



**Franscois van Gijsen**

# CGT and the use of a portion of your primary residence as a home office

## Fiduciary Matters

Brought to you by the **Fiduciary Institute of Southern Africa (FISA)**

### CAPITAL GAINS TAX

The deduction of expenses incurred in respect of a home office has been a controversial issue since judgement in the case of *KBI v Van der Walt* was handed down.

And these days, with many professionals choosing to practise from home, almost everyone knows that there is an income tax deduction to be had in respect of home office expenditure should you use a portion of your home for business purposes.

Undoubtedly, working from home often makes a lot of financial sense. However, few people are aware of the effect that having a home office has on your CGT liability.

Right from the advent of capital gains tax homeowners have been afforded a considerable measure of tax relief in respect of the capital gains resulting from the sale of their primary residence. This is the result of the primary residence exclusion contained in par 45 of the 8th

Schedule.

The lesser known flipside of this generosity is that this paragraph also excludes a portion of the capital losses that the taxpayer may suffer on the sale of her house. These days the capital gain or loss on any property of less than R2 000 000 is excluded entirely, while the first R2 000 000 capital gain or loss, in respect of a residence of more than R2 000 000 in value, is excluded.

However, if any part of the residence was used for business purposes for any period of time after the advent of CGT on 01 October 2001, then paragraph 49 requires that the capital gain or capital loss resulting from the disposal of the residence must be apportioned between such residential and business use.

This apportionment must take into account the period that the residence was used for such business purposes (as a fraction of the entire period that the property was owned) as well as the extent

of the property (as a fraction of the whole) that was used for this purpose. In other words the act requires two apportionments to be done.

The following example serves to illustrate the apportionment.

Yolande acquired her residence on 1 October 2003 and has resided there for the past 10 years. Her base cost in respect of the property is R500 000.

On 1 October 2008 she started a Financial and Legal Consulting practice which she operated from the residence.

Approximately 35% of the residence's floor space was used for this purpose. Yolande also claimed 35% of her costs as a business against her business income for income tax purposes.

In October 2011 she decided to expand her business. This required that she use the entire property for the business. She accordingly purchased a new property to live in and converted the old residence into business

premises. She spent a further R800 000 doing so. On 30 September 2013 she sold the property for R3,7 million.

We now know that the capital gain attributable to the property's use as a primary residence is R1 668 000 (See calculation below). This gain, as it is less than the R2 000 000 exclusion provided by par 45(a), is not subject to capital gains tax. We also know that the portion of the capital gain attributable to her use of the property as a business premises is: R2 400 000 - R1 668 000 = R732 000. This R732 000 has to be aggregated with any other capital gain or losses that Yolande may have arising in the year of disposal. (For the purposes of this article it is assumed that there are none.)

This aggregated amount must then be reduced by the annual exclusion of R30 000 leaving an aggregated capital gain of R702 000. From this aggregate capital gain must be deducted any assessed capital loss that Yolande may have carried forward from any previous year of assessment resulting in a net capital gain or assessed capital loss for the year. (Once again it is assumed there is none.) Accordingly, Yolande's net capital gain for the year is R702 000. This is multiplied by her inclusion rate of 33,33% leaving her with a taxable capital gain of R233 976,60 which will be taxed at her marginal rate of tax. If we

assume a marginal rate of tax of 40% then the tax payable is R93 590,64.

Of course this article is not intended to suggest that taxpayers should not avail themselves of the income tax deductions that may be available to them when using their residential property for business purposes, but rather to remind business owners who plan on practising from home, that a residence becomes tainted as a result of any use thereof for the purpose of trade. It is important also to remember that once a property is so tainted it is then irrelevant whether the person is or was entitled to any deduction in respect of the expenditure relating to the part used for trade purposes and whether or not such person actually used such a deduction.

*This article was written by Franscois van Gijsen, a member of FISA and Director: Legal Services at Finlac Risk and Legal Management.*

*FISA is a non-profit organisation that represents practitioners in the fiduciary industry and sets high minimum standards to protect the public's interests. Activities of FISA members include but are not restricted to the drafting of wills, administration of trusts, beneficiary funds and estates, tax and financial advice and the management of client funds. FISA has over 700 individual members who collectively manage in excess of R250 billion. Membership is open to any professional who meets the membership criteria.*

### THE CALCULATION IS AS FOLLOWS:

Proceeds upon disposal.....	<b>R3 700 000</b>
Less base cost (R500 000 + R 800 000) .....	<b>R1 300 000</b>
Capital Gain.....	<b>R2 400 000</b>
<b>Less:</b> apportionment for period that property was used exclusively for business purposes 2 years - (R2 400 000 x 2/10).....	<b>R480 000</b>
Less: apportionment while property was partially used for business purposes [(R2 400 000 x 3/10) x 35% = R252 000].....	<b>R252 000</b>
Portion of capital gain attributable to use as a primary residence.....	<b>R1 668 000</b>