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Opportunity knocks!

John F Kennedy said that when written in Chinese, the word "crisis" is composed of two characters. One represents danger and the other represents opportunity. Perhaps this would be a lesson well adhered to in our current environment as even in a recessionary climate, opportunity still exists. Retirement Annuities represent one such prospect.

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Because of changes in tax legislation retirement annuity funds have become one of the best investment options.

The exemptions on interest earnings, capital gains tax and retirement fund contributions, and the new dividends withholding tax changes have given retirement savings a significant edge over other savings vehicles.

Any money you invest in tax-incentivised savings or discretionary savings (especially those assets that pay interest or dividends), where you use money on which you have already paid tax needs to be reconsidered.

Tax Incentivised Savings:

Retirement savings

It is clear from the Budget proposals that a tax-incentivised retirement fund will continue to offer one of the best places to save money for the long term. This can be an employee benefits fund sponsored by your employer and/or a retirement annuity fund provided by the financial services sector.

A good deal has just become a great deal. The simple reason is tax savings. These savings are:

- No capital gains tax (CGT) while you are building up your savings or on withdrawal. (From March 1, the top effective rate of CGT for individuals will be 13.3 percent.)
- No dividends tax while you are building up your savings or on withdrawal. (Dividends tax of 15 percent will be levied on dividends received from March 1.)
- From March 1, 2014, you will be allowed to deduct as a percentage of your taxable income 22.5 percent (if you are below the age of 45) or 27.5 percent (if you are 45 or older) of the higher of your employment income or your taxable income. The deduction will include your and your employer's contributions, plus fund administration costs and the premiums for group life assurance cover. Granted, there are caps on the annual rand amounts that can be claimed as a deduction, but the levels are high, hitting only very high-income earners.
- You can take a lump sum of R315 000 tax-free when you start to draw a pension. You can withdraw more than R315 000 at preferential tax rates, starting at 18 percent for the next R315 000 and 36 percent for amounts over R945 000.
- Deferred tax. When a pension is drawn, it is taxed at your then marginal rate of income tax, on both the portion that comes from your accumulated savings and from any investment growth. Until you withdraw money as a pension, you are in fact earning returns on money that would otherwise have been subject to tax.
- On death, estate duty may be avoided (20 percent after an exemption of R3.5 million), because your beneficiaries can receive the money as an income stream, which will be taxed at their marginal rate of tax when they receive the payments (with the CGT and dividends tax exemptions).

Discretionary Savings and Investments

If you have investments outside of a tax-incentivised retirement fund, you need to take account of how the Budget proposals will affect interest-earning investments (such as bank deposits, money market accounts and RSA Retail Bonds), dividend-earning investments and assets that will attract capital gains tax (CGT).

Interest-earning investments

The Minister of Finance has given notice that from the 2013/14 tax year the tax exemptions on interest earnings will be terminated and replaced by new savings vehicles that will allow you to save

capped amounts every year, which you will be able to deduct from your taxable income.

For the first time in years, the exemptions on local interest and foreign dividends were left unchanged in this year's budget. The first R22 800 in local interest is tax-free if you are under the age of 65 (R33 000 if you are 65 or older). Over and above these limits, interest earnings are taxed at your marginal rate of tax. So if you are on a marginal rate of 40 percent, you will, from March 1, 2014, pay tax of 40 cents of every R1 earned in interest.

Depending on your marginal rate of tax, this will mean that in most cases, after taking inflation into account, interest-earning investments will be a poor investment.

Dividend-earning investments

Dividends tax will replace secondary tax on companies, which in effect was a tax paid on dividends by the company itself. This meant that shareholders paid the tax.

Dividends tax has been set at 15 percent. This is a higher rate and is primarily because retirement savings have been exempted from dividends tax, so the government has to make up the shortfall.

However, the rate is still substantially lower than the rate payable on an interest-earning investment, and the returns over the longer term will also in all likelihood be better.

Capital gains tax

CGT closes the gap between the rich and the poor and is based on the same principle as income tax: you pay more on the rands you earn above what someone on a low income would pay.

