

# Proof Krugerrands and Capital Gains Tax

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## **INTRODUCTION**

A recent question posed to the author was whether **proof** Krugerrands will attract Capital Gains Tax (CGT) when sold at a profit. The question originates from the perception that collectors' coins seem to be exempt from CGT, whereas this is not the case for bullion Krugerrands. Proof Krugerrands are deemed as "collector coins" and the argument is therefore raised that they should also be exempt from CGT. Proof Krugerrands coins are minted with mirror-like finishes, frosted designs and in limited numbers only to cater for the collectors market. Scrutiny of the CGT law revealed that this is a complex matter, however, and Krugerrand owners and collectors of rare coins should be aware of the possible tax implications. The key reference used in this document is the *SARS Comprehensive Guide to Capital Gains Tax (Issue 5)* compiled by the CGT research team under the guidance of Duncan McAllister of the SARS Legal and Policy Division (McAllister, 2015). This reference is an 861 page document, which already gives an indication of the complexities involved with CGT.

## **CAPITAL VERSUS REVENUE**

The first hurdle with Krugerrand sales is that the proceeds will not necessarily be deemed as capital gains by SARS, but may also be classified as "income". This distinction between income and capital is important because a lower rate of tax will apply in the case of capital gains. Section 2.4.3.2 of McAllister (2015) deals specifically with Krugerrands. This section is quoted directly below:

“Since Krugerrands by their nature do not provide their holder with an income return, there is an inference in the absence of evidence to the contrary that they have been purchased for resale at a revenue profit. In some cases taxpayers have been able to prove that the proceeds realised on disposal of Krugerrands are of a capital nature. Typically this occurs when the coins are held as part of a collection, or when the taxpayer intends to bequeath them on death (that is, there is no intention to dispose of them at a profit).”

McAllister (2015) gives the cases that have to date been heard by the courts in South Africa and these are given in Table 1 below:

**Table 1.** Court cases related to the disposal of Krugerrands (after McAllister, 2015).

Case	Court's finding – capital or revenue	Period held	Intention in acquiring	Reason for selling
ITC 1355 <sup>106</sup>	Capital	4 to 5 years	Bought as an investment to assist during bad times.	To assist family members (ill father, bedridden sister and provide dowry for sister).
ITC 1379 <sup>107</sup>	Capital	1 to 13 years	Bought as an easily transportable investment that retained its value.	Sold all after repeated warnings that gold price was too high and would fall.
ITC 1525 <sup>108</sup>	Revenue	12 years	To provide funds for a rainy day. Tendency to spend surplus cash on liquor.	Sold to inject capital into new business.
ITC 1526 <sup>109</sup>	Revenue	8 months to 9 years	To provide a store of wealth for his children and protection from inflation.	Improvements to home and garden, buying two holiday apartments, a home for each of his daughters, repaying loan account, buying a car for his daughter, paying university fees and buying shares.
ITC 1543 <sup>110</sup>	Capital	12 years	Bought by family company as hedge against inflation for benefit of children.	To finance reroofing of house, and to switch into shares because of a declining gold price.
<i>CIR v Nel</i> <sup>111</sup>	Capital	13 years	Long-term investment. Hedge against inflation. No intention to sell but rather to bequeath to children.	Urgent need by taxpayer to purchase a car for his wife.

From Table 1, in two of the cases heard in court, the sale of Krugerrands was considered as revenue and not capital gains. The onus of proving that an amount is of a capital or income nature rests on the taxpayer under section 102 of the Tax Administration Act. This distinction between income and capital is not clear and much litigation between SARS and taxpayers occurred over many decades. As a result, the courts have developed a number of tests to distinguish between the two. McAllister (2015) nevertheless includes the quote that there is:

*“no single infallible test of invariable application”*

Some of these rules applied by the courts which may be of interest to Krugerrand owners or rare coin collectors are (see McAllister, 2015, for the others):

1. The key test for determining the capital or revenue nature of a particular accrual is the taxpayer’s intention when acquiring the asset.
2. An asset yielding a meagre return may be indicative of an intention to resell at a profit, in which case the profit will be classified as income. This also applies to assets that do not produce an income such as Krugerrands and diamonds. The taxpayer’s intention and the surrounding circumstances must nevertheless be taken into account.
3. The length of time that an asset is held is an unreliable indicator of whether the proceeds from its disposal will be of a capital or revenue nature. While a lengthy holding period may be indicative of capital intent, the period of holding is far less important than other factors such as the taxpayer’s intention in buying and selling the asset, and the manner in which the asset is dealt with.

