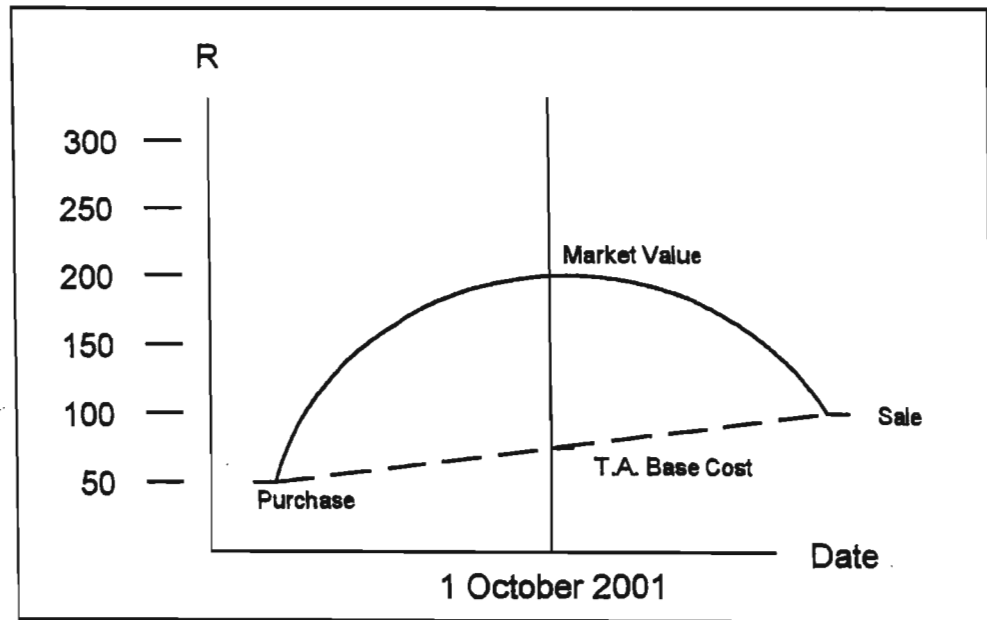
Where a person adopts the market value as the valuation date value of the asset disposed of, and the proceeds from the disposal of the asset do not exceed the market value, the person must substitute the higher of the following as the valuation date value of the asset.

- The expenditure allowable in terms of paragraph 20 incurred before the valuation date in respect of the asset.
- The proceeds less the expenditure allowable in terms of paragraph 20 incurred after the valuation date in respect of the asset.

These different possibilities can be diagrammatically illustrated as follows:



The solid concave line plots market value, intersecting the transitional date line at R150. It will be seen that where the value of an asset is increasing exponentially, that the dotted time apportionment election is likely to be favourable since the time apportionment line intersects the transition date at a value higher than actual market value on that date. It will also generally be a figure greater than 20% of proceeds.



It will be seen from the above illustration that where the value of an asset has flattened out or is in decline (but nonetheless above actual base cost expenditure incurred) that market value, as at the transition date, would produce a capital loss, whereas there has actually been an economic gain. In such a case neither the market value nor the time apportionment base cost is permitted and the higher of the alternatives discussed above must be substituted. Assume in this case that expenditure pre-transition date is 50, expenditure post-transition date is 40 and proceeds are 100, the value having declined from market value of 200 at transition date. The substituted transition base costs are accordingly the higher of:

- 50 (pre-transition date expenditure), and
- $100 - 40 = 60$ (proceeds less post-transition date expenditure).

The base value is accordingly 60 and the capital gain is equal to $100 - 60 = 40$ ²³

²³ Paragraph 26 (3)

These special rules are an attempt to substitute an economically real gain for artificial losses - whether this is fair is another matter entirely!

3.1.2.1 Proceeds do not exceed expenditure

Where an actual economic loss is suffered - that is where proceeds accruing do not exceed total pre and post transition date base cost expenditure.

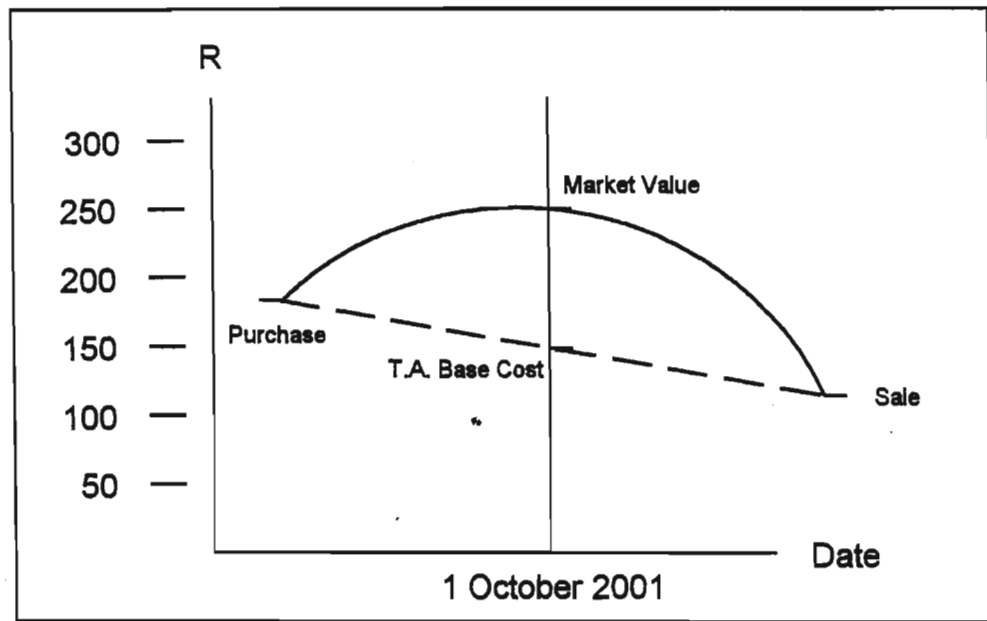
Paragraph 27(1) provides the method to determine the valuation date value of an asset disposed of, after the valuation date where

- the asset was acquired before the valuation date,
- its proceeds do not exceed the expenditure, allowable in terms of paragraph 20, incurred both *before* and *after* the valuation date, and
- the asset is not an instrument as defined in section 24J of the Act. (These assets are dealt with in terms of paragraph 28.)

Where all three of the above criteria are met, the person is entitled to determine the valuation date value of the asset as any of the following:

- Where the market value was not adopted on the valuation date, the valuation date value of the asset is the time-apportionment base cost of the asset.
- Where a person adopts the market value, then the person must adopt as the valuation date value of the asset disposed of, the lower of the market value or the time-apportionment base cost of the asset.

These different possibilities can be diagrammatically illustrated as follows:



In this illustration, the time apportionment line intersects the transition date at a lower value than market and the allowable capital loss is accordingly reduced. Note that this is not the only curve which could give rise to the implementation of this rule - a shallow concave curve in which value drops the transition date and then recovers to a sale price which is still below total economic base cost, would still fall within its terms. In that event the market value (if available) would be the lower value and would give rise to a CGT gain (in place of a loss based on time - apportionment).

The rule is intended to substitute a portion of actual economic loss in place of a larger artificial loss, or a small gain for an artificial loss (depending on the value curve) - whether that is fair is another matter²⁴.

But in terms of paragraph 27(2), where the expenditure allowable in terms of paragraph 20, incurred *before* the valuation date in respect

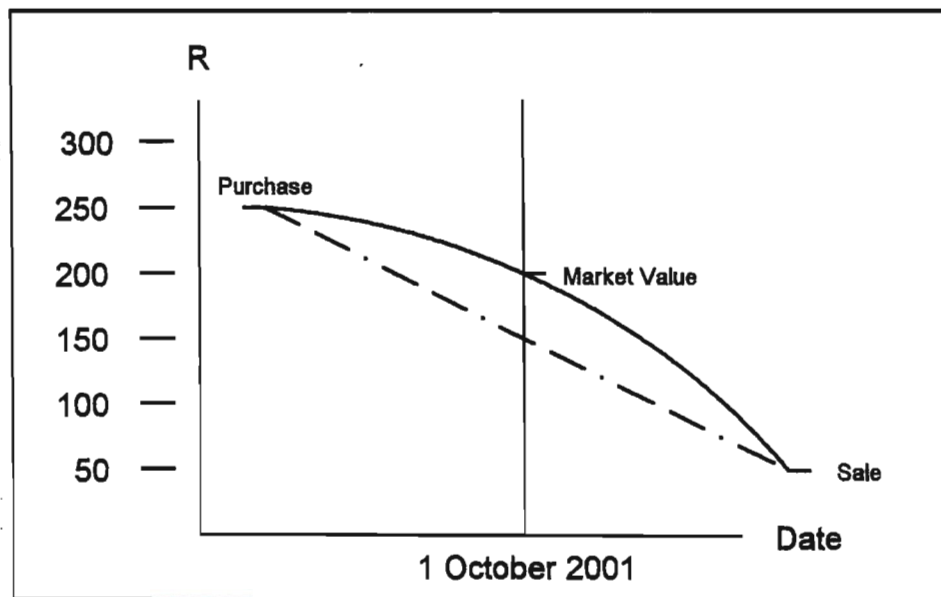
²⁴ Paragraph 27 (1)

of the asset, exceeds both the proceeds from the disposal of the asset and the market value of the asset, the person must adopt the valuation date value of the asset as the higher of :

- the market value, or
- Proceeds less post-transition date base cost expenditures²⁵.

