

**A FRAMEWORK FOR
WEALTH TRANSFER TAXATION IN SOUTH AFRICA**

by

ELZETTE MULLER

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PROMOTOR: PROF RCD FRANZSEN

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SUMMARY

The South African tax system currently provides for wealth transfer taxation by virtue of estate duty in terms of the Estate Duty Act and donations tax in terms of Part V of the Income Tax Act, which are primarily levied on the transferor.

At the outset, this study investigates the conceptual justification for this type of taxation in the South African context, especially in view of the fact that some countries have recently abolished their wealth transfer taxes. It is concluded that the arguments against wealth transfer taxation are not compelling enough to justify its abolition from the South African tax system. It is also submitted that the levying of capital gains tax on the death of a wealth holder cannot act as a substitute measure to tax wealth transfers in the South African system. It is, however, explained that the levying of both taxes reflects a scenario of double taxation on a deceased estate and that the equity criterion supports the taxation of wealth transfers in the hands of the recipient. The possibility of merely including inheritances and gifts in the “gross income” of a beneficiary is explored, but it is submitted that such a move would be politically and administratively unlikely.

After having come to the conclusion that wealth transfer taxation is indeed justifiable for the South African tax system, two key issues are explored in the study. The first issue relates to the lack of integration that exists between the taxation of *inter vivos* transfers (under the donations tax regime) and the taxation of transfers on death (under the estate duty regime). After having compared the systems in the United Kingdom, the Netherlands and Ireland, it is concluded that it is conducive to equity, neutrality and tax administration that the rules relating to the jurisdictional basis, double taxation relief, tax rates and valuation rules apply (in general) equally to *inter vivos* transfers and transfers on death. It is evident, however, that it remains necessary to distinguish between the two types of transfers, because this creates a flexible platform to accommodate special circumstances and differences. A number of measures to improve integration under the current regimes are recommended, but it is suggested that, ideally, the Estate Duty Act and Part V of the Income Tax Act should be replaced by a single integrated statute.

The second issue deals with the question whether or not the well-established estate duty and donations tax regimes should be replaced by a recipient-based system, especially in view of its theoretical appeal. After having shown that a recipient-based wealth transfer tax offers more appropriate solutions to some of the problem areas common to wealth transfer taxation in general (such as the accommodation of third-party life insurance benefits, limited interests and a special regime for discretionary trusts), it is concluded that the current regimes should be replaced by a recipient-based wealth transfer tax, which may even be accommodated as a separate schedule to the existing Income Tax Act in much the same way as capital gains tax.

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1.1 BACKGROUND AND PURPOSE OF STUDY

The taxation of inherited wealth is one of the oldest fiscal instruments and can be traced back to the ancient civilisations of the Egyptians, Romans and Greeks.¹ The taxation of transfers on death, which has over time been supplemented by a tax on *inter vivos* gifts,² will for the purposes of this study be collectively referred to as “wealth transfer taxation”.

This type of taxation has evolved over many centuries and can presently still be found in many tax jurisdictions in various diverse forms. What is noteworthy is that two main approaches to taxing wealth transfers developed, namely transferor-based taxation levied on deceased estates or donors, and recipient-based taxation levied on the individual beneficiaries of the wealth. Although tax reform in the area of wealth transfer taxation has been prolific over the past century, it seems as if a universal approach is far from a realistic possibility. As will appear more fully in the discussion in Chapter 3 below, tax review commissions in various countries have reviewed this type of taxation, and their recommendations were far from being uniform. To add insult to injury, some countries have abolished their wealth transfer taxes in the past few decades, which has sparked an international debate as to whether or not this type of taxation is conceptually justifiable.

¹ Van Nispen and Shuttevaer (1969) 124 succinctly state that “[d]e successiebelasting nu is ouder dan de weg na Rome”.

² Although the term “gift” is commonly used internationally, the synonym “donation” is more often used in a South African context. These two terms will therefore be used interchangeably throughout this thesis.



