Provisions in Act can defer payment of CGT

By Graeme Palmer

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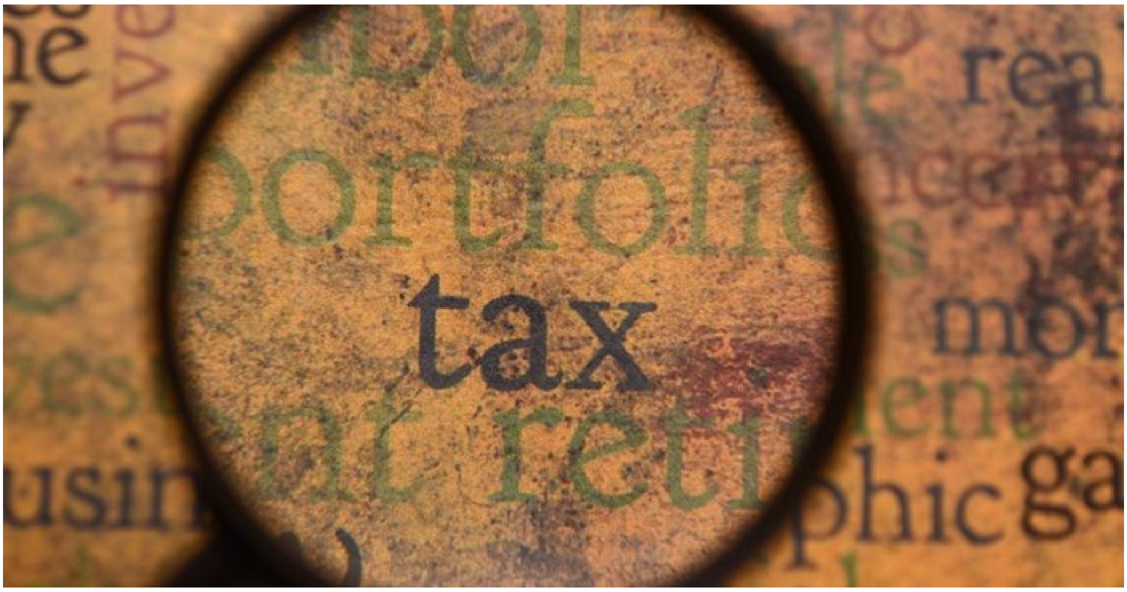
If a person disposes of an asset during the current tax year, but only becomes entitled to payment in future tax years, the Income Tax Act, 1962 provides that the amount is deemed to have accrued to that person during the current tax year.



Therefore a person disposing of an asset will have to account for Capital Gains Tax (CGT) in the current tax year in circumstances when he will only receive payment in future tax years. This may place a strain on cash flow, and is exactly what the parties to a sale of shares agreement were trying to avoid in the case Gani v Hassim, in re East Coast Access (Pty) Ltd v Gani.

Gani and Hassim each held 50% of the shares in an IT company. They concluded an agreement, without the assistance of an attorney, whereby Gani sold his 50% shareholding to Hassim for R5m. R1m was payable each year for three years with the remaining R2m payable if a profit target of R2.7m was achieved in year three. Hassim never paid the R2m as he contended that 'profit' referred to after tax profit and the target was not achieved. Gani disagreed, alleging that 'profit' was before tax profit and the target was met.

Purpose of target condition

The court was of the view that the purpose of the profit target condition was simply to delay payment of CGT. There are provisions in the Act which can provide relief for taxpayers and defer payment of CGT, such as:

- Paragraph 13(1) of the 8th Schedule: a taxpayer will only have to account for CGT when an agreement subject to a suspensive condition becomes unconditional;
- Section 24M(1): if the proceeds from the disposal of an asset are quantifiable at a future date, the taxpayer will only account for CGT when the amount becomes quantifiable;
- Section 24N: which deals with the disposal of equity shares for an amount payable in future tax years and certain conditions having been met.

Although the court made no finding as such, the profit target condition in the agreement could, for tax purposes, be seen as a simulated transaction or an impermissible tax avoidance arrangement. Ultimately the court held that a sensible and businesslike interpretation of the word 'profit' meant profit before tax, therefore the R2.7m target was met, and Hassim was obliged to pay Gani.

ABOUT GRAEME PALMER

Graeme Palmer is a director in the commercial department of Garlicke & Bousfield.

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