Note that if this expenditure has not been paid at the time of the disposal event, it is only allowed on the date of payment.

This can be illustrated dramatically as follows:



Assume in this instance that pre-valuation base cost is 250, post-valuation base cost is 10 and proceeds are 50. Market value at valuation date was 200.

In that instance the allowable valuation date value is the higher of 200 (market value) and 50 (proceeds) -10 (post valuation expenses) = 40. On that basis, the computed capital loss is 50 - 200 = (150).

²⁵ Paragraph 27 (2)

3.1.2.2 Instruments

Paragraph 28 deals with interest-bearing arrangements, for example, bank deposits, loans, stocks, bonds, debentures and similar assets.

The valuation day value of an instrument must be either its

- 'adjusted initial amount' as determined in section 24J on valuation date, or
- the market value as determined in terms of paragraph 31 (see below).

In essence, the 'adjusted initial amount' is the initial amount paid for the instrument, plus the cumulative amount of all interest deemed to have accrued, less all amounts actually received from its date of acquisition to 1 October 2001.

The market value is basically the price obtainable upon a sale of the instrument between a willing buyer and a willing seller dealing at arm's length in an open market (see below).

The following example, adapted from the Explanatory Memorandum, illustrates how the adjusted initial amount of an instrument is calculated for the purpose of calculating it at the valuation date to be used as one of the values under the provisions of paragraph 28²⁶.

Example

On 31 December 2000 Argh (Pty) Ltd, which has a financial year end of 30 June, acquires a financial instrument with a term of two years at a discount of R1 200 000 to its face value of R10 000 000. Interest is receivable six monthly, calculated at 3% of its face value. At maturity date, 31 December 2002, the instrument will be redeemed at par (R10 000 000).

²⁶ At 55-6

Calculation of its yield to maturity

The cash flows may be summarised as follows:

31 December 2000	-8 800 000
30 June 2001	300 000
31 December 2001	300 000
30 June 2002	300 000
31 December 2002	<u>10 300 000</u>
	<u>2 400 000</u>

The accrual period is six months, and the resultant yield to maturity is 6,50308% per accrual period.

Calculation of interest accrued for the year ending 30 June 2001

Interest accrued calculated as follows:

$$R8\ 800\ 000 \times 6,50308\% = R572\ 271.$$

Calculation of interest accrued up to valuation date, that is, from 30 June 2001 to 30 September 2001:

Interest accrued:

$$(R8\ 800\ 000 + R572\ 271 - R300\ 000) \times 6,50308 \times 3 \text{ months}/6 \text{ months} = R294\ 988.$$

Calculation of its adjusted initial amount on valuation date

Initial amount paid.	8 800 000
Less total cash inflows resulting from transactions.	-300 000
Add total interest accrued to 30 September 2001 (R572 271 + R294 988)	<u>867 259</u>
Adjusted initial amount.	<u>9 367 259</u>

3.1.3 Market Value on Valuation Date

Paragraph 29 is a transitional measure, which deals with the requirements regarding the valuation of assets on valuation date.

(Paragraph 31 contains the permanent market value rule.)

For the purposes of paragraph 29, in terms of paragraph 29(3)(a), the last price quoted for a specific day means the average of the buying and selling prices quoted at close of business on the day.

3.1.3.1 Financial instruments listed in the Republic:

In terms of paragraph 29(1)(a)(i) financial instruments listed on a recognised exchange in the Republic will be valued at the average of the last price quoted on each of the five 'days of trading' preceding the valuation date.

Since 29 and 30 September 2001 fall on a weekend, they will not qualify, as 'days of trading', with the result that the prices quoted from Monday 24 September 2001 to Friday 28 September 2001 will be used.

In order to assist with this valuation, paragraph 29(1)(a)(i) provides that the valuation date prices, as determined on the above basis, must be published by the Commissioner by way of a notice in the *Gazette*.

The following example adapted from the Explanatory Memorandum illustrates how the average will be determined²⁷.

Example

The following table illustrates the buying and selling prices of a share in Queue Ltd on the Johannesburg Stock Exchange during the last five trading days preceding 1 October 2001:

Date	Last buying Price	Last selling price	Average
Monday 24 September 2001	200	210	205
Tuesday 25 September 2001	190	196	193
Wednesday 26 September 01	185	195	190
Thursday 27 September 2001	180	190	185
Friday 28 September 2001	<u>190</u>	<u>190</u>	<u>190</u>
Total	<u>945</u>	<u>981</u>	<u>963</u>

The valuation date value will be = 192,6 (963/5).

²⁷ At 57

3.1.3.2 Financial instruments not listed in the Republic:

In terms of paragraph 29(1)(a)(ii) financial instruments listed on a recognised foreign exchange outside the Republic will be valued at the last price quoted on the last trading day before valuation date.

In the situation of a dual listing, for example a share listed on both the Johannesburg Stock Exchange and the London Stock

Exchange, the price as valued in paragraph 29(1)(a)(i) will be used.

3.1.3.3 South African equity and property unit trusts:

In terms of paragraph 29(1)(b)(i) units in South African equity and property unit trusts will be valued at the price published by the Commissioner in the *Gazette*, which will be the average of the price at which a unit can be sold to the management company of the scheme (usually the 'sell' price quoted in most newspapers) for the last five trading days before valuation date.

3.1.3.4 Foreign unit trusts:

In terms of paragraph 29(1)(b)(i) units in foreign unit trusts will be valued at the last price published before valuation date at which a unit can be sold to the management company of the scheme, or where there is not a management company, the price obtainable upon a sale of the asset between a willing buyer and a willing seller dealing at arm's length in an open market.

3.1.3.5 Other assets:

Paragraph 29(1)(c) provides that all other assets will be valued at their market value on valuation date as determined in terms of paragraph 31 (see below).

3.3.1.6 Valuation of controlling interest in listed shares:

A controlling interest in a listed company usually gives the shareholder the right to appoint the board of directors, pass resolutions and generally control the direction of the company. A person acquiring a controlling interest will usually pay a premium for the privilege, though in some situations the shares may be disposed of at a discount. If a controlling interest were to be valued according to the normal prices quoted on an exchange, the result in

most situations will be that the base cost of the shares will be understated.

In order to avoid the problems inherent in valuing a controlling interest on valuation date, paragraph 29(2) provides that the premium or discount must be determined at the date of disposal by comparing the actual selling price with the last price quoted prior to the announcement of the disposal.

The premium or discount will then be applied to the base cost of the shares disposed of.

The term 'controlling interest' is defined in paragraph 29(3)(b). In terms of this definition, which is solely for the purposes of this paragraph, a 'controlling interest' in a company means an interest in more than 50% of the equity share capital of the company.

For the provisions of paragraph 29(2) to apply, certain other conditions must exist. These conditions are as follows:

- The company must be a listed company.
- The buyer must not be a connected person of the seller.
- The seller must dispose of his entire controlling interest in the company.

The following example, adapted from the Explanatory Memorandum, illustrates the application of the provisions of paragraph 29(2) and (3)²⁸.

Example

Sweet Pea Ltd holds 51% of the issued share capital of Pea Ltd, which has been listed on the Johannesburg Stock Exchange for the past six years. Sweet Pea Ltd disposes of its entire interest in Pea Ltd to Oh (Pty) Ltd. The following details relate to this transaction.

- Date of sale: 1 October 2002.
- Total number of Pea Ltd shares held by Sweet Pea Ltd:
3 000 000.

- Last buying price of a Pea Ltd share on 30 September 2002 (as quoted): R1,95.
- Last selling price of a Pea Ltd share on 30 September 2002 (as quoted): R2,05.
- Price per share in terms of sale agreement: R2,20.
- Gazetted average price per Pea Ltd share (as published in terms of paragraph 29(1)(a)(i)): R1,50.

Calculate the market value on valuation date (1 October 2001):

Valuation date market value (3 000 000 x R1,50) = R4 500 000

Calculate control premium or discount:

Average last price quoted: $(R1,95 + R2,05)/2 = R2$.

Base cost adjustment expressed as a %: $(R2,20 - R2) / R2 = 10\%$.

Determine the base cost

Control premium: $R4\ 500\ 000 \times 10\% = R450\ 000$

Base cost is therefore R4 950 000 (R4 500 000 plus the premium of R450 000).

Determine the capital gain on 1 October 2002

Proceeds: $3\ 000\ 000 \times R2,20$ 6 600 000

Base cost (as determined above) 4 950 000

Capital gain 1 650 000

3.1.3.7 Time limit on obtaining valuations:

A person wishing to use the market value basis for determining the base cost of an asset must in terms of paragraph 29(4), have the asset valued within two years after valuation date, in other words, by no later than 30 September 2003 (see paragraph 29(8) – discussed below).

