**Assessed Losses**

> Carry forward an assess loss from current year to following year

Or

> Utilize an assessed loss against taxable income from the prior year

**More than one trade**

<table>
<thead>
<tr>
<th>Trade 1</th>
<th>Trade 2</th>
<th>Trade 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment</td>
<td>Author</td>
<td>Consultant</td>
</tr>
<tr>
<td>R200 000</td>
<td>R55 000</td>
<td>(R25 000)</td>
</tr>
</tbody>
</table>

>> Taxable income/loss for the year:

\[
= 200\,000 + 55\,000 - 25\,000
\]

= R230 000 Taxable Income

**Balance of Assessed losses**

**Year 1:** Taxable income = (R50 000) →  
* Assessed Loss = (R50 000)

> Taxable Total = 0

**Year 2:** Taxable income = R30 000

* Assessed loss (YR1) = (R 50 000)

* Assessed Loss = (R20 000)

> Taxable Total = 0

**Year 3:** Taxable Income = (R60 000)

* Assessed loss (Yr2) = (R20 000)

* Assessed Loss = (R80 000)

> Taxable Total = 0

> Can offset income and losses from different trades together

>> As you pay one lump tax total!!
How does an assessed loss arise?

If there's more deductions than that of income!! (Gross income - Exempt income)

- Deductions such as:
  a) S11a and other deductions
  b) Capital allowances (also form of deduction)

Consequences when a deduction was allowed but the amount has been recouped:

- Include the recoupment in gross income

Example:
- X buys a computer = R100
- Wear and tear claimed after 2 years = (R60)
- Tax Value of computer = R40
- X sells computer for R100
- Recoupment = R60

Consequences when you’ve had a deduction but cannot pay the debt back and there’s a bad debt write off:

1. Reduce cost of asset by benefit received up to 0.
2. Any excess is a recoupment!

1. Trading stock

> Would receive a tax benefit as:
  - Yr 1 Bought trading stock for R100
  - Deduction received = (R100)

> Tax effect would be: (R100)!

- BUT, can only pay R50 of debt, rest written off!!

> Received full deduction, but only paid R50!!

> Thus the cost of the asset must be reduced by the benefit you received

> Cost: R100 - R50 = R50!
Therefore Closing inventory = R50

* Tax effect YR 1 = (R50) >> NOT (R100)!

>> End result: Have cancelled out the benefit received

2. PPE

> Would receive a tax benefit as:

- Yr 1 Bought PPE for R500
- Deduction received = (R200) >>> 5 year write off period, 2 years passed

* Tax effect would be: (R200)!

- BUT, can only pay R300 of debt, rest written off!!

>> Received full deduction per year, but only paid R60 per year!! => (300/5)

* Total benefit received = (R100 - R60) = (40) X 2 = (R80)

> Thus need to reduce cost of asset (tax base-> Effects recoupment)
  AND (base cost -> Effects CGT)

a) Carry on using asset = affects wear and tear

> R500 - R200 = R300 Carrying amount

>> R300 - R80 = R220 Reducing asset cost

>> R220/3 (years remaining) = 73.333 pa = New wear and tear, NOT R100 pa

** Cancelling out R26.66 pa worth of deduction for 3 years remaining

>> R80 = (100-73.33) = (26.666 * 3)

b) Selling the asset E.g R1000

1. Tax Base = R500 - R200 - R80 = R220

   Recoupment = R500 - R220 = R280

>> Include in gross income

2. Base Cost = R500 - R200 - R80 = R220

   CGT = R1000 - R220 - R280 = R500

> Effects of having no bad debt benefit:

1. Tax Base = R500 - R200 = R300

   Recoupment = R500 - R300 = R200

>> Include in gross income

2. Base Cost = R500 - R200 = R300

   CGT = R1000 - R300 - R200 = R500

>> These are the rules as of January 2013; the prior compromises rules are replaced by this

> Not in old book!
Assessed loss and compromise with creditors

- The amount owed to the creditor was used to fund:
  - a) Expenditure or b) An asset

- And a tax deduction was allowed for the above
  
  **Step 1:** Reduce cost of stock by compromise
  - Reduce **base cost or tax base** by compromise
  
  **Step 2:** Include in excess in gross income as a recoupment (amount smaller than 0)

Assessed loss and Foreign Trade

- A loss from a foreign trade **can only** be offset against income from a foreign trade
- A loss from SA trade **can** be offset against income from a foreign trade