In the words of Richard Bird: “[d]eath may still be certain, but death taxes no longer are!”³

The South African tax system currently provides for wealth transfer taxation by virtue of estate duty on deceased estates in terms of the Estate Duty Act⁴ and donations tax on donations *inter vivos* in terms of Part V of the Income Tax Act.⁵ Since the introduction of the existing wealth transfer tax system in 1955, its nature and character had been examined by three government-appointed commissions of enquiry, reporting on aspects of the tax structure, namely:

- the Commission of Enquiry into Fiscal and Monetary Policy in South Africa, chaired by DG Franzsen (the “Franzsen Commission”), which issued two reports under the title *Taxation in South Africa* in 1968 (the “First Franzsen Report”) and 1970 (the “Second Franzsen Report”);
- the Commission of Inquiry into the Tax Structure of the Republic of South Africa, chaired by CS Margo (the “Margo Commission”), which issued a single wide-ranging report in 1986 (the “Margo Report”);
- the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa, chaired by MM Katz (the “Katz Commission”), which issued nine interim reports during the period 1994–1999, of which the reports issued in 1994 (the “Interim Katz Report”), in 1995 (the “Third Interim Katz Report”) and in 1997 (the “Fourth Interim Katz Report”) are of particular relevance for this thesis.

As Chapter 3 will reveal in more detail, all three of the tax reform commissions endorsed the existence of wealth transfer taxation in the South African tax system. In addition, all three commissions favoured a transferor-based approach to taxing wealth transfers. Because the Margo Commission had been informed that, in the government’s opinion,

³ Bird (1991) *Can Publ Pol* 323.

⁴ Act 45 of 1955.

⁵ Act 58 of 1962.



estate duty was “terminally ill”,⁶ the recommendations to be made by the commission were highly anticipated. The report detailed a number of areas in need of reform, including the lack of taxing wealth transfers under an integrated regime. As a consequence, the commission proposed that estate duty and donations tax should be replaced with a “capital transfer tax”.⁷ The government accepted this recommendation in principle,⁸ but failed to act on it.

In the 1993 Budget Review it was reported that the Taxation Advisory Committee had recommended that the possibility be investigated that the existing Estate Duty Act and the donations tax provisions of the Income Tax Act be combined and adapted so as to provide for a more effective wealth transfer tax system. Apparently, draft legislation was being drawn up.⁹ Furthermore, the Katz Commission supported the Margo Commission’s idea of an integrated capital transfer tax.¹⁰ It was, nonetheless, concluded that there is “no pressing need” to proceed with the legislative process and that this can be done as and when there are resources available within the South African Revenue Service (hereafter SARS) to do so.¹¹ However, to date nothing has materialised.

Although many of the minor recommendations by the commissions were enacted by virtue of amendments to the existing legislation, some of the major issues that were identified were left unattended to, as will more fully appear from the discussion in Chapter 7 below.

⁶ Hansard (Volksraad Debatte) 19 (1985) 7661; Editorial (1986) *Taxpayer* 61.

⁷ Margo Report (1986) pars 20.50 and 20.53.

⁸ White Paper on the Margo Report (1988) 16 and 53.

⁹ Budget Review (1993) par 3.2 as referred to by Meyerowitz (1993) *Taxpayer* 48.

¹⁰ Third Interim Katz Report (1995) pars 7.1.12 and 7.4.1 and Fourth Interim Katz Report (1997) par 5.1.

¹¹ Fourth Interim Katz Report (1997) par 5.9.

The introduction of capital gains tax into the South African tax system in 2001,¹² which provided for a deemed disposal of all the deceased's assets to his or her deceased estate at the moment of death, has awakened the speculation that estate duty may be abolished in the not too distant future. Mazansky commented that it is foreseeable that the revenue derived from capital gains tax payable on death could at some point in the future prompt estate duty and donations tax to land in the "fiscal dustbin".¹³

At the outset, this study will investigate the conceptual justification of wealth transfer taxation in the South African context. It is noteworthy that this area has received little attention in South Africa, unlike the United States, where it prompted lively debate, as will more fully appear in the discussion in Chapter 4 below. Because it will be concluded that this type of taxation is essential for purposes of the South African tax system, the study will explore some key policy issues that relate to the current wealth transfer tax system. The first issue relates to the lack of integration between the taxation of *inter vivos* transfers (under the donations tax regime) and the taxation of transfers on death (under the estate duty regime). The current regimes will be evaluated to assess the discrepancies between the two regimes; this will assist in identifying ways and means of improving the integration of *inter vivos* transfers and transfers on death. Furthermore, this thesis will re-open the debate between transferor-based taxation and recipient-based taxation in the South African context, especially because of the theoretical appeal that underpins recipient-based taxation, as will be explored more fully in Chapter 4.