With the current maximum effective rate of 10 percent, CGT contributes about R2 billion (less than one percent) of what individuals pay in income tax.

However, CGT is flawed, as it is to some degree, a tax on inflation, not only on your capital gain. A percentage of the perceived improvement in the value of an asset that is subject to CGT will be as a result of inflationary increases!

For example: you have an asset valued at 1 million Rand that grows in value by 10 percent (R100 000) over a year, but the inflation rate is six percent, so your real return has been only R40 000.

If the entire R100 000 were subject to CGT at the current top effective rate of 10 percent, you would pay R10 000 in tax, and not R4000, which would be the case if inflation were excluded. In other words, you become liable for tax on money you have not actually received. However, this tax on inflation has been partially offset by allowing various exemptions on CGT. For example, the exemption on the gain made when you dispose of your primary residence has been increased from R1.5 million to R2 million for the 2012/13 tax year, and the annual exemption has been increased from R20 000 to R30 000.

With the top effective rate of CGT increasing from 10 percent to 13.3 percent – and possible increases in the future – you now need to be a lot more discerning in your choices, particularly because the tax exemptions on interest earnings are to be closed off and other investments become a better option.



Death is a CGT event. In simple terms, when you pass away, all your assets are valued and CGT is levied on the difference between what you paid for an asset and its value at the time of death. The first R300 000 (in the 2012/13 tax year) in capital gains is exempt from CGT, but you will pay 13.3 percent on the balance.

Therefore, maximizing what your beneficiaries will receive on your death will require that you take advantage of the annual exemption and this will mean selling and repurchasing investments.

But to do this, you will have consider two main issues and take into account:

1. **Liquidity** (the ability to sell the asset). You need to have assets that you can sell and buy quickly so that time delays do not change their value. The most liquid assets would be listed shares and collective investments, such as unit trust funds and exchange traded funds (ETFs).
2. **Good record-keeping**. CGT is based on first bought, first sold, so you need to know when you bought, say, a share and at what price so you can match the gain to the CGT exemption.

In the end, however, it is never wise to make an investment decision based entirely on tax considerations alone. You also need to consider factors such as liquidity, costs, risk, returns and diversification along with tax.

Danger + Opportunity = Crisis?
The Chinese term controversy

Do "danger" plus "opportunity" equal "crisis" in Chinese?

Is the Chinese symbol *crisis* made up of "danger" and "opportunity" as is often quoted?

First of all, the Chinese symbol *crisis* is not one symbol but two.

The symbols for *crisis* in Chinese are made up of these two words:

They are pronounced *wei1 ji1*.

wei means "danger; peril".

And *ji* means "opportunity; crucial point"

So literally *wei* plus *ji* equals "danger" plus "opportunity".

However in reality, a crisis is still a dangerous state of affairs - regardless of the language.

Crisis *wei ji* still means "a situation that has reached an extremely difficult or dangerous point".

However, a dangerous situation can become an opportunity if *wei ji* becomes *zhuan3 ji1*.

Zhuan ji means "turn for the better". *Zhuan* means "turn into". So *zhuan ji* means "turn into opportunity".

In this sense, the Chinese symbol *crisis* can mean "opportunity" in a time of "danger".

wei ji is commonly used as in *wei1 ji1 gan3* meaning "sense of crisis" and *wei1 ji1 si4 fu2* meaning "beset with danger; danger lurking in every direction".



Selling a home can be a challenging experience: preparing for show days, dealing with estate agents, considering offers to purchase, trying to make sense of legal contracts. And after the home is sold there remains one possible further task: working out whether the taxman will take a slice of the profit ….

Many homeowners believe that the sale of a personal residence simply doesn't attract Capital Gains Tax ("CGT"). While this is often the case, it is not necessarily so. This article looks at how and when CGT applies to the sale of a personal residence.

CGT: latest changes

Finance Minister Pravin Gordhan recently announced some fairly major changes to the CGT regime which impact on the tax consequences for a taxpayer selling his or her home and these changes took effect from 1 March 2012.

