Disposal of shares by non-residents: Gaining the capital perspective

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Capital gains tax (CGT) was introduced to the Income Tax Act (the Act) on 1 October 2001. The basis from which it operates is that if a capital asset is sold at a profit, the profit is subject to CGT, and if it is sold at a loss, the capital loss can be set off against other capital profits.

Although there are no fixed rules to determine whether the sale of an asset is subject to normal tax and when it is subject to tax on capital gains, section 9C of the Act sets out certain instances where the sale of shares is deemed to be of a capital nature. Specifically, section 9C(2) of the Act deems the proceeds of the shares disposed of to be of a capital nature, if the shares are equity shares in a South African resident company, and they have been held for at least three years.

Once it has been established that the relevant shares have been held for the requisite three-year period, it is still necessary to confirm whether the disposal will trigger any CGT. Paragraph 2(1)(b) read with paragraph 2(2) of the Eighth Schedule of the Act describes when CGT will be applicable to both residents and non-residents.

Residents pay CGT on the disposal of assets situated anywhere in the world, while non-residents are taxed on gains made on only the disposal of certain assets, among them, immoveable property and any interest in immovable property situated in South Africa.

An interest in immoveable property situated in South Africa includes equity shares in a company. This means that if the non-resident disposes of his interest and 80% or more of the market value of such an interest at the time of its disposal is attributable, directly or indirectly, to immoveable property and the non-resident (in the case of a company or other entity), holds at least 20% of the interest, then the resultant gains from the disposal will be subject to CGT.

On 1 February 2018 the South African Revenue Service issued a ruling in respect of the application of section 9C and the Eighth Schedule of the Act in respect of the disposal of shares held by a non-resident individual. The facts are briefly outlined below.

The applicant, a non-resident person, disposed of shares held in a private South African company that owns no immoveable property. However, the company leases the premises on which it carries on business. The applicant owned 330 shares and sold them to two separate purchasers, who were residents, where part of the purchase price would be received in monthly instalments for 48 months.

SARS ruled that the amounts received by or accrued to the applicant from the disposal of his shares in the company will be deemed to be of a capital nature under the provisions of section 9C(2) and that the disposal of the shares will not be subject to the Eighth Schedule by virtue of paragraph 2(1)(b) read with paragraph 2(2). The applicant will therefore not have to pay CGT in South Africa on the disposal of the shares even though the disposal would be deemed to be of a capital nature.

The ruling presents an interesting interpretation of paragraph 2(1)(b) read with paragraph 2(2) Eighth Schedule in that the lease was not regarded as an indirect attribution to any immoveable property. The relevant provisions were interpreted restrictively to exclude the lease in determining whether the disposal of shares was attributed to any immoveable property. The ruling does not provide any indication of where the non-resident resides and the extent to which any double taxation agreement would be applicable. Presumably, this is because the ruling held that no CGT would be triggered.

Therefore, in confirming the tax consequences for future transactions it is necessary to delve deeper into the activities of the company in which a non-resident holds shares and seek advice to determine whether the disposal of their interest will carry any CGT implications or not.

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