1.2 EXPOSITION

Chapter 2 provides a general background relating to the origin and essence of taxation, its objectives and its central tax policy considerations. The discussion will also provide a brief exposition of a contemporary tax system comprising the taxation of income,

¹² Eighth Schedule to the Income Tax Act.

¹³ Mazansky (2002) *Executive Business Brief* 17.



consumption and wealth, with specific reference to the South African context. This is important, because “any measures or proposed amendments should be considered within the context of the system as a whole, and be judged as to its contribution towards the advancement of the overall economic and fiscal objectives”.¹⁴ The various treatments of the unrealised gains upon death or the making of a donation will be reviewed in order to give the reader an understanding of the interaction between capital gains taxation and wealth transfer taxation.

Chapter 3 provides a historical overview of wealth transfer taxation from the time of the Roman Empire through the Middle Ages to the evolution and development of this type of taxation in a selection of countries. The discussion will demonstrate the gradual evolution of transferor-based taxation and recipient-based taxation on an international level and will also point to the decline of wealth transfer taxation in a number of leading jurisdictions over the last few decades, which stimulated the debate on the conceptual justification for this form of taxation.

Chapter 4 evaluates all the policy considerations relevant to this debate, and will conclude that some form of wealth transfer taxation is justified and desirable for the South African tax system. In particular, it will be shown that the levying of capital gains tax upon a wealth holder’s death does not replace the function and role of a wealth transfer tax. Although wealth transfers may conceptually be taxed in a comprehensive income or a direct consumption tax, these options are not currently on the cards for the South African system.

The aim of Chapters 5 and 6 is to provide a contemporary overview of the South African wealth transfer tax system. Chapter 5 deals with the provisions of the donations tax regime, while Chapter 6 deals with the main characteristics of the estate duty regime.

¹⁴ Interim Katz Report (1994) par 1.5.4 (d).



Chapter 7 outlines some key policy issues and problem areas relevant to the current South African wealth transfer tax system. To illustrate the lack of integration between the taxation of *inter vivos* transfers and the taxation of transfers on death, the discrepancies between the estate duty regime and the donations tax regime are outlined. This leads to the conclusion that the lack of integration is not conducive to horizontal equity in the system. The second issue relates to the debate on the choice between transferor-based taxation and recipient-based taxation. Because of the theoretical appeal of recipient-based taxation demonstrated in Chapter 4, the question is posed whether the current transferor-based approach should be retained or whether it should be replaced by a recipient-based system. Because such a question cannot appropriately be answered without consideration of problem areas experienced under the current system, the discussion will outline a number of current issues.

Chapters 8, 9 and 10 contain a comparative discussion of the contemporary wealth transfer tax systems in the United Kingdom, the Netherlands and Ireland respectively. The fact that South African estate duty was largely premised on the English example necessitates an overview of the United Kingdom wealth transfer tax system as a point of departure. Also, the United Kingdom system provides a classic example of a well-rooted transferor-based wealth transfer tax system. The recipient-based system in the Netherlands was chosen for the comparative survey because the South African common law is rooted in the Roman-Dutch law that was applied in the province of Holland in the seventeenth and eighteenth centuries. Although wealth transfer tax legislation in South Africa was not based on the Dutch precedent, the numerous similarities in some basic property law concepts (such as a usufruct and *fideicommissum*) render the Dutch system of comparative interest. It is also of paramount importance to consider the main characteristics of a recipient-based tax. The Dutch system, being one of the oldest systems in continental Europe, provides a well-documented and well-debated example. The system in Ireland is of comparative interest because it provides an example of a traditional common-law legal system that successfully replaced its transferor-based estate duty with a recipient-based acquisitions tax.



Chapter 11 contains conclusions and reform proposals on the key policy issues identified in Chapter 7. Firstly, a comparative exposition is provided of the level of integration that exists between the taxation of *inter vivos* transfers and transfers on death in the systems of the countries surveyed. It will be shown that, generally, the rules relating to the jurisdictional basis, unilateral double taxation relief provisions and valuation rules apply equally to all wealth transfers. However, all three systems differentiate between *inter vivos* transfers and transfers on death to provide for flexibility in certain areas. Most significantly, both types of transfers are taxed under a single legislative regime in all three systems. It is concluded that, although integration under the South African system may be improved with a few amendments to the estate duty and donations tax regimes, the taxation of *inter vivos* transfers and transfers on death should ideally be integrated under a single legislative structure, such as provided for in the United Kingdom, the Netherlands and Ireland. On the transferor-based tax/recipient-based tax debate, it is concluded that South Africa should replace its transferor-based regimes with an (integrated) recipient-based system. To arrive at this conclusion, a number of policy considerations are evaluated. In addition, it will be shown that some of the significant problem issues identified in Chapter 7, which are actually common to wealth transfer taxation in general, are more appropriately dealt with in a recipient-based tax.