3.1.3.8 Compulsory submission of valuations:

In terms of paragraph 29(5) persons wishing to adopt the market value basis will only be permitted to do so if they submit the required proof of the valuation to the Commissioner.

²⁸ At 58-9

Proof of valuation is required in the following circumstances.

- For an asset whose market value exceeds R10 million.
- For an intangible asset (other than a financial instrument) whose market value exceeds R1 million.
- For an unlisted share, when the market value of all its shares held by a person exceed R10 million.

The Commissioner will prescribe the form in which the proof must be submitted and the proof must be submitted with the first return submitted after 30 September 2003. If the asset is, however, disposed of before proof of valuation has been submitted as required above, proof of valuation must be submitted with the return for the year of assessment during which the asset was disposed of.

3.1.3.9 Submission of proof of valuation upon disposal:

In terms of paragraph 29(6) when an asset (other than one to which the provisions of paragraph 29(5) apply) which has been valued is disposed of, proof of valuation must be submitted with the return for the year of assessment during which the asset was disposed of.

3.1.3.10 Right of Commissioner to amend valuation or call for further particulars:

Where the Commissioner is not satisfied with a valuation, he may under the provisions of paragraph 29(7),

- request further information or documents relating to the valuation, or
- adjust the valuation.

His right to adjust the valuation is subject to objection and appeal in terms of section 3(4).

3.1.3.11 Period for performing valuations may be extended by the Minister:

In terms of paragraph 29(8) the period within which all valuations must be performed (that is, by 30 September 2003) may be extended by the Minister by notice in the *Gazette*.

3.1.4 Time-Appportionment Base Cost

In terms of paragraph 30(1) the time-apportionment base cost of a pre-valuation date asset is determined in accordance with the following formula:

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

In this formula the number of years pre- valuation date that can be taken into account is sometimes limited to 20 (below). The effect of the formula is to multiply the actual pre- valuation economic expense by a factor, which increases it in the ratio of the pre- valuation period to the whole period of ownership. When this amount is deducted from the actual proceeds, it gives the effect of the gain having arisen at an equal amount per annum over the whole period of ownership. However, where the base cost has been incurred in different years (whether before or after the valuation date) the formula must be varied to take that influence into account.

In which formula

- 'Y' represents the amount to be determined;
- 'B' represents the amount of expenditure allowable in terms of paragraph 20 in respect of the asset that is attributable to the period of ownership before valuation date;
- 'P' represents the proceeds as determined in terms of paragraph 35, in consequence of the disposal of the asset, or where paragraph 30(2) applies, the amount of proceeds attributable to the expenditure in 'B' as determined in accordance with paragraph 30(2);
- 'N' represents the number of years or part thereof the asset was owned prior to the valuation date, which number of years may not exceed twenty in the situation where the expenditure allowable in terms of paragraph 20 in respect of the asset was

incurred in more than one year of assessment prior to the valuation date; and

- 'T' represents the number of years or part thereof the asset was owned after valuation date.

The limitation of 20 years prior to valuation date as the maximum over which the time apportionment base value can be calculated applies only where "the expenditure allowable was incurred in more than one year of assessment prior to the valuation date". Note that where there is only a single tranche of expenditure incurred more than 20 years before valuation date, there is no limitation to the period over which time apportionment takes place. It is suggested that this terminology is faulty since the limitation to 20 years will apply where all tranches of expense were incurred more than 20 years ago although the apparent purpose is to deal with situations where at least one tranche is incurred within 20 years of the valuation date.

- 3.1.4.1 Where base cost expenditure is incurred over a period:
Where base cost expenditure is incurred in more than one tax year the item P in the formula above is determined in accordance with the formula below. It should be remembered that few major capital expenses are incurred in a single disbursement. The building of a domestic house may last for almost a year (and frequently over a tax year-end), the acquisition and installation of heavy machinery may involve progress and installation payments extending over much the same period. If these amounts are paid both before and after the transition date then it is necessary to employ the formula below, even though there was a single contract or project and no subsequent improvements. (Paragraph 30(2))

The time-apportionment base cost of the asset must be determined in accordance with the following formula.

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

In which formula

- 'P' represents the amount to be determined;
- 'T' represents the total amount of proceeds as determined in terms of paragraph 35 in consequence of the disposal of the pre-valuation date asset;
- 'A' represents the amount of expenditure allowable in terms of paragraph 20 in respect of the asset that is incurred on or after valuation date; and
- 'B' represents the amount of expenditure allowable in terms of paragraph 20 in respect of the asset that is incurred before valuation date.

The effect of this when applied to the basic formula in the preceding paragraph, is to reduce the amount by which pre-valuation date expenditure is increased, to bring it to a valuation date equivalent value, in a simple ratio of pre-transition date expenses to total expenses.

Paragraph 30 provides for two situations.

The first being where an asset was acquired before the valuation date and the total amount of expenditure allowable in terms of paragraph 20 (before its disposal) was not incurred in more than one year of assessment.

The second being where an asset was acquired before the valuation date and the total amount of expenditure allowable in terms of paragraph 20 (before its disposal) was incurred in more than one year of assessment.

The first situation, which is dealt with in paragraph 30(1), involves no further expenditure as contemplated in paragraph 20, in respect of the asset other than the actual cost of acquisition (including any qualifying expenditure incurred in the same year of assessment as the acquisition cost).

The application of this formula is set out in the following example adapted from the Explanatory Memorandum²⁹.

Example:

Barbara acquired a piece of land in Johannesburg thirty years prior to the valuation date for R200 000. She disposed of it ten years after the valuation date for R2 000 000. Barbara incurred no other 'qualifying' expenditure allowable in terms of paragraph 20 during her ownership of the land. As she had not valued the land at valuation date she adopted the time-apportionment basis (TAB) in determining the valuation date value.

Paragraph 30(1) applies to this situation. Its formula is as follows:

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

$$Y = R200\ 000 (B) + ((R2\ 000\ 000 (P) - R200\ 000 (B)) \times 30 (N) / (10 (T) + 30 (N)))$$

$$Y = R200\ 000 + (R1\ 800\ 000 \times 30/40)$$

$$Y = R200\ 000 + R1\ 350\ 000 = R1\ 550\ 000$$

The TAB cost is R1 550 000 and the capital gain or capital loss is determined as follows:

Proceeds	2 000 000
Less TAB cost (see above)	<u>1 550 000</u>
Capital gain	<u>450 000</u>

Note that where expenditure was incurred in only one year of assessment prior to the valuation date, 'N' in the formula, is not limited to twenty years.

²⁹ At 61-2

If Barbara made improvements after the valuation date, for example, built a shopping centre, this would not affect the valuation date value in terms of the TAB. Expenditure incurred after the valuation date will be added to the valuation date value in terms of paragraph 25 in order to determine the base cost of the asset. The second situation, which is dealt with in paragraph 30(2), involves further expenditure as contemplated in paragraph 20, in respect of the asset, in addition to the actual cost of acquisition, incurred in more than one year of assessment prior to the valuation date. Note that expenditure includes reductions to base cost, for example, wear-and-tear allowances.

The application of this formula is set out in the following example adapted from the Explanatory Memorandum³⁰.

Example:

The facts are the same as in the example above, except that Barbara erected a shopping centre upon her piece of land two years before the valuation date for R5 000 000. One year after the valuation date she effected improvements to the shopping centre at a cost of R1 000 000. She disposed of the shopping centre along with the land, ten years after the valuation date, for R12 000 000. As the total amount of expenditure allowable in terms of paragraph 20 was incurred in more than one year of assessment, the proceeds to be used in determining the TAB cost must be determined in accordance with the following formula as set out in paragraph 30(2).

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

$$P = (R12\,000\,000 (T) \times (R200\,000 + R5\,000\,000 (B)) / (R1\,000\,000 (A) + (R200\,000 + R5\,000\,000 (B)))$$

$$P = R62\,400\,000 / R6\,200\,000 = R10\,064\,516.$$

The purpose of this formula is to allocate the percentage of proceeds attributable to the period of ownership before valuation

³⁰ At 61-2

date. The answer to this formula, represented by symbol 'P', is then used in the paragraph 30(1) formula, which is as follows:

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

$$Y = R5\,200\,000 (B) + ((R10\,064\,516 (P) - R5\,200\,000 (B)) \times 20 (N) / 10 (T) + 20 (N))$$

$$Y = R5\,200\,000 + (R4\,864\,516 \times 20 / 30)$$

$$Y = R5\,200\,000 + R3\,243\,011 = R8\,443\,011.$$

The time-apportionment valuation date value equals R8 443 011.

The base cost is this value plus the expenditure allowable in terms of paragraph 20 incurred after valuation date. The capital gain or capital loss is determined as follows:

Proceeds	12 000 000
Less base cost (R8 443 011 + R1 000 000)	<u>9 443 011</u>
Capital gain	<u>2 556 989</u>

Note that where expenditure was incurred in more than one year of assessment prior to the valuation date, 'N' in the formula, is limited to twenty years. In this example, Barbara loses ten years in respect of valuing her piece of land. This also means, however, that although the major portion of her expenditure, allowable in terms of paragraph 20, relates to a period shortly before the valuation date, this too is spread back to the date of the first expense forming the base cost of the asset. (In this situation it is spread back eighteen years.)

