CAPITAL GAINS TAX (2):

*This **draft legislation** is released for public information. The amendments contained in this draft are merely proposals which are **subject to change and final approval by the Minister of Finance**. Early comments on this draft will be considered for possible inclusion in a revised draft Bill.*

It is the intention to release the revised draft Bill in the first seven days of October, prior to the commencement of the informal Parliamentary process.

There will be an opportunity to comment on the revised draft Bill, either directly to the National Treasury and SARS or during the public hearings in the Parliamentary Committees in mid-October 2003.

Due to time constraints, it will not be possible to respond individually to comments received. However, receipt of comments will be acknowledged and fully considered by the National Treasury and SARS.

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Amendment of paragraph 74 of the Eighth Schedule to Act 58 of 1962

. Paragraph 74 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the insertion after the definition of "company" of the following definition:
"'date of distribution' in relation to any distribution, means the date of approval of the distribution by the directors or by some other person or body of persons with comparable authority conferred under the memorandum and articles of association of the company making the distribution or under a law, regulation or rule to which that company is subject".

Income Tax: Amendment of paragraph 74 of Eighth Schedule to the Income Tax Act, 1962

See the notes under Clause XX which deals with paragraph 75.

Amendment of paragraph 75 of the Eighth Schedule to Act 58 of 1962

. Paragraph 75 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution for subparagraphs (1) and (2) of the following subparagraphs:

(1) Where a company makes a distribution of an asset *in specie* to a shareholder <u>(including an interim dividend)</u>, that company must be treated as having disposed of that asset to that shareholder for proceeds equal to market value.

(2) The market value of any asset contemplated in subparagraph (1) must be its market value on the date <u>of</u> **[the]** distribution **[is approved by the directors or by some other person with comparable authority conferred under the memorandum and articles of association of the company making the distribution]** <u>except where the distribution contemplated in subparagraph (1) is made—</u>

(a) <u>by a company subject to the condition that it be payable to shareholders registered in that company's share register on a specified date, in which case it must be the market value on that date;</u>

(b) <u>by a company to shareholders of that company otherwise than by way of a formal declaration of a dividend, in which case it must be the market value on the date on which the shareholders became entitled to that distribution; or</u>

(c) <u>by the liquidator of a company to the shareholders of that company in the course of the winding up or liquidation of that company, in which case it must be the market value on the date on which the shareholders became entitled to that distribution.</u>

Income Tax: Amendment of paragraph 75 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 75 provides that distribution of an asset by a company to a shareholder must be treated as having been made for proceeds equal to the market value of the asset. The market value must be determined on the date the distribution is approved by the directors or by some other person with comparable authority conferred by the memorandum and articles of association of the company.

In the case of listed company distributions by these companies must be approved by shareholders in terms of the rules of the JSE Securities Exchange. The paragraph does not cater for this as the authority for the approval comes from the JSE rules and not the memorandum and articles of association. Even if the approval by the shareholders was sanctioned then the question still arises on what date the market value should be determined as in these transactions there are a number of possible dates. For example, should it be the date of the shareholder meeting, the date on which the shareholder must be registered to participate in the distribution or the date the asset is distributed? Similarly the authority of liquidators is not covered by this provision as the authority for the distribution comes from a law nor is a distribution which is not a formal dividend covered. The question also arises as to when an interim dividend accrue – when it is paid or when approved at the end of the year shareholder meeting. Similar questions arose in regard to the dates of declaration of dividends for the purposes of secondary tax on companies and section 64B(4) of the Income Tax Act was introduced to prescribe specific rules.

It is proposed that rules similar to those in section 64B(4) be introduced in paragraphs 74 and 75 to clarify the position.

Amendment of paragraph 78 of the Eighth Schedule to Act 58 of 1962

. (1) Paragraph 78 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in subparagraph (2) for item *(b)* of the following item:

"*(b)* those newly issued shares must be treated as—

(i) having **[an aggregate base cost]** been acquired for an amount of expenditure equal to the aggregate **[base cost]** expenditure allowable in terms of paragraph 20 incurred in respect of **[the]** those previously held shares which expenditure must be treated as having been incurred on the same date as the expenditure incurred in respect of those previously held shares **[with the aggregate base cost allocated among all those newly issued shares in proportion to their relative market values; and]**;

(ii) having been acquired on the same date as those previously held shares; and

(iii) having a market value equal to any market value adopted or determined in respect of those previously held shares in terms of paragraph 29(4),

with the aggregate expenditure or market value as the case may be allocated among all those newly issued shares in proportion to their relative market values.".

(b) by the substitution in subparagraph (3) for item (b) of the following item:

" *(b)* both the substitution and that capital distribution must be treated as separate transactions with the **[base cost]** expenditure allowable in terms of paragraph 20 and any market value adopted or determined in terms of paragraph 29(4) in respect of those previously held shares allocated between both transactions based on the relative market values of the newly issued shares and that capital distribution received in exchange therefor.”.

(2) Subsection (1) shall be deemed to come into operation on 1 October 2001.

Income Tax: Amendment of paragraph 78 of the Eighth Schedule to the Income Tax, 1962

Paragraph 78 deals with the shareholder level consequences of the issue of shares by a company.

Subclause (a): Paragraph 78(2) provides a tax-free roll over for CGT purposes where new shares are substituted for previously held shares by reason of a subdivision, consolidation or similar arrangement. The ‘base cost’ of the previously held shares is allocated to the new shares with reference to the market value of the new shares.

It is proposed that the reference to the base cost of the previously held shares be replaced by references to—

- the expenditure incurred in terms of paragraph 20;
- the dates on which the expenditure was incurred; and
- any market value adopted or determined in terms of paragraph 29(4),

in respect of the previously held shares.

The intention always was that the expenditure, date of incurral thereof and market value on valuation date in respect of the previously held shares be carried over to the new shares. Under the previous wording it was unclear how the time-apportionment base cost (TAB) method was to be applied to the new shares. Under TAB the base cost is only determined when the new shares are disposed of and the proceeds are known. For TAB purposes it therefore made no sense to refer to base cost at the time of the substitution. It was always the intention that paragraph 78(2) be applied in this manner, and this amendment now merely gives effect to this intention. Furthermore, the amendment provides clarity as to what constitutes expenditure before the valuation date in respect of the new shares for the purpose of applying the kink tests in paragraphs 26 and 27.

Subclause (b): Paragraph 78(3) deals with the situation where cash or assets *in specie* plus shares are given to a shareholder in substitution of previously held shares. A capital gain or loss is determined in respect of the non-share portion of the substitution.

For the same reasons explained in subclause *(a)* it is proposed that the reference in paragraph 78(3) to ‘base cost’ be replaced with a reference to the expenditure incurred and the market value adopted or determined in terms of paragraph 29(4).

It is proposed that the amendment be deemed to come into operation on 1 October 2001