Companies and Close Corporations v Individuals

<table>
<thead>
<tr>
<th>Companies/ CC</th>
<th>Individuals</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Can only offset a loss against <strong>trade income</strong>, NOT interest income</td>
<td>- Can offset an assessed loss against <strong>trade AND non-trade income</strong>!</td>
</tr>
<tr>
<td><strong>Carry forward:</strong></td>
<td><strong>Carry Forward</strong></td>
</tr>
<tr>
<td>- Need to carry on a trade to carry forward assessed loss</td>
<td>- Don’t need to carry on a trade</td>
</tr>
</tbody>
</table>

- If a person's estate is sequestrated, assessed loss **remains** in the insolvent estate
- Anti-Avoidance applies: S20A Suspect trade and prevention of offsetting assessed loss!
**Rules:**

1. Retirement fund lump sums cannot be reduced by an assessed loss!

2. **Trade:**
   - **Company:** Can only carry forward an assessed loss if it *carries on a trade in a year*
     - Bazaars (Pty) Ltd v CIR
   - What is meant by carrying on a trade:
     - Income need not be received or accrue, but it must trade: passive income such as interest is **not** carrying on a trade: Consider strict SARS practice

**Example:**

Year 1: Assessed Loss = R200 000

Year 2: Did not trade

Year 3: Taxable income = R400 000

**In year 2, the assessed loss carried over from Year 1 cannot be used as no trade was carried on in Year 2!**

**FALLS AWAY!**

**Losses from one trade against another**

- Can offset

- Natural persons (individuals) subject to S20A Anti Avoidance provisions: **Suspect Trades!**

- Company/CC is a separate person from the shareholder of that company!

  - Cannot offset a loss from the company to the natural persons taxable income (even if he’s the sole shareholder [100%]) as it’s a separate legal entity!

**The purchase of a company with an assessed loss**

**Anti-Avoidance: Assessed losses**

a) Change in shareholding/members interests

> If done solely and mainly for the purpose of using the assessed loss
SARS can disallow the offsetting of the assessed loss, but companies normally come up with a different main purpose/reason for buying that company so that the assessed loss can be utilized. Normally commercial reasons: New customer base, New Town/Country

**Individuals (Natural Persons) and Suspect Trades: S20A**

> **Ring-Fencing Rules:**

1. Individuals/Natural persons **ONLY**!
2. Must be on the **TOP RATE OF TAX:** \text{40\%} @ \text{R that exceeds R638 600 during 2014 year of assessment BEFORE} any current or previous losses !!!
3. 3/5 year (have had losses for 3 out of any 5 consecutive years) **OR** on the list of suspect trades
4. The escape clause must not apply! \xrightarrow{\text{Cannot apply if the 6/10 year rule applies}}

\text{Requirement 3 = OR!}

\text{So only one of the requirements in number 3 needs to be met!}

\xrightarrow{\text{WATCH OUT!!}}

\\nb\text{**NB:** Suspect Trades and ring-fencing only applies to natural persons/individuals AND NOT COMPANIES OR CC’S!!}

**The List of Suspect Trades**

- Sport
- Dealing in Collectibles (cars, stamps, coins)
- Residential accommodation used by relatives (80% rule)
- Rental of vehicles, aircraft or boats used by relatives (80% rule)
- Animal showing (horses, dogs, cats)
- Part-time farming => FULL TIME FARMING IS **NOT** A SUSPECT TRADE!
- Performing or creative arts carried on by the taxpayer or any relative (acting, singing, writing, photography)
- Betting or gambling

\text{80\% Rule: Trading amongst relatives-> 80\% or more makes it a suspect trade!}
3/5 Year Rule:

- Look at current year & Look at prior 4 years
- Requirement is met if: There are losses in **ANY** 3 years
  - It does not have to be consecutive losses!

Escape Clause Must NOT Apply

- Escape clause is where:
  - There’s a reasonable prospect
  - Of making future taxable income
  - Within a reasonable period
- The onus is on the taxpayer, NOT SARS!!

> The 6/10 Rule: If losses are made in 6/10 years the escape clause falls away and will NOT be met = Ring - Fenced!
- Too many loses made in that period of time, not a reasonable prospect!

Look at the facts and circumstances of the business!!