The following example adapted from the Explanatory Memorandum illustrates the application of paragraph 30(1) and (2)³¹.

Example:

Emme (Pty) Ltd disposes of one of its smaller factories and all its plant involved in the manufacture of gadgets, to allow it to concentrate on its core business of manufacturing widgets. It

³¹ At 62-3.

disposes of the factory on 1 October 2011 for R12 000 000. The following information is also relevant.

- Emme (Pty) Ltd purchased a plot of land for R200 000. In 1986 it erected thereon a factory at a cost of R1 800 000. Emme (Pty) Ltd used the factory wholly or mainly for carrying on a process of manufacture. The building was subject to an initial allowance of 17,5% and an annual allowance of 2%.
- Plant costing R1 000 000 was acquired on 1 October 1986 and wear and tear was allowed by the Commissioner at the rate of 10% a year on the reducing balance method.
- Additional new plant costing R1 500 000 was acquired on 1 October 1989 and was written-off over three years for normal tax purposes.
- Additional plant costing R2 500 000 was acquired on 1 October 2008 and was written-off over five years for normal tax purposes.

Emme (Pty) Ltd's year-end is 31 December. No valuation was carried out at 1 October 2001. Emme (Pty) Ltd has elected the time-apportionment basis (TAB) to determine the capital gain.

Factory building

Original cost	1 800 000
Less initial allowance (17,5%)	<u>315 000</u>
	1 485 000
Less annual allowances (2%)	<u>772 200</u>
Tax value at date of disposal	<u>712 800</u>
Recoupment at disposal (R1 800 000 – R712 800)	<u>1 087 200</u>
Plant acquired in 1986	
Original cost	1 000 000
Less tax allowances	<u>935 390</u>
Tax value at date of disposal	<u>64 610</u>
Recoupment at disposal (R1 000 000 – R64 610)	<u>935 390</u>

Plant acquired in 1989	
Original cost	1 500 000
Less tax allowances	<u>1 500 000</u>
Tax value at date of disposal	<u>Nil</u>
Recoupment at disposal (R1 500 000 – 'nil')	<u>1 500 000</u>
Plant acquired in 2008	
Original cost	2 500 000
Less tax allowances	<u>1 500 000</u>
Tax value at date of disposal	<u>1 000 000</u>
Recoupment at disposal (R2 500 000 – R1 000 000)	<u>1 500 000</u>

As the total amount of expenditure in terms of paragraph 20 was incurred in more than one year, paragraph 30(2) is first applied. The recouped amounts must be deducted from proceeds in terms of paragraph 35(3):

Proceeds =

R12 000 000 – R1 087 200 – R935 390 – R1 500 000 – R1 500 000 = R6 977 410.

$P = (R6\,977\,410 \times (R712\,800 + R64\,610 + R\,nil)) / R1\,000\,000 + ((R712\,800 + R64\,610 + R\,nil))$

$P = (R6\,977\,410 \times R777\,410) / R1\,777\,410$

$P = R5\,424\,308\,300\,000 / R1\,777\,410 = \underline{R3\,051\,805}$.

Then the formula in paragraph 30(1) is applied.

$Y = (R712\,800 + R64\,610 + R\,nil) + ((R3\,051\,805 - (R792\,000 + R64\,610 + R\,nil) \times 15) / (11 + 15))$

$Y = R777\,410 + (R2\,195\,195 \times 15 / 26)$

$Y = R777\,410 + R1\,266\,459 = \underline{R2\,043\,869}$.

The plant acquired in 2008 for R1 000 000 is excluded from the formula because it is an asset acquired after the valuation date.

The capital gain or capital loss is determined as follows:

Total proceeds (see above)	6 977 410
Total base cost (R2 043 869 + R1 000 000)	<u>3 043 869</u>
Capital gain upon disposal	<u>3 933 541</u>

3.1.5 Market Value

Paragraph 31 provides how the market value is to be determined for different kinds of assets. The term is used throughout the Eighth Schedule in a wide variety of circumstances, for example, on valuation date, death, donation, emigration and immigration.

The following is a summary of paragraph 31.

3.1.5.1 Financial instruments:

In terms of paragraph 31(1)(a) the market value of a financial instrument listed on a recognised exchange is the average of listed buying and selling prices at close of business on the last trading day before disposal.

3.1.5.2 Long term insurance policies:

In terms of paragraph 31(1)(b) the market value of a long term insurance policy is the greater of its surrender value, and the insurer's fair market value of it (assuming the policy runs to maturity).

3.1.5.3 Equity and property unit trusts:

In terms of paragraph 31(1)(c)(i) the market value of a unit in an equity or a property unit trust is the management company's repurchase price of it.

3.1.5.4 Foreign unit trusts:

In terms of paragraph 31(1)(c)(ii) the market value of a unit in a foreign unit trust is the management company's repurchase price of it, or if not available, its price based on a willing buyer, and a willing seller acting at arm's length in an open market.

3.1.5.5 Limited interests:

In terms of paragraph 31(1)(d) the market value of a fiduciary, usufructary or other similar interest in any property, is an amount determined by capitalising at 12% the annual value of the right of enjoyment of the property subject to that fiduciary, usufructary or other like interest, as determined in terms of paragraph 31(2), over the expectation of life of the person entitled to that interest, or if that

right of enjoyment is to be held for a lesser period than the life of that person, over that lesser period.

Paragraph 31(2) then provides that where the Commissioner is satisfied that the property which is subject to that interest could not reasonably be expected to produce an annual yield equal to 12% on that value of the property, he may fix such sum as representing the annual yield as may seem to him to be reasonable, and the sum so fixed must for the purposes of paragraph 31(1)(d) be treated as being the annual value of the right of enjoyment of that property. This decision of his is subject to objection and appeal. In terms of paragraph 31(1)(e) the market value of any property which is subject to a fiduciary, usufructuary or other similar interest in favour of any person, is the amount by which the fair market value of the full ownership of that property exceeds the value of that fiduciary, usufructuary or other like interest determined in accordance with paragraph 31(d) (see above).

3.1.5.6 Immovable farming property:

In terms of paragraph 31(1)(f) the market value of immovable property used for bona fide purposes is either

- the land bank value (as defined in the Estate Duty Act), or
- the price based on a willing buyer, and a willing seller at arm's length in an open market.

On disposal by death, donation or a non-arm's length transaction the land bank value may be used only if it is used in determining the base cost of the disposer on

- valuation date, or
- on the date he acquired it by inheritance, donation or under a non-arm's length transaction at land bank value.

3.1.5.7 Any other asset:

In terms of paragraph 31(1)(g) the market value of any other asset is its price based on a willing buyer, and a willing seller at arm's length in an open market.

3.1.5.8 Unlisted shares:

In terms of paragraph 31(3) the market value of any shares of a person in an unlisted company must be determined at a value equal to the price which could have been obtained upon a sale of the share between a willing buyer and a willing seller dealing at arm's length in an open market. This provision is, however, subject to the following conditions.

- No regard shall be had to any provision restricting the transferability of the shares therein, and it shall be assumed that those shares were freely transferable.
- No regard shall be had to any provision whereby or where under the value of the shares is to be determined.
- If upon the winding-up of the company a person would have been entitled to share in the assets of the company to a greater extent *pro rata* to shareholding than other shareholders, the value of the shares held by him must not be less than the amount to which he would have been so entitled if the company had been in the course of winding-up and the said amount had been determined as at valuation date.

CHAPTER 4 : Samples and Results

The following “base cost” calculations were obtained from the accounting firms Ernst & Young and Deloitte & Touché. In a few of the examples they have removed the names of the business enterprises and individuals concerned for confidentiality reasons.

CASE NUMBER 1.

Franchise Sale

This particular case involves the sale of three franchises that were started from scratch and have been sold.

Three methods have been used :-

Method 1 splits the proceeds per store on the basis of cost.

Method 2 splits the proceeds based on the value gained per store over the period it traded.

Method 3 takes the time period as 9 years for the calculation.

