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MoneyTalk

CGT: Last chance to Value Assets

THE DEADLINE for valuing your assets for capital gains tax (CGT) purposes is almost upon us: 30 September 2004. Since this deadline has already been extended by a year, a further extension is unlikely, so if you haven't taken action yet, the following advice from Justin Liebenberg, senior tax manager at Grant Thornton, will be just what you need.

In a recent issue of e-Taxline, Liebenberg discussed the significance of obtaining a market value and detailed how this aligns to the taxpayer's overall CGT planning efforts.

CGT REVISED

Capital gain or loss

Liebenberg explains that CGT arises when an asset is disposed of, for example by a sale, and the tax is imposed on the capital gain realised on the disposal. A capital gain or loss is determined by deducting the base cost of the asset from the proceeds received at disposal.

If the proceeds exceed the base cost, a capital gain is realised and if the base cost exceeds the proceeds, a capital loss is incurred.

The base cost is therefore important in calculating CGT. How the base cost is determined depends on whether the asset was acquired prior to 1 October 2001 or after that date (which is the date from which CGT became effective), explains Liebenberg.

CGT on assets acquired after 1 October 2001

The calculation of CGT on assets acquired after 1 October 2001 is a relatively simple one. The base cost of these assets consists of the original purchase price plus any additional expenditure incurred in respect of the assets.

CGT on these assets can be minimised by ensuring that all costs that are eligible for inclusion are included and that adequate proof of these costs is kept, says Liebenberg. The market value at 1 October 2001 is obviously irrelevant to these assets since they were not owned at that date.

CGT on assets acquired prior to 1 October 2001

The calculation of CGT on these assets is more complicated. Theoretically, only the capital growth that took place in these assets after 1 October 2001 should be taxed. To achieve this, the base cost of these assets is not the original cost of the asset but rather the value of the asset at 1 October 2001.

The value of the asset at 1 October 2001 could potentially be one of three values, says Liebenberg.

It could be the market value of the asset, the time apportionment base cost or 20 per cent of proceeds (i.e. 20 per cent of what the taxpayer receives when he/she disposes of his/her asset).

Below, Liebenberg goes on to explain the first two methods of calculating base cost, and advises how to select the most favourable method.

Time apportionment base cost

The time-apportionment method can only be used if the taxpayer can prove all the actual expenditure incurred in respect of the asset and the period that he has held the asset. The calculation can only be done when the disposal takes place.

The basic time apportionment formula is as follows:

$$\text{Original expenditure} + \text{Gain/loss} \times \left\{\frac{\text{Period held before valuation date}}{\text{Total period held}}\right\}$$

This is a relatively easy way of determining the 1 October 2001 value.

Market value

The market value is defined as: "The price, which could have been obtained upon the sale of an asset between a willing buyer and a willing seller dealing at arm's length in an open market".

The onus of proving the capital gain or loss (and therefore the market value) on the disposal of an asset is always on the taxpayer. Depending on the nature of the asset, it may be necessary for the taxpayer to use an expert to perform the valuation if he is not qualified to do so himself.

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It is important that adequate documentation is kept relating to the valuation of the asset so that there is sufficient evidence to prove the valuation. If the SARS is not satisfied with the proof of valuation, it is empowered to request any further information or documents relating to the valuation.

If SARS is still not satisfied with the amount at which an asset is valued, it may adjust the market value. The taxpayer can only use the market value if the valuation is completed before 30 September 2004.

The general rule is that proof of the valuation of an asset must be submitted with the tax return in respect of the year in which the asset is disposed. Special rules do apply, however, in respect of any asset falling within any of the following categories:

*A market value exceeding R10million;
*An intangible asset with a market value exceeding R1 million; or
*An unlisted share and the market value of all the shares exceeds R10 million.

In the case of these assets, proof of valuation has to be submitted with the first tax return submitted after 1 October 2004.

Selecting the most appropriate value

Taxpayers should obviously strive to use the method that provides the highest value at 1 October 2001. In some circumstances the taxpayer has a choice and in others, the method is prescribed.

There is a relatively complex set of rules that determines when a choice can be made and when the method is prescribed by the Income Tax Act (beyond the scope of this article). As a rule of thumb though, if the proceeds exceed the original cost of the asset the taxpayer has a choice between the three methods.

Remember that although you may choose to submit your valuation with the first tax return for 30 September 2004, you are still entitled to select the most advantageous valuation method when the asset is disposed of.

PRACTICAL STEPS TO PLAN FOR CGT

Liebenberg says taxpayers should already have given thought to the following actions that should be taken to plan for CGT:

Asset identification

Taxpayers should identify all the assets that they own, including intangible assets such as goodwill that may have been overlooked.

Identify capital assets

Assets may be classified in two broad categories: capital assets and 'revenue assets'. Revenue assets, such as trading stock, give rise to normal income tax when they are disposed of. Capital assets give rise to CGT when disposed of. Once all assets are identified, the capital assets amongst these should be identified.

Maximise the base cost of capital assets

Maximising base cost minimises CGT. The base cost of assets acquired after 1 October 2001 is maximised by identifying all costs that can be included in their base cost and ensuring that adequate records are kept of these.

The base cost of assets acquired after 1 October 2001 is maximised by ensuring that, if there is a choice, the method giving rise to the highest value is adopted. This may entail the determination of the market value of certain assets.

Value the assets before 30 September 2004

Those assets that have been identified as requiring a market value at 1 October 2001, should be valued before the deadline.

Submit the valuations

On completion of the valuations, taxpayers should ensure that they are submitted on time.

CONCLUSION

Liebenberg says compliance with the CGT legislation is a potential minefield and he advises taxpayers to seek professional advice on how to most effectively comply with the legislation while at the same time minimising any potential CGT exposure.

This article was extracted from Tax Breaks.

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