

Capital Gains Tax: Relief on the Disposal of Small Business Assets

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Capital gains tax was introduced in 2001. South African tax residents are liable for capital gains tax on disposal of their worldwide assets. Non-residents are liable for capital gains tax on disposal of their immovable assets situated in South Africa or any assets effectively connected to their permanent establishment in South Africa.

Capital gains tax is generally triggered on the disposal or deemed disposal of assets. The Eighth Schedule of the Income Tax Act No. 58 of 1962 (“the Eighth Schedule”), however provides for several exclusions to this general rule. One such exclusion relates to the disposal of small business assets or an interest in a small business up to an amount of R1.8 million. There are several requirements that must be met before the exclusion applies.

Para 57(2) of the Eighth Schedule provides that a natural person must disregard any capital gain determined in respect of the disposal of a:

- a) An active business asset of a small business owned by that natural person as a sole proprietor; or
- b) An interest in each of the active business assets of a business, which qualifies as a small business, owned by a partnership, upon that natural person’s withdrawal from that partnership to the extent of his or her interest in that partnership; or
- c) An entire direct interest (shareholding) in a company (which consists of at least 10 per cent of the equity of that company), to the extent that the interest

relates to active business assets of the business, which qualifies as a small business of the company.

The following requirements must all be met for the above relief to be available:

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

Of note is that this relief is only available to natural persons. The definitions of 'a small business' and 'active business asset' are also important. A small business means a business of which the market value of all its assets at the date of disposal do not exceed R10 million. In practice, it is very common that one person can operate more than one small business. So, what then happens where a person operates more than one small business? Is the limit of R10 million in the value of small business assets available to each separate small business? The answer is no. In as much as a person who operates more than one business may include every such business in the calculation of the exclusion, where the total market value of all assets of those small businesses exceeds R10 million, the exclusion will not be available. In simple terms, the assets of the combined businesses may not exceed R10million otherwise the business is not a small business.

An active business asset is an immovable property to the extent that it is used for business purposes. It is also any other asset which is not immovable property used or held wholly and exclusively for business purposes. Important to note is that the immovable property can be used for other purposes however the relief will only be applicable to the extent that the immovable property was used for business purposes. The capital gain should be apportioned between business use and non-business use and the portion allocated to non-business use will not be exempt. However, for all other assets (i.e., not immovable property), the assets must have been used wholly and exclusively for business purposes. If the assets were used partially for business the -relief will not be available.

This capital gains tax exclusion is limited to R1.8 million during the natural person's lifetime. Thus, any excess capital gain above R1.8million will be taxed in the normal manner. Natural person taxpayers should be mindful of this provision should they dispose of any small business assets to ensure they get the relief offered to them.

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Should you have any queries on this matter, please feel free to contact your PKF relationship partner or firm.

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