Method 1 :-

YEAR END 31 AUGUST 2002 CALCULATION OF BASE COST AND CAPITAL GAINS TAX

Cost per Store:

	R	%
G	508 446	10.54
A	1 995 000	41.35
P	<u>2 321 211</u>	<u>48.11</u>
	4 824 657	100.00

Proceeds per Store:

Split based on % cost per store

	R	%
G	1 238 050	10.54
A	4 857 763	41.35
P	<u>5 652 077</u>	<u>48.11</u>
	11 747 890	100.00

Period in Operation up to 1 October 2001:

A portion of a year is regarded as a full year

	Years	Established	Capital Gains
G	5	01-Dec 96	30-Sept 01
A	9	30-Aug 93	30-Sept 01
P	9	15-Mar 93	30-Sept 01

Period from 1 October 2001 to date of sale:

A portion of a year is regarded as a full year

	Years	Capital Gains	Sold
G	1 Year	01-Oct 01	30-Apr 02
A	1 Year	01-Oct 01	30-Apr 02
P	1 Year	01-Oct 01	30-Apr 02

1. Base Cost as per Time Apportionment Formula : Paragraph 30 (1)

$$\text{Formula} = B + \frac{[(P - B) \times N]}{T + N}$$

B = Cost
P = Proceeds
N = Years up to 1 October 2001
T = Years from 1 October to date of sale

Base Cost based on Formula

G	1 116 449	508 446+ $\frac{[(1\ 238\ 050-508\ 446) \times 5]}{5 + 1}$
A	4 571 487	
P	<u>5 318 990</u>	
	11 006 926	

Capital Gains Tax:

	Proceeds Base	Base Cost	Capital Gains
G	1 238 050	1 116 449	121 601
A	4 857 763	4 571 487	286 276
P	<u>5 652 077</u>	<u>5 318 990</u>	<u>333 087</u>
	11 747 890	11 006 926	740 964

Taxable 50%

R 370 482

Capital Profit

	Cost	Base Cost	Capital Profit
G	508 446	1 116 449	608 003
A	1 995 000	4 571 487	2 576 487
P	<u>2 321 211</u>	<u>5 318 990</u>	<u>2 997 779</u>
	4 824 657	11 006 926	6 182 269

Total Profit

	Proceeds	Cost	Profit
G	1 238 050	508 446	729 604
A	4 857 763	1 995 000	2 862 763
P	<u>5 652 077</u>	<u>2 321 211</u>	<u>3 330 866</u>
	1 747 890	4 824 657	6 923 233

Reconciliation of Profit:

Capital Profit	6 182 269
Capital Gains (taxable)	<u>740 964</u>
	<u>R 6 923 233</u>

Method 2 :-

YEAR END 31 AUGUST 2002 CALCULATION OF BASE COST AND CAPITAL GAINS TAX

Cost per Store:

	R	%
G	508 446	10.54
A	1 995 000	41.35
P	<u>2 321 211</u>	<u>48.11</u>
	4 824 657	100.00

Proceeds per Store:

Split based on value gained per store from date of acquisition to date of sale

	R	%
G	2 124 282	18.08
A	4 580 336	38.99
P	<u>5 043 272</u>	<u>42.93</u>
	11 747 890	100.00

Period in Operation up to 1 October 2001:
 A portion of a year is regarded as a full year

	Years	Established	Capital Gains
G	5 Years	01-Dec 96	30-Sept 01
A	9 Years	30-Aug 93	30-Sept 01
P	9 Years	15-Mar 93	30-Sept 01

Period from 1 October 2001 to date of sale:
 A portion of a year is regarded as a full year

	Years	Capital Gains	Sold
G	1	01-Oct 01	30-Apr 02
A	1	01-Oct 01	30-Apr 02
P	1	01-Oct 01	30-Apr 02

2. Base Cost as per Time Apportionment Formula : Paragraph 30 (1)

$$\text{Formula} = B + \frac{[(P - B) \times N]}{T + N}$$

B = Cost
 P = Proceeds
 N = Years up to 1 October 2001
 T = Years from 1 October to date of sale

Base Cost based on Formula

G	1 854 976
A	4 321 802
P	<u>4 771 066</u>
	10 947 844

Capital Gains Tax:

	Proceeds Base	Base Cost	Capital Gains
G	2 124 282	1 854 976	269 306
A	4 580 336	4 321 802	258 534
P	<u>5 043 272</u>	<u>4 771 066</u>	<u>272 206</u>
	11 747 890	10 947 844	800 046

Taxable 50%

R 400 023

Capital Profit

	Cost	Base Cost	Capital Profit
G	508 446	1 854 976	1 346 530
A	1 995 000	4 321 802	2 326 802
P	<u>2 321 211</u>	<u>4 771 066</u>	<u>2 449 855</u>
	4 824 657	10 947 844	6 123 187

Total Profit

	Proceeds	Cost	Profit
G	2 124 282	508 446	1 615 836
A	4 580 336	1 995 000	2 585 336
P	<u>5 043 272</u>	<u>2 321 211</u>	<u>2 722 061</u>
	11 747 890	4 824 657	6 923 233

Reconciliation of Profit:

Capital Profit	6 123 187
Capital Gains (taxable)	800 046
	<u>R 6 923 233</u>

Method 3 :-

YEAR END 31 AUGUST 2002
CALCULATION OF BASE COST AND CAPITAL GAINS TAX
WHERE THE BASE COST IS INCURRED OVER A PERIOD

Determine Proceeds

$$P = \frac{T \times B}{(A + B)}$$

T = Total Proceeds

B = Pre-Transition Date Base Cost Expenditure

A+B = Total Base Cost Expenditure

$$= \frac{11\,747\,870 \times 4\,824\,657}{(0 + 4\,824\,657)}$$

$$P = R\,11\,747\,890$$

3. Determine Valuation Date Value : Paragraph 30 (2)

$$Y = \frac{B + [(P - B) \times N]}{T + N} = 4\,824\,657 + \frac{(11\,747\,890 - 4\,824\,657) \times 9}{1 + 9}$$

$$Y = 4\,824\,657 + 6\,230\,910$$

$$Y = \text{R } 11\,055\,567$$

Assuming no post 1 October 01 capital expenditure, this is equal to the "base cost"

Calculate Capital Gain

$$\begin{aligned} \text{Gain} &= \text{Proceeds} - \text{Base Cost} \\ &= 11\,747\,890 - 11\,055\,567 \\ &= \text{R } 692\,323 \end{aligned}$$

$$50\% \text{ Inclusion } \quad \underline{\text{R } 346\,162}$$

4. Summary of the three methods used.

Method 1 gives the second best result as far as the seller is concerned as it produces a taxable amount of R 370 482

Method 2 does not give a favourable result as far as the seller is concerned as it gives a high value than method 1 of R 400 023

Method 3 uses the longest time period the various businesses have been in operation which gives a far better result to the seller than methods 1 or 2 of R 346 162.

CASE NUMBER 2.

Sale of Shares

SALE OF SHARES IN AN UNLISTED COMPANY – ACQUIRED PRE 1 OCTOBER 2001 – BY A COMPANY

Expenditure pre 01/10/2001 (Purchase price of the shares)	B	4 350 000
Proceeds at 01/06/2002	P	175 000 000
Market Value 01/10/2001		150 000 000
Years owned pre 01/10/2001	N	12
Years owned post 01/10/2001	T	1

1. Base Cost as per Time Apportionment Formula

$$\text{Formula} = B + \frac{[(P - B) \times N]}{T + N}$$

B =	Cost
P =	Proceeds
N =	Years up to 1 October 2001
T =	Years from 1 October to date of sale

$$4\,350\,000 + \frac{[(175\,000\,000 - 4\,350\,000) \times 12]}{1 + 12}$$
$$4\,350\,000 + 157\,523\,077$$
$$= \underline{161\,873\,077}$$

Capital Gains Tax:

<u>Proceeds Base</u>	<u>Base Cost</u>	<u>Capital Gains</u>
<u>175 000 000</u>	<u>161 873 077</u>	<u>13 126 923</u>
Taxable 50%	R 6 563 462	
Rate 30%	R 1 969 038	

2. Market Value Method

Capital Gains Tax:

<u>Proceeds Base</u>	<u>Base Cost</u>	<u>Capital Gains</u>
<u>175 000 000</u>	<u>150 000 000</u>	<u>25 000 000</u>
Taxable 50%	R 12 500 000	
Rate 30%	R 3 750 000	

3. Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula	= R 1 969 038
Market Value Method	= R 3 750 000

CASE NUMBER 3.

Sale of a Ship

1. Base Cost as per Time Apportionment Formula

SALE OF SHIP [Agemo (Pty) Ltd.]	2001	2002	2003
NIBT	15,554,347	42,742,741	31,944,000
Deduct Wear and Tear	72,000,000	72,000,000	54,000,000
Add back Depreciation	27,692,308	27,692,308	27,692,308
Original Cost of Rig			360,000,000
Wear and Tear			198,000,000
Tax Value			162,000,000
Sale Price (\$65m x 11)			715,000,000
Recoupment			198,000,000
Capital Gains Tax			
Original Purchase Price(1 March 2000)			360,000,000
Time Apportioned Base Cost (calculation A)			478,333,333
Proceeds on Sale Rig (1 January 2003)			715,000,000
Capital Gain			236,666,667
Net Capital Gain (50%) / taxable income inclusion			118,333,333
Taxable Income/ Assessed Loss	59,862,039	87,050,433	321,969,641
Tax Payable (30%)	0	0	96,590,892

Calculation A

Time Apportionment Base Cost

$$360,000,000 + \frac{(715,000,000 - 360,000,000) * 1}{2 + 1} = \underline{\underline{R 478,333,333}}$$

2. Market Value Method

SALE OF SHIP [Agemo (Pty) Ltd.]	2001	2002	2003
NIBT	15,554,347	42,742,741	31,944,000
Deduct Wear and Tear (prorated for 2003)	72,000,000	72,000,000	54,000,000
Add back Depreciation (prorated for 2003)	27,692,308	27,692,308	20,769,231
Original Cost of Rig			360,000,000
Wear and Tear			198,000,000
Tax Value			162,000,000
Sale Price (\$65m x 11)			715,000,000
Recoupment			198,000,000
Capital Gains Tax			
Original Purchase Price(1 March 2000)			360,000,000
Market Value as at 1 October 2001			532,500,000
Proceeds on Sale Rig (1 January 2003)			715,000,000
Capital Gain			182,500,000
Net Capital Gain (50%) / taxable income inclusion			91,250,000
Taxable Income/ Assessed Loss	59,862,039	87,050,433	287,963,231
Tax Payable (30%)	0	0	86,388,969

3. Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula	= R 96 590 892
Market Value Method	= R 86 388 969

CASE NUMBER 4.

