

CANCELLATION, TERMINATION OR VARIATION OF DISPOSALS SUBJECT TO CAPITAL GAINS TAX

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When two people transact, they normally negotiate the terms in good faith, but things happen to transactions and the seller may agree to repay part of the purchase price to the purchaser.

The purchase price may even be reduced because of a cancellation, termination or variation of an agreement.

It may also happen that the purchase price be reduced due to prescription, a waiver of a claim, a release from an obligation or any other event.

Where the original transaction was the sale of an asset, it may be subject to capital gains tax (CGT). The seller may have to account for a capital gain on the sale (if the purchase price exceeds the cost) or for a capital loss (if the cost exceeds the purchase price).

CGT language refers to the purchase price as the '*proceeds*', which in general is the amount received by or accrued to a person in respect of the disposal of an asset. The cost is the '*base cost*' and in general the expenditure actually incurred in respect of the cost of acquisition.

Where however the '*proceeds*' are reduced because:

- any amount of the proceeds has been repaid or has become repayable to the person to whom that asset was disposed, or
- any reduction, as the result of the cancellation, termination or variation of an agreement or due to the prescription or waiver of a claim or release from an obligation or any other event, of an accrued amount forming part of the proceeds of that disposal,

the proceeds '*must be reduced*'.

There is no time limit linked as a repayment or a reduction, for the proceeds to be reduced, but it may be very difficult for a person to exercise this relief after a period of time.

When a repayment occurs or a reduction arises of the proceeds taken into account for CGT purposes, the person should seek a reduced assessment of the year in which the asset was so disposed of.

If a repayment occurs or a reduction arises within three years after the assessment of the year in which the CGT was accounted for, the person should object to that year's assessment and SARS should issue a reduced assessment to give effect to the reduction of the proceeds.

If three years have elapsed the person cannot object to the relevant assessment anymore and SARS can also not issue a reduced assessment.

This is a dilemma, because although the proceeds must be reduced, legislatively after a period of three years SARS would aver that they are barred from giving effect thereto.

SARS seems to be of the view that the peremptory obligation that the proceeds must be reduced, i.e. in the year of disposal, is either not applicable if the repayment or reduction is not in the same year as the disposal or three years thereafter (within the three-year cut off), and thereafter the person must claim a capital loss which can be set off against future capital gains.

A capital loss can either relate to the current year or to a previous year.

The current year's capital loss is simply when the base cost exceeds the proceeds.

A previous year's capital loss, for purposes of this article, is equal to the proceeds received or accrued in respect of the disposal of that asset that have been taken into account during any year in determining the capital gain or capital loss in respect of that disposal:

- as that person is no longer entitled to as a result of the cancellation, termination or variation of any agreement, or due to the prescription or waiver of a claim or a release from an obligation or any other event during the current year of assessment;
- as has become irrecoverable during the current year of assessment; or
- as has been repaid or has become repayable during the current year of assessment.

At first glance it seems that the relief via capital loss may be logical and fair, because if the person is not getting relief in the specific year of disposal, a loss will be created in a following year, available to be set-off against future capital gains.

There are a number of problems with this false logic and fairness.

CGT is a transaction tax and based on transactions which is generally speaking not frequently arising, otherwise such transactions may be revenue and subject to income tax. It may be that where a loss is created that it is unlikely that it is something that can be used in the future, as the person may not have a capital gain to set it off against.

Capital losses are not permitted to be offset against taxable income.

National Treasury is aware of this illusion, and in National Treasury's Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015, it at least admits that this situation needs to be clarified and suggest certain amendments to achieve the clarification.

Unfortunately, National Treasury is not coming to the taxpayer's rescue. The suggested amendments in the Taxation Laws Amendment Bill, 2015, on the face of it seems to achieve the result that only a current year's repayments and cancellations must reduce the proceeds and future years' repayments and cancellations will create a tax loss.

The problem with the suggested amendments is that it is creating further uncertainties and anomalies. One of the problems is that current year's cancellations refer to a '*prescription*' that only arises after say three years.

The commencement of the amendment is also unclear, especially whether it would apply to disposals prior to the promulgation of the Bill.

A number of other amendments could have achieved the same result, which submittedly would have been fairer.

The advice is that when drafting agreements for the disposal of assets, which would be subject to CGT, that the parties should explore the use of suspensive conditions, because the time of disposal of an asset subject to a suspensive condition (as opposed to a resolute condition) is the date on which the condition is satisfied.

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