1.3 LIMITATION OF SCOPE

This study focuses on the taxation of the gratuitous transfer of wealth. Other transfer taxes, such as the tax payable on the transfer of immovable property (known in South Africa as transfer duty) or shares and securities (known in South Africa as a securities transfer tax), are therefore specifically excluded from this study.

It should furthermore be noted that this study is limited to the taxation of the gratuitous transfer of capital, and not the *ownership* or *profit* of capital, which are accommodated in taxes such as periodic net wealth taxes or capital gains taxes. Although a reference to the treatment of capital gains tax on death and the making of a donation is necessary to assess whether it can serve as an alternative to wealth transfer taxation (this is also undertaken in



order to provide a more complete view of the tax system as a whole), capital gains taxation in South Africa will be referred to where relevant and will not be critically assessed.

Chapter 7 outlines a number of significant problem areas that exist under the current South African wealth transfer tax system. This is done mainly to assess whether the current transferor-based approach should be replaced by a recipient-based approach. However, this study will not attempt to provide solutions for all these issues.

Aspects of compliance and tax administration are also generally excluded from the focus of this study.

This thesis does not take into account any development in the law that occurred after 1 January 2010.

CHAPTER 2

THE HISTORICAL DEVELOPMENT, OBJECTIVES AND POLICY CONSIDERATIONS OF TAXATION IN GENERAL

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2.1 INTRODUCTION

The existence of taxation within a modern economy has become a widely accepted reality. As a point of departure, this chapter examines the historical development of taxation in general, with emphasis on the taxation of income, wealth and consumption. This provides the reader with a contextual understanding of a modern tax system and the interaction of wealth transfer taxation with the other taxes in the system. For the sake of completeness, a reference to the contemporary South African tax system is provided.

In view of the fact that any proposal for tax reform should take cognisance of policy considerations, the objectives and essential principles of taxation are outlined, with special reference to the South African context. This is followed by a brief discussion of the South African constitutional considerations applicable in the realm of taxation.

2.2 A GENERAL ORIENTATION TO TAXATION AND AN OVERVIEW OF THE TAXATION OF INCOME, WEALTH AND CONSUMPTION**2.2.1 General Orientation*****2.2.1.1 The Origin, Historical Development and Theoretical Basis of Taxation***

The idea of taxation developed closely with the idea of an orderly society and the institution of a government with authority.¹ In ancient times the mere power of the sovereign was the foundation of its entitlement to commit acts of aggression against its

¹ Piek and Franzsen in Van Jaarsveld and Oosthuizen *eds* (1988) 903; Brautigam in Brautigam, Fjelstad and Moore *eds* (2008).

subjects, including its claim against their resources.² Apparently the first known system of taxation can be found in Ancient Egypt around 3000 BCE–2800 BCE, where the pharaoh conducted a biennial tour of the kingdom, collecting contributions from the people. Apparently, the tax was at some point calculated by measuring the rise and fall of the Nile River.³ In the ancient Roman and Greek Empires, contributions were initially collected in indirect ways, such as through spoils of war, harbour dues, tolls and customs on trade and commerce.⁴ During the reign of the Roman Emperor Diocletian (284–305 CE), the first extensive direct taxes were imposed on Roman citizens based on heads (*capita*) and land (*iuga*), to provide funding for the increasing expenditure needs of the empire. After the decline and fall of the Western Roman Empire (*circa* 476 CE), the capitation and property taxes, being symbols of oppression, became unenforceable and disappeared completely.⁵

With the subsequent rise of various empires and kingships, for example the empire of Charlemagne in Europe and the Saxon kings in England, contributions to the sovereign were initially voluntary.⁶ It was unacceptable for a sovereign to impose taxation on its subjects, unless in times of war⁷ or in exchange for a specific benefit.⁸ Indirect collection

² Adriani and Van Hoorn Vol 1 (1954) 184–186; Hepker (1973) 11 refers to a clay tablet found in Iraq which dates 3 500 years ago with the inscription: “You can have a Lord, you can have a King, but the man to fear is the tax collector.”