Share Portfolio (Time Apportionment Basis vs Market Value Method : Table)

Date Purchased	Number of Shares Purchased	Original Cost	Date of Sale	Name of Shares	Number Of Shares	Cost Of Shares Sold	Proceeds	Calculation of base Cost Using time Apportionment basis	Capital gain/loss using Time apportionment basis	Value at 1 Oct 2001 Deemed value at date of Purchase	Proceeds	Capital gain/(loss) Using Market Value
06/09/00	4400	138.412	02/11/01	Fedsure	4400	58211	6481	23.725	-17.243	4.939	6.481	1.542
12/10/01		14.949	05/11/01	Investec	99	14.949	15.682	14.949	733	14.949	15.682	733
13/02/01	41000	37.203	02/11/01	SB AMS	41000	37.203	3.981	20.592	-16.611	5.330	3.981	-1.349
22/05/01	75000	71.834	05/12/01	BP Ang	75000	71.834	76.059	73.946	2.112	33000	76.059	43.059
09/07/01	100000	71.584	05/12/01	UB AMS	100000	71.584	105.390	88.487	16.903	61000	105.390	44.390
29/08/01	4000	60.494	18/02/02	M-Cell	4000	60.494	47.918	54.206	-6.288	51.160	47.918	-3.242
08/03/00	903	21.778	18/02/02	Std Bank	3403	88.323	94.057	92.145	1.911	100.763	94.057	-6.706
	2500	66.544										
29/05/01	50000	62.509	27/02/02	Metro Cash	50000	62.509	94.451	78.480	15.971	76.000	94.451	18.451
	50000	62.509										
									-2.511			96.878

NOTES RE: CALCULATION OF BASE COST

1 ISCOR SHARES

2 SAPPI

3 STANBIC

4 GENCOR

COST PER SHARE AS
PER PROCEEDS 29.73

COST PER SHARE AS
PER PROCEEDS 117.96

COST PER SHARE AS
PER PROCEEDS 42.62

4.1 COST PER SHARE AS
PER PROCEEDS 42.62

SALE OF 4500 SHARES
2400 @ R29.73 = R 71 352
2100 @ R29.73 = R 62 433

SALE OF 1500 SHARES
1000 @ 117.96 = R 117 960
500 @ 117.96 = R 58 980

SALE OF 2000 SHARES
1200 @ 42.62 = R 51 144
800 @ 42.62 = R 34 096
670 @ 28.13 = R 18 847

4.2 COST PER SHARE PURCHASED 2001
800 SHARES AS FOLLOWS
TOTAL OF 1800 SHARES PURCHASED FOR R99 316
THEREFORE 99 316 / 1800 * 800 = R 44 140

COST OF 4500 SHARES
2400 COST R 54 911

COST PER SHARE PURCHASED 2001
120 485 / 2000 X 500 = R 30 121

THEREFORE 2100 SHARES:

71 201 / 4600 * 2100 = R 32 504

		FEDSURE	INVESTEC	NUMBER OF SHARES	
				FEDSURE	INVESTEC
Opening cost	Mar 1 2001	138,412.00	96,792.00	4,400	400
Purchases	May 11 2001		45,893.00		200
Unbundling	Jun 15 2001	65,252.00	65,252.00		286
		73,160.00	207,937.00		
Sale	Aug 7 2001		207,937.00		886
		58,211.00	14,949.00		
Sale	Nov 2 2001	-58,211.00	-14,949.00	4,400	-99
Capital Gains Tax Calculation					
Base Cost @ Oct 1 2001		19,888.00			
Adjustment for unbundling @ Oct 12 2001		14,949.00	14,949.00		
New Base Cost		4,939.00	14,949.00		
Selling Price		6,481.38	15,681.70		
Capital Gain/(Loss)		1,542.38	732.70		

1. Summary

Base Cost as per Time Apportionment Formula = R **-2.511.00**

Market Value Method = R **96.878.00**

CASE NUMBER 5.

Share Portfolio (Time Apportionment Basis vs Market Value Method : Table)

	Date Purchased	Number of Shares Purchased	Cost	ANALYSIS OF CAPITAL GAINS/LOSS				Proceeds	Calculation of base cost using time apportionment basis	Capital gain/loss using time apportionment basis	Value at 1 Oct 2001/Deemed value at date of Purchase	Capital gain/loss using market value
				Date of Sale	Name of Shares	Number of Shares	Cost					
1	23/02/00	2400	54911	02-Nov-01	ISCOR	4.500	87.416	133.780	113.340	20.440	113.490	20.290
	28/02/01	4600	71201	28-Nov-01	ISCOR	5.000	0	28.983	69.303	-40.371	126.100	-97.168
	11/06/01	2500	70978									
	15/11/01	5000	144000	13-Feb-02	KUMBA	3.000	86.400	130.750	0	0	86.400	44.350
2	31/05/01	4200		17-Jan-02	Brait	4.200	50.178	58.008	54.093	3.915	54.684	3.325
	24/02/00	1000	58476	17-Jan-02	SAPPI	1.500	88.596	176.940	142.682	34.258	109.110	67.830
	28/02/01	2000	120485	28-Jan-02	SAPPI	1.500	90.364	186.490	138.427	48.063	109.110	77.380
3	23/02/00	3600	93279	13-FEB-02	STANBIC	4.359	98.760	122.615	98.605	11.891	129.070	-6.455
	28/02/01	670	5391						12.119			
4	23/02/00	1200	34036	16-Feb-02	GENCOR	2.000	35.935	85.236	45.440			
	4.2	28/02/01	800	44144					39.119	677	57.480	27.756
	09/01/01	400	22685	06-Dec-01	D.D PLC	400	22.685	28.532	25.608	2.924	6.132	5.004
				20-Dec-01	PPC	600	31.155	43.550	37.353	6.198	36.132	7.418
	27/12/00	1000	51925	24-Dec-01	PPC	400	20.770	28.635	24.703	3.933	24.088	4.547
				17-Jan-02	Remgro	1.901	121.719	114.852	118.286	-3.434	113.746	1.106
										208.993		311.032
D.D. PLC = Dimension Data PLC						PPC = Pretoria Portland Cement						

		INVESTEC	KUMBA	Number of shares	
				FEDSURE	INVESTEC
Opening cost	Mar 1 2001	138,412.00	96,792.00	4,400	400
Purchases	May 11 2001		45,893.00		200
Unbundling	Jun 15 2001	-65,252.00	65,252.00		286
Sale	Aug 7 2001	73,160.00	207,937.00		886
Sale	Nov 2 2001	58,211.00	14,949.00	-4,400	99
Capital Gains Tax Calculation					
Base Cost @ Oct 1 2001		19,888.00			
Adjustment for unbundling @ Oct 12 - 01		14,949.00	14,949.00		
New Base Cost		4,939.00	14,949.00		
Selling Price		6,481.38	15,681.70		
Capital Gain/(Loss)		1,542.38	732.70		

ISCOR							
	NO OF SHARES	ORIGINAL COST	BASE COST @ 1/10/01	UNBUNDLING - KUMBA	AMENDED BASE COST	PROCEEDS	GAIN/(LOSS)
23/02/00	2400	54,911.00	60,528.00		60,528.00		
28/02/01	4600	71,201.00	116,012.00		116,012.00		
11/06/01	2500	70,977.57	63,050.00		63,050.00		
	9500	197,089.57	239,590.00		239,590.00		
02/11/02	-4500	93,358.22	113,490.00		113,490.00	133,972.00	20,482.00
	5000	103,731.35	126,100.00	133,400.00			
28/11/02 - (one for one)	0						
Totals	14500	300,820.92	239,590.00				

1. Summary

Base Cost as per Time Apportionment Formula = R 208.993

Market Value Method = R 311.032

CASE NUMBER 6.

Share Option Exercised : Mark Canning.

Options Section 8A Calculation

Year	Option Offer Price	Vested Options	Date of Exercise	MV on Exercise	Section 8A Gain	Tax at 40%
1998	2.60	135 333.00	08/10/2002	4.35	236,832.75	94,733.10
1999	3.22	90 000.00	08/10/2002	4.35	101,700.00	40,680.00
2001	2.82	100 000.00	08/10/2002	4.35	153,000.00	61,200.00
Totals		325 333.00			491,532.75	196,613.10

Capital Gains Implications when the Shares Acquired in Terms of Option Exercised are Transferred to Investment Co.