The Ins and Outs of CGT

It is the disposal of an asset that triggers the application of CGT. The definition of "disposal" is far reaching. The sale of an asset is an obvious disposal, but the donation or destruction of an asset is also defined as a disposal. And if a taxpayer dies or emigrates they are deemed to have disposed of all their assets!

The gain (or loss) that a taxpayer makes on the disposal of an asset is calculated by deducting the "base cost" of acquiring the asset from the net proceeds of the disposal. The net proceeds are the proceeds of the disposal left after payment of disposal costs, such as estate agent's fees in the case of the sale of a property. If the taxpayer receives no proceeds (for example on the donation of an asset to his or her child) then the proceeds are deemed to be equal to the market value of the property at the time. Thus one can't avoid CGT by simply donating assets to children: in fact this can be an expensive option as donations tax is also likely to apply.

The base cost of a disposed asset is generally the outlay or expenditure actually incurred in acquiring the asset (the price payable in the case of the purchase of a house), the cost of improving the asset (eg home extensions or building a swimming pool) and any expenditure directly related to its acquisition (for example transfer duty and conveyancing costs incurred on purchasing a property). It is important to note that interest paid on a mortgage bond is not considered part of the acquisition cost of a home. Generally the method of funding the acquisition (bond and/or cash) is irrelevant to the determination of a future CGT liability upon sale. If the disposed asset was acquired before the introduction of CGT on 1 October 2001, then only the portion of the gain attributable to the period after this date is taxed. Put another way, the gain attributable to the pre-CGT era is excluded from taxation. There are a number of options available to a taxpayer in calculating the base cost of assets acquired before 1 October 2001 and specific advice should be sought in this regard.

Once the gain or loss on the disposal of each asset has been established, the sum of all such gains (less any capital losses) are tallied, and from this total amount, an exemption of a not-so-whopping R16,000 is allowed each tax year (and only for natural persons i.e. individual taxpayers not companies or trusts).

An increased cut

A portion of a taxpayer's total capital gains in excess of the annual exemption is added to his or her normal taxable income for the particular tax year.

With effect from 1 March 2012, increases in the taxable portions of gains were announced. In the case of "natural" persons, 33.3% of the total net capital gains for the year is added to the taxpayers his or her income (previously 25%) and in the case of companies and trusts, 66.6% (previously

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Home truths

transfer concession deadline draws nearer

Many taxpayers hold their homes through the means of family trusts, companies or close corporations. This could be for a range of reasons including protection from creditors, and long-term estate planning advantages.

However, the introduction of Capital Gains Tax in 2001 resulted in a tax disadvantage for taxpayers holding homes in such entities. This is because the tax-free amount deductible from any gain made when a primary residence is sold (currently R2 million) does not apply when the property sold is held in a trust or company.

If a taxpayer holding his or her home in a trust or company wishes to get out of that structure by transferring the property into his or her own name, the tax cost of doing so would normally be prohibitive: transfer duty, capital gains tax and in the case of companies, STC/dividends tax would be payable. With a view to ridding the tax base of dormant trusts and companies which exist only to hold a taxpayer's home, some years ago SARS announced a concession whereby these taxes would be waived or "rolled over" for taxpayers transferring a residence from a qualifying entity into their own name, subject to certain criteria being met.

The current version of the concession applies to properties owned by qualifying trusts or companies and which properties

Home truths *(continued)*

have been "mainly used for domestic purposes by one or more natural persons [who must be related to the trust or company] during the period from 11 February 2009 to the date of disposal by the company or trust". SARS have added a requirement to the current concession in terms of which the trust or company must be wound up after the transfer of the property.

It is a further requirement that the disposal of the property by the trust or company to the related individual must be made on or before 31 December 2012.

Depending on a taxpayer's future plans and intentions, it may be more tax advantageous to continue to hold a property in a trust or company even if the R2m tax-free CGT amount will be forfeited. Other considerations that may mitigate against taking advantage of the concession include the expense of transferring the property (eg conveyancing fees, bond costs) and if the property is bonded, the fact that the bond will have to be settled or substituted with a new bond taken out by the person taking transfer – who may find that he or she no longer qualifies for a bond at existing interest rates, if at all.

