PRIVATECLIENT FINANCIAL

How To Get a R1.8m CGT Exclusion When Selling Your Small Business.

"The tax on capital gains directly affects investment decisions, the mobility and flow of risk capital... the ease or difficulty experienced by new ventures in obtaining capital, and thereby the strength and potential for growth in the economy" (John F. Kennedy)

Since October 2001 South African tax residents have been liable for capital gains tax (CGT) on the disposal or "deemed disposal" of assets, such as a business or a property. Events that trigger a disposal include a sale, donation, exchange, loss, death, and emigration. For individuals, the CGT rate is a stiff 18%. No separate registration for CGT is required. Since CGT forms part of the income tax system, a person must simply declare capital gains and capital losses in the annual income tax return. All capital gains and capital losses made on the disposal of assets are subject to CGT unless excluded by specific provisions.

One of the lesser known of these exclusions offers CGT relief, for individuals older than 55 years, up to R1.8 million on the disposal of a small business with a market value not exceeding R10 million; or active business assets of a small business; or an interest in a small business.

Start planning for your retirement with this exclusion.

The exclusion is ideal for those thinking of selling their small business to retire. Whilst, as we see below, you have to be over 55, or disposing because of retirement, infirmity, ill-health or death to actually take advantage of it, it makes sense for a business owner of any age to start planning upfront to meet the various requirements.

Of course, pages of conditions apply, and these are described briefly below to help you determine if this exception is applicable to you already, or how it can be applied to your future planning should you dispose of your small business; your shares in it; or the qualifying assets.

Do you qualify? Take the quiz!

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If you answer yes to all these questions, you may qualify for the R1.8 million CGT exclusion.

1. **Do you, as an individual, own a small business or a share in a small business?** A small business is defined as one in which the market value of all the assets is less than R10 million. The business liabilities are not included in the calculation. The individual may be a sole proprietor; run the business in a partnership; or hold a direct interest relating to 'active business assets' and have a shareholding of at least 10% in the company.
2. **Are you older than 55? Or is the disposal in consequence of ill-health, other infirmity, superannuation, or death**?
3. **Will the gain (profit) from selling the assets or business accrue to you personally?**
4. **Have you held the business or interest in the business for a continuous period of at least five years?**
5. **Have you been substantially involved in the running of the business during the above-mentioned five-year period?** If, for example, you employ a full-time manager to run the business, the exclusion will not apply.
6. **Is the market value of all assets of the small business (as well as other businesses owned) less than R10 million at the date of disposal?** The market value of all assets - whether 'active business assets' or not - must be included. If you are a sole proprietor of a business, who also owns a rental property, both these assets must be included. If you own more than one small business, the combined assets of all your businesses must be less than R10 million. If the business is a partnership, and the business assets of the partnership has a combined market value of more than R10 million, none of the partners qualify for the special CGT exclusion.
7. **Is each asset eligible for the capital gains exclusion?** Eligibility is determined on an asset-by-asset basis because the exclusion only relates to "active business assets". These include moveable assets such as furniture and equipment used **exclusively** for business purposes. For immoveable assets like a building, where part is used for personal purposes, the capital gain must be apportioned between business use (exempt) and non-business use (not exempt). Assets generating passive income (investment income, rental, royalties)

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and financial instruments (bank deposits, loans, options, shares, unit trusts and more) are also not exempt.

8. **Will the capital gain be realised within two years from the date of the first disposal?** If you sell the business in stages, you only qualify for the exclusion when the full capital gain is realised at the completion of the sale, and that must be within two years.
9. **Have you already made use of the exclusion?** This CGT exclusion is cumulative and limited to R1.8 million during the natural person's lifetime. If you sell your business this year and claim R800,000 as a capital gains exclusion, you could possibly have R1 million to deduct in the future against the capital gain of another business. Any capital gain above R1.8 million is taxed as per usual.

Best advice!

CGT is a very complex area and there are many issues to be considered.

However, not taking advantage of this exclusion if it applies to you could make a substantial difference to your future plans.

For example, let's say you bought shares in a company 7 years ago for R2 million, and have since been actively involved in running the business. You decide to sell your share for R4 million, triggering a capital gain of R2 million. Taxed at your marginal rate of 18%, the CGT due would amount to R360,000 (R2 million x 18%). Applying the R1.8-million exclusion, only the remaining R200,000 is taxed at 18%, reducing the CGT due to R36,000.

Take professional advice to ensure that you qualify for the maximum benefits while ticking all the compliance boxes.

Contact Jeremy Burman (jeremy@privateclient.co.za) and the Private Client Tax team to seek further advice and have your questions answered.

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