No. of Shares Acquired	MV at Acquisition	MV on Disposal	Proceeds	Capital Gain	Tax at 10%
325 333.00	4.35	4.35	1 415 198.55	0	0

Case Number 6 Continued:

1. Base Cost as per Time Apportionment Formula

Date Shares Purchased	Number of Shares Purchased	MV of Shares on Disposal	ANALYSIS OF CAPITAL GAINS/LOSS				Calculation of base cost using time apportionment basis	Capital gain/loss using time apportionment basis	Tax at 10%	Gain per Share
			Proceeds	Number of Years Held pre 2001/09/30	Number of Years Held post 2001/10/01	Allowable Costs				
05/04/1993	20 000	4.34	86 800.00	9	1	0	78 120.00	8680.00	868.00	0.44
02/12/1998	86 667	4.34	376 134.78	3	1	0	282 101.08	94 033.70	9 403.37	1.09
21/12/2000	125 120	4.34	543 020.80	1	1	0	271 510.40	271 510.40	27 151.04	2.17
08/06/2001	184 060	4.34	798 820.40	1	1	0	399 410.20	399 410.20	39 941.02	2.17
	415 847		1 804 75.98				1 031 1.68	773 634.30	77 363.43	

2. Market Value Method

Balance of Vested Shares Held	Balance of Deferred Delivery Shares	Base Cost 01/10/2001	MV on Disposal 02/09/2002	Proceeds	Capital Gain	Tax at 10%	Gain/Share
231 787.00	184 060.00	3.62	4.34	1,804,775.98	299,409.84	29,940.98	0.72

3. Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula = R 77 363.43

Market Value Method = R 29,940.98

CASE NUMBER 7.

Share Option Exercised : Norman Thomson.

Options Section 8A Calculation

Year	Option Offer Price	Vested Options	Date of Exercise	MV on Exercise	Section 8A Gain	Tax at 40%
Totals	NIL	NIL	NIL	NIL	NIL	NIL

Capital Gains Implications when the Shares Acquired in Terms of Option Exercised are Transferred to Investment Co.

No. of Shares Acquired	MV at Acquisition	MV on Disposal	Proceeds	Capital Gain	Tax at 10%
NIL	NIL	NIL	NIL	NIL	NIL

Case Number 7 Continued:

1. Base Cost as per Time Apportionment Formula

Date Shares Purchased	Number of Shares Purchased	MV of Shares on Disposal	ANALYSIS OF CAPITAL GAINS/LOSS				Calculation of base cost using time apportionment basis	Capital gain/loss using time apportionment basis	Tax at 10%	Gain per Share
			Proceeds	Number of Years Held pre 2001/09/30	Number of Years Held post 2001/10/01	Allowable Costs				
05/04/1993	40 759	4.34	176894.06	8	1	0	157 239.16	19 654.90	1 965.49	0.48
08/12/1998	70 000	4.34	303800.00	3	1	0	227 850.00	75 950.00	7 595.00	1.09
19/04/2000	50 000	4.34	217000.00	3	1	0	162 750.00	54 250.00	5 425.00	1.09
21/12/2000	59 200	4.34	256928.00	1	1	0	128 464.00	128 464.00	12 846.40	2.17
16/03/2001	133 333	4.34	578665.22	1	1	0	289 332.61	289 332.61	28 933.26	2.17
08/06/2001	224 059	4.34	972 416.06	1	1	0	486 208.03	486 208.03	48 620.80	0.22
Totals	577 351		2 505 03.34				1 451 3.80	1 053 859.95	105 385.95	

2. Market Value Method

Balance of Vested Shares Held	Balance of Deferred Delivery Shares	Base Cost 01/10/2001	MV on Disposal 02/09/2002	Proceeds	Capital Gain	Tax at 10%	Gain/Share
577 351	NIL	3.62	4.34	2 505 03.34	415 692.72	41 569.27	0.72

3. Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula = R **105 385.95**

Market Value Method = R **41 569.27**

CASE NUMBER 8.

Share Option Exercised : Richard Butt.

Options Section 8A Calculation

Year	Option Offer Price	Vested Options	Date of Exercise	MV on Exercise	Section 8A Gain	Tax at 40%
1998	2.60	21 000	08/10/2002	4.35	36 750	14 700.00
1999	3.22	50 000	08/10/2002	4.35	56 500	22 600.00
2001	2.77	53 900	08/10/2002	4.35	85 162	34 064.80
Totals		124 900			178 412	71 364.80

Capital Gains Implications when the Shares Acquired in Terms of Option Exercised are Transferred to Investment Co.

No. of Shares Acquired	MV at Acquisition	MV on Disposal	Proceeds	Capital Gain	Tax at 10%
124 900	4.35	4.35	543 315	0	0

Case Number 8 Continued:

1. Base Cost as per Time Apportionment Formula

Date Shares Purchased	Number of Shares Purchased	MV of Shares on Disposal	ANALYSIS OF CAPITAL GAINS/LOSS				Calculation of base cost using time apportionment basis	Capital gain/loss using time apportionment basis	Tax at 10%	Gain per Share
			Proceeds	Number of Years Held pre 2001/09/30	Number of Years Held post 2001/10/01	Allowable Costs				
08/06/2001	192 254	4.34	834 382.36	1	1	0	417 191.18	417 191.18	41 719.12	2.17
Totals	192 254		834 382.36				417 191.18	417 191.18	41 719.12	

2. Market Value Method

Balance of Vested Shares Held	Balance of Deferred Delivery Shares	Base Cost 01/10/2001	MV on Disposal 02/09/2002	Proceeds	Capital Gain	Tax at 10%	Gain/Share
NIL	192 254	3.62	4.34	834 382.36	138 422.88	13 842.29	0.72

3. Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula = R 41 719.12

Market Value Method = R 13 842.29

CASE NUMBER 9.

Share Option Exercised : Cherrie Lowe.

Options Section 8A Calculation

Year	Option Offer Price	Vested Options	Date of Exercise	MV on Exercise	Section 8A Gain	Tax at 40%
1999	3.22	21 000	08/10/2002	4.35	23 730.00	9 492.00
2000	2.70	20 000	08/10/2002	4.35	33 000.00	13 200.00
2000	2.77	34 640	08/10/2002	4.35	54 731.20	21 892.48
Totals		75 640			111 461.20	44 584.48

Capital Gains Implications when the Shares Acquired in Terms of Option Exercised are Transferred to Investment Co.

No. of Shares Acquired	MV at Acquisition	MV on Disposal	Proceeds	Capital Gain	Tax at 10%
75 640	4.35	4.35	329 034.00	0	0

Case Number 9 Continued:

1. Base Cost as per Time Apportionment Formula

Date Shares Purchased	Number of Shares Purchased	MV of Shares on Disposal	ANALYSIS OF CAPITAL GAINS/LOSS				Calculation of base cost using time apportionment basis	Capital gain/loss using time apportionment basis	Tax at 10%	Gain per Share
			Proceeds	Number of Years Held pre 2001/09/30	Number of Years Held post 2001/10/01	Allowable Costs				
08/06/2001	16 770	4.34	72 781.80	1	1	0	36 390.90	36 390.90	3 639.09	2.17
Totals	16 770		72 781.80				36 390.90	36 390.90	3 639.09	

2. Market Value Method

Balance of Vested Shares Held	Balance of Deferred Delivery Shares	Base Cost 01/10/2001	MV on Disposal 02/09/2002	Proceeds	Capital Gain	Tax at 10%	Gain/Share
NIL	16 770	3.62	4.34	72 781.80	12 074.40	1 207.44	2.17

3. Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula = **R 3 639.09**

Market Value Method = **R 1 207.44**

CASE NUMBER 10.

Share Option Exercised : Kevin Stanford.

Options Section 8A Calculation

Year	Option Offer Price	Vested Options	Date of Exercise	MV on Exercise	Section 8A Gain	Tax at 40%
1998	2.6	102 000	08/10/2002	4.35	178 500.00	71 400.00
1999	3.22	50 000	08/10/2002	4.35	56 500.00	22 600.00
2000	2.77	55 820	08/10/2002	4.35	88 195.60	35 278.24
2001	2.82	100 000	08/10/2002	4.35	153 000.00	61 200.00
Totals		307 820			476 195.60	190,478.24

Capital Gains Implications when the Shares Acquired in Terms of Option Exercised are Transferred to Investment Co.

