

Tax Alert

2 June 2011

Automatic CGT charge for some shareholders on 1 July 2011

As July approaches, shareholders are reminded that capital distributions received before October 2007 could trigger a tax charge on 1 July 2011.

The relevant provisions are contained in para 76A of the 8th Schedule of the SA Income Tax Act. Specifically, where:

- a shareholder received a “*capital distribution*” before 1 October 2007; and
- the shares, in respect of which the capital distribution had been received, are still held by the shareholder on 1 July 2011;

para 76A triggers an automatic tax event on 1 July 2011.

Perhaps the most common example of a “*capital distribution*” would have been where a company made a return-of-Share-Premium payment to its shareholders.

The nature of the tax event on 1 July 2011 depends on the shareholder’s method of determining its base cost of the shares.

Where the shareholder uses the so-called “weighted average” method, the tax event only arises if the shareholder has a “negative base cost” in the share. This is understood to refer to a situation where the amount of the capital distribution(s) received by the



shareholder exceeds that shareholder’s original base cost of the corresponding share(s). In this case, the excess (or “negative base cost”) will be deemed to be an immediate capital gain on 1 July 2011. (The “weighted average” base cost method is typically applicable only to listed shares, and is also subject to certain other conditions.)

If the shareholder uses any other base cost method, the likelihood of a tax event on 1 July 2011 is more certain. In this case, the 1st of July will trigger an automatic deemed

part-disposal of the shares. (That is, a portion of each share will be deemed to be disposed of on 1 July 2011.) The deemed disposal proceeds will be the amount of the capital distribution(s) received before 1 October 2007 in respect of those shares. The deemed base cost will be a portion of the total original base cost, and determined with reference to the relationship between the amount of the proceeds (i.e. the original capital distribution) and the market value of the shares on 30 June 2011. The

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determination may be more complex if the shares in question were acquired before the introduction of CGT in October 2001.

Affected shareholders are thus advised to review and confirm their records in respect of affected shares. This will include information like:

- the total amount of capital distribution(s) received before October 2007;
- which of the shares held on 1 July 2011 relate to the capital distribution(s) received;
- the base cost of these shares; and
- the market value on 30 June 2011 of these shares.

Note that separate deemed disposal rules apply in respect of capital distributions received from 1 October 2007 onward —not discussed in this Alert.

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