It would make sense for taxpayers who are able to take advantage of the concession to seek professional advice as to the advantages and disadvantages long before the end of year deadline.

50%) is added to taxable income.

The amount of additional income tax payable on the capital gain on the disposal of assets will depend entirely on the amount of other taxable income earned by the taxpayer in that year. If, for example, the taxpayer has earned sufficient income in that year to put him or herself into the highest marginal income tax bracket (40%), then the 33.3% portion of his capital gains when added to his normal income will attract tax at 40%. This means that this taxpayer will pay "CGT" on his gains at an effective rate of 13.3% of the gain (i.e. 33.3% x 40%). It can thus be said that the net effective "rate of CGT" in the case of natural persons thus ranges from zero up to a maximum of 13.3% of net capital gains made.

Home sweet home

What about CGT on the sale of a home? In the case of the disposal by a taxpayer of his or her personal residence there is a major concession made by SARS: with effect from 1 March 2012 the first R2m of any gain made on the disposal of one's "primary residence" is exempt from CGT (increased from R1.5 million in 2011/12). Only the gain in excess of this amount (if any) will attract CGT. For many taxpayers this means that the gain made on such a sale will not attract any tax. However, house prices have increased considerably since 2001 and even in the current economic climate many homeowners who have owned their homes for some years may find themselves one day paying CGT on the sale of their property.

It is important to note that the R2m tax-free concession only applies to the disposal of what SARS terms a "primary residence": this is a property which (a) is owned by a natural person (not a trust, company or close corporation), and (b) the owner or spouse of the owner must ordinarily reside in the home and must also "mainly" use the home for domestic or private residential purposes. Spouses who are married in community of property are deemed to have shared the gains made on disposal of assets, and in their case the R2m exemption will also be shared: they do not each receive the full exemption.

Business is business

While the "primary residence" exemption applies to the sale of most homes, there are a number of situations where the unsuspecting home-owner may not qualify for the exemption, or will otherwise be liable for some CGT on the sale of a home despite being able to claim the exemption. Let's look at some of these situations….

When assessing the primary residence exemption, "work-from-home" taxpayers should proceed with caution. Firstly, the exemption will not apply at all if a home is used "mainly" as a business (i.e. more than 50% for business in terms of floor space usage) even if the business owner resides in the premises. Furthermore, there are implications even if only a small portion of a disposed home has been used for business purposes, for example where a study in a home is used as an office, or a "granny flat" is used to generate rental income. In these situations, the proportion of the property that is used for non-residential purposes will be excluded from benefiting from the exemption and that portion will attract CGT on disposal of the property.



"Home! Sweet Home!" (also known as **"Home, Sweet Home"**) is a song that has remained well-known for over 150 years. Adapted from American actor and dramatist John Howard Payne's 1823 opera *Clari, Maid of Milan*, the song's melody was composed by Englishman Sir Henry Bishop with lyrics by Payne. The opening lines: *Mid pleasures and palaces though we may roam, Be it ever so humble, there's no place like home;* have become famous.

Trust matters

Most importantly, to qualify for the "primary residence" exemption, the home must be owned by the taxpayer in his or her own right. If the home is owned by the taxpayer's family trust or a company, the exemption will not apply at all. This will be the case even if the taxpayer is a beneficiary of the trust and occupies the house as his or her residence. The only exception to this exclusion is where the individual taxpayer owns the home by way of a shareholding in a "share block" company: here the R2m exemption is not forfeited (NOTE: SARS are offering a concession until 31 December 2012 for taxpayers to transfer their homes from trusts or companies into their own names without paying transfer duty, capital gains tax or related taxes – see article below).

The bottom line

A home is often the most valuable asset one ever acquires, and one's financial planning should accurately take into account the impact of Capital Gains Tax on a home upgrade, downscale on retirement or disposal on or prior to death.