No. of Shares Acquired	MV at Acquisition	MV on Disposal	Proceeds	Capital Gain	Tax at 10%
307 820	4.35	4.35	1 339 017	0	0

Case Number 10 Continued:

1. Base Cost as per Time Apportionment Formula

Date Shares Purchased	Number of Shares Purchased	MV of Shares on Disposal	ANALYSIS OF CAPITAL GAINS/LOSS				Calculation of base cost using time apportionment basis	Capital gain/loss using time apportionment basis	Tax at 10%	Gain per Share
			Proceeds	Number of Years Held pre 2001/09/30	Number of Years Held post 2001/10/01	Allowable Costs				
08/12/1998	100 000	4.34	434 000.00	3	1	0	325 500.00	108 500.00	10 850.00	1.09
08/06/2001	102 713	4.34	445 774.42	1	1	0	222 887.21	222 887.21	22 288.72	2.17
Totals	202 713		879 774.42				548 387.21	331 387.21	33 138.72	

2. Market Value Method

Balance of Vested Shares Held	Balance of Deferred Delivery Shares	Base Cost 01/10/2001	MV on Disposal 02/09/2002	Proceeds	Capital Gain	Tax at 10%	Gain/Share
100 000	102 713	3.62	4.34	879 774.42	145 953.36	14 595.34	0.72

3. Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula = R 33 138.72

Market Value Method

= R 14 595.34

CASE NUMBER 11.

Share Option Exercised : Richard Inskip.

Options Section 8A Calculation

Year	Option Offer Price	Vested Options	Date of Exercise	MV on Exercise	Section 8A Gain	Tax at 40%
1999	3.22	90 000	08/10/2002	4.35	101 700	40 680.00
2001	3.03	174 075	08/10/2002	4.35	229 779	91 911.60
Totals		264 075			331 479	132 591.60

Capital Gains Implications when the Shares Acquired in Terms of Option Exercised are Transferred to Investment Co.

No. of Shares Acquired	MV at Acquisition	MV on Disposal	Proceeds	Capital Gain	Tax at 10%
264 075	4.35	4.35	1 148 726.25	0	0

Case Number 11 Continued:

1. Base Cost as per Time Apportionment Formula

Date Shares Purchased	Number of Shares Purchased	MV of Shares on Disposal	ANALYSIS OF CAPITAL GAINS/LOSS				Calculation of base cost using time apportionment basis	Capital gain/loss using time apportionment basis	Tax at 10%	Gain per Share
			Proceeds	Number of Years Held pre 2001/09/30	Number of Years Held post 2001/10/01	Allowable Costs				
08/12/1998	21 000	4.34	91 140.00	3	1	0	68 355.00	22 785.00	2 278.50	1.09
21/12/2000	149 180	4.34	647 441.20	1	1	0	323 720.60	323 720.60	32 372.06	2.17
16/03/2001	100 000	4.34	434 000	1	1	0	217 000.00	217 000.00	21 700.00	2.17
Totals	270 180		1 172 81.20				609 075.60	563 505.60	56 350.56	

2. Market Value Method

Balance of Vested Shares Held	Balance of Deferred Delivery Shares	Base Cost 01/10/2001	MV on Disposal 02/09/2002	Proceeds	Capital Gain	Tax at 10%	Gain/Share
270 180	NIL	3.62	4.34	1 172 81.20	194 529.60	19 452.96	0.72

3. Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula = **R 56 350.56**

Market Value Method = **R 19 452.96**

CHAPTER 5 : Conclusions

As stated in the literature review the dilemma of whether to do the valuation is clearly shown in the above cases along with the need to do the valuation exercise to see which method will give a more favourable outcome for the taxpayer.

Case Number 1.

The sale of the franchises means there is a **disposal** as laid down in the Act. This means a CGT event has occurred and the calculation needs to be done. The method of determining the amount to be paid is up to the taxpayer. In this example the base cost expenditure is incurred over a period and as such the formula as laid down in Paragraph 30(2) can be used.

The period under review is Nine years.

Case Number 2.

The sale of shares in this example of an unlisted company is another case in point of why it is so critical to do the various valuation methods. The period under review is Twelve years.

Summary of Tax Payable:-

Base Cost as per Time Apportionment Formula	= R 1 969 038
Market Value Method	= R 3 750 000

The difference in the two methods amounts to R 1 780 962.

Summary of Cases 1 & 2.

The key issue regarding these two cases is the length of time the respective owners have owned the assets in question. The results clearly show that the use of the Time Apportionment Formula

produces a far more favourable outcome than using the Market Value Method.

The key issue as stated in the literature explains the reason for this, "the effect of the formula is to multiply the actual pre-valuation economic expense by a factor, which increases it in the ratio of the pre-valuation period to the whole period of ownership. When this amount is deducted from the actual proceeds, it gives the effect of the gain having arisen at an equal amount per annum over the whole period of ownership." The longer the time period that the asset has been owned the bigger the denominator becomes in the equation thus helping to reduce the **base cost**.

Case Number 3.

The sale of ship produces a counter argument to cases 1 & 2. In this example the Market Value Method produces the better result.

Summary of Tax Payable:-,

Base Cost as per Time Apportionment Formula = R 96 590 892

Market Value Method = R 86 388 969

The difference in the two methods amounts to R 10 201 923.

Summary of Case 3.

The reason for this is the limited time the asset was owned, a mere two years. The Time Apportionment Formula does not play a significant role in this case. The actual Market Value on 1st October 2001 is far higher than the result obtained from the Time Formula thus helping to reduce the amount of capital gain achieved.

Case Numbers 4 & 5.

In these two examples we are dealing with share portfolios. The Time Apportionment Formula gives better results.

Case No. 4 - Summary of Gain or Loss

Base Cost as per Time Apportionment Formula	= R -2.511.00
Market Value Method	= R 96.878.00

Case No. 5 - Summary of Gain or Loss

Base Cost as per Time Apportionment Formula	= R 208.993
Market Value Method	= R 311.032

Summary of Cases 4 & 5.

The main reason for this is the negative returns that the Time Apportionment Formula produces in relation to the Market Value Method.

These two cases highlight another important aspect that was mentioned earlier in the text, the question of whether to wait or do the valuation now. These two cases show the importance of being able to choose which method the person will use to value their assets. The importance of making this choice now is that once the tax payer has elected to use one method or the other, that method becomes the method of choice from then onwards. The taxpayer can not go back later and use the other method because it now gives a better outcome.

Case Numbers 6 - 11.

These cases are dealing with individual client share transactions. The examples all show the difference between the two methods and the out come in these cases is always in favour of the Market Value Method.

The following table provides a summary of the results.

Name of Individual	Time Apportionment Formula	Market Value Method
Mark Canning	77 363.43	29 940.98
Norman Thomson	105 385.95	41 569.27
Richard Butt	41 719.18	13 842.29
Cherrie Lowe	3 639.09	1 207.44
Kevin Stanford	33 138.72	14 595.34
Richard Inskip	56 350.56	19 452.96

In order to give more clarity on the difference between using the Time Apportionment Formula against the Market Value Method the exercise was done using Norman Thomson's case. It was assumed he had owned all the shares for eight years. The Time Apportionment Formula would then give you an answer of R 27 841.15 against the figure of R 41 569.27.

The only reason for the change in the answer is the amount of time he would have owned the assets.

Summary of Cases 6 - 11.

The Market Value Method provides a better result for the above individuals mainly due to the relatively short duration the shares were held by the individuals before being sold off. The Time

Apportionment Formula comes into play once the asset or assets have been owned for a number of years. In the majority of these cases the time period is only one year. The Market Value Method takes into account Paragraph 29(1)(a)(i) that provides for the valuation date prices to be printed by way of a notice in the *Gazette*.

One other important aspect that these cases high light is the reference to “ a person wishing to use the market value basis for determining the base cost of an asset must in terms of paragraph 29(4), have the asset valued within two years after valuation date, in other words, by no later than 30 September 2003”.

If the valuation exercise is not done before the cut off date the taxpayer could end up paying a far higher tax on those assets than is necessary.

Conclusion

The object of this paper was to try and answer the questions of :-

- (i) whether to elect the actual value of an asset at 1 October for **base cost** purposes or to accept the 'default' time apportionment method?
- (ii) should asset owners' delay doing a valuation exercise on the assets they presently own or proceed with a valuation exercise now?

The answer to the first question of which method to use can only really be answered after answering the second question.

The answer to the second question is undoubtedly the option to proceed with a valuation exercise now. The result of not doing this exercise can and most properly will end up having severe financial implications for the taxpayers concerned.

The reason for saying that it could have severe financial implications for the taxpayer is that the option of using the Market Value Method has an expiry date. Thus if the taxpayer does not do the valuation exercise and finds out later that the Market Value Method would have giving a better result, it is too late.

The answer to question one really needs to be answered in two parts. One, how long has the asset been owned by the business or individual? Secondly, has the valuation exercise been undertaken? The longer the time span the asset has been owned the more likely the Time Apportionment Formula will produce the better result. Case Number 2 high lights this point very clearly. The time scale is twelve years, thus the Time Apportionment Formula gives a far better result for the taxpayer.

The examples in Cases Six – Eleven show why it is necessary to do the valuation exercise as the time limit on using the Market Value Method is running out.

CHAPTER 6 : Recommendations

Taking the above into consideration it is recommended that :-

- (i) a valuation exercise be undertaken on all capital assets owned by businesses or individuals without delay.
- (ii) this will help determine which base cost calculation method will be in the best interest of the taxpayer.

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