In summary, regarding the first tax hurdle, it is clear that there is no distinction between proof and bullion Krugerrands. Even for proof Krugerrands where personal-use cannot be proved (section below), the onus will be on the owner of proving that the profit made from a sale is of a capital and not an income nature. **Persons buying proof Krugerrands purely for future profit and who cannot prove it was acquired for personal-use (section below) should be made aware of the risk that profit from future sales may in fact be classified as “income” and taxed at a higher rate than CGT.**

#### **DEFINITIONS AND EXCLUSION OF CURRENCY**

According to McAllister (2015) an asset includes *“property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum;”*

The definition of ‘asset’ excludes ‘currency’ but includes gold and platinum coins. The word ‘currency’ is not defined in the Act, but McAllister (2015) refers to the Shorter Oxford English Dictionary on Historical Principles and uses the definition:

*“The fact or quality of being in circulation as a medium of exchange.”*

The interpretation by McAllister is:

*“According to this meaning, currency would not include*

- an old coin or note no longer in circulation, or*
- a new coin or note not intended for circulation such as mint collectors’ issues of new coins or notes.*

*It follows that notes or coins held as collectors’ items are assets for CGT purposes. However, such collectors’ items may constitute personal-use assets, and if so, any gain or loss on their disposal must be disregarded.”*

This definition and interpretation of McAllister may in fact be wrong. All legal tender, which includes historic ZAR and Union coins and notes, can probably still be considered as “currency”.

Regarding **proof** Krugerrands, McAllister (2015) refers directly to them in Section 4.1.2.6

*“While all gold or platinum coins constitute assets, capital gains and losses arising on the disposal of coins that constitute personal-use assets must be disregarded. Personal-use assets refer to assets that are not used mainly for the purpose of carrying on a trade. Whether the value of a gold or platinum coin is mainly (> 50%) attributable to its metal price rather than its scarcity value will be a question of fact. For example, if 40% of a proof Krugerrand’s value were attributable to the gold price with the other 60% being attributable to its Numismatic value, it would comprise a personal use asset provided it was acquired for purposes other than trade.”*

The arbitrary percentage of 50% given above for proof Krugerrands may be problematic regarding the current selling prices of these proof coins. This implies a proof Krugerrand must be traded for more than double the gold price otherwise it would not be considered a personal use asset.

## **EXCLUSION OF PERSONAL-USE ASSETS**

According to McAllister (2015), a capital gain when disposing of a personal-use asset will not attract CGT. A personal-use asset is defined as:

*“an asset of a natural person or a special trust that is used mainly for purposes other than the carrying on of a trade”.*

*“Examples of personal-use assets include artwork, jewellery, household furniture and effects, a microlight aircraft or hang glider with a mass of 450kg or less, a boat that is 10 metres or less in length, veteran cars, private motor vehicles (including a vehicle used mainly for business purposes in respect of which a travel allowance is received), stamp or coin collections (but excluding gold or platinum coins whose value is mainly derived from the metal content). In order to qualify as a personal-use asset the asset must be used ‘mainly’ for non-trade purposes. The word ‘mainly’ has been held to mean more than 50%.”*

He also mentions that personal-use assets do not include the following:

*“A coin made mainly from gold or platinum of which the market value is mainly attributable to the material from which it is minted or cast.”*

No mention is made of proof Krugerrands in this particular section of the SARS document. The previous section highlights, however, that these proof Krugerrands may indeed be considered a personal use asset if their collector’s value exceed the value of the precious metal content. It is the perception of the author that the onus of proof of “personal-use” will nevertheless be very high on persons selling proof Krugerrands.

## **SUMMARY**

From the information collected, the following conclusions are made:

- Coin collections (excluding gold or platinum coins whose value is mainly derived from the metal content) is considered as personal-use assets if it is used ‘mainly’ for non-trade purposes and will not be subject to CGT.
- Coins made mainly from gold or platinum of which the market value is mainly attributable to the material from which it is minted or cast will be subject to CGT.
- It appears from the one statement made by McAllister (2015) that for a proof Krugerrand, where part of the value is attributable to the gold price (<50%) and the other being attributable to its Numismatic value (>50%), it would comprise a personal

use asset, provided it was acquired for purposes other than trade. It will therefore probably not attract CGT provided the selling price is more than double the gold price. This may be unrealistic considering the current selling prices of these coins. Collectors will also have to supply proof that it was indeed acquired for “personal-use”. This will probably be very difficult in a court of law for persons who are not coin collectors. The particular statement in McAllister’s document and percentages also needs to be verified.

- Regarding the sale of bullion Krugerrands, care should also be exercised as it is not certain if SARS will regard the proceeds as “income” or “capital”. Income will be taxed at a higher rate than CGT. Persons buying proof Krugerrands purely for future profit and who cannot prove it was acquired for personal-use should be made aware of the risk that profit from future sales may even be classified as “income” and taxed at a higher rate than CGT.

#### **REFERENCES**

McAllister, D.S. SARS Comprehensive Guide to Capital Gains Tax (Issue 5), 2015.