³ Croome PhD Thesis (2008) 1 n 2 and accompanying text.

⁴ Seligman (1921) 4; Brissaud (1969) 100; Sabine (1980) (in general); Piek and Franzsen in Van Jaarsveld and Oosthuizen *eds* (1988) 904; Doyle (2008) par 1.2.1. War victories allowed the Romans to seize the wealth of the conquered people. Taxes through spoils of war therefore initially fell on those living in the provinces controlled by the Roman Empire. See Coffield (1970) 1, 4.

⁵ Klein-Wassink in Jongsma and Verburg *eds* (1975) 93–94.

⁶ Seligman (1969) 2; Klein-Wassink in Jongsma and Verburg *eds* (1975) 94; Piek and Franzsen in Van Jaarsveld and Oosthuizen *eds* (1988) 903–904.

⁷ Hepker (1973) 11; Theron LLD Thesis (1994) 12 n 7. A well-known “war tax” in England was known as “Danegeld”. The tax was originally introduced in 845 to protect England against the Danish invaders, but it was later retained as a form of land tax. See Hepker (1973) 12; Sabine (2006) 11; Brautigam in Brautigam, Fjelstad and Moore *eds* (2008) 7 and Doyle (2008) par 1.2.1.

⁸ Buehler (1948) 318.

of revenue through excise taxation on, for example, salt, beer, soap, candles, leather and meat became the principal way of filling the ruler's coffers.⁹ These voluntary contributions were based on the principles of the social contract,¹⁰ the so-called "contractual taxation".¹¹ However, the difficulty with contractual taxation is that it requires a consensual undertaking by the citizen¹² and could therefore not serve as a foundation for *inter alia* the redistribution of resources.¹³

During the Middle Ages, the idea developed that taxation is actually an inherent and indispensable power of the government to coerce its subjects to surrender their property without their consent, a process of "forced exchange", or "coercive taxation".¹⁴ This

⁹ Smith (1776) book v ch ii pt ii art iv, available at <http://www.adamsmith.org> (accessed on 20 June 2008); Klein-Wassink in Jongsma and Verburg *eds* (1975) 94.

¹⁰ Brissaud (1969) 476 explains the concept of the *social contract* as follows: "[It] properly so assumed that men lived at first in a state of nature or anarchy, as was sometimes fancied according to the traditions of the classical antiquity (golden age, etc); they escaped from it through the social contract, that is to say, by an agreement in virtue of which they bound themselves to live in society, each man surrendering his rights to the community and promising to obey the sovereign whom it should give. The state of nature and the social contract, – it is upon these chimeras that our modern liberties rest."

¹¹ Epstein (1986) *Soc Philos Pol* 49 n 1; Musgrave (2000) 136; Wolfram in Racheter and Wagner *eds* (2002) 50–54; Brautigam in Brautigam, Fjelstad and Moore *eds* (2008) 12–15. The two predominant theories underpinning contractual taxation are the *exchange theory* and the *insurance theory*. According to the *exchange theory*, subjects surrender their resources to the government in exchange for the protection of their liberty and property. See Adriani and Van Hoorn Vol 1 (1954) 187–188 and Loeckx and Van Dionant (1980) 97–98. Klein-Wassink in Jongsma and Verburg *eds* (1975) 96 mentions that this theory is closely related to the "benefit-principle" (see par 2.4.2.1.1). The *insurance theory* is based on the idea that taxation offers an insurance premium for the protection of liberty and property by the government. See Adriani and Van Hoorn Vol 1 (1954) 186; Van Nispen and Schuttevaer (1969) 35 and Loeckx and Van Dionant (1980) 98.

¹² Wagner in Racheter and Wagner *eds* (2002) 43 explains that taxation cannot be imposed on a voluntary basis: "People would have strong incentives to take free rides on the contributions of others. As a result, such common valued services as civil order and national security, which requires expenditures on military, police, and courts, are likely to be under funded." See also Buehler (1948) 319; Epstein (1986) *Soc Philos Pol* 49; Franzsen LLD Thesis (1990) 10; Theron LLD Thesis (1994) 16; Mack in Racheter and Wagner *eds* (2002) 9–26 and Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 116.

¹³ Musgrave (2000) 136.

¹⁴ Adriani and Van Hoorn Vol 1 (1954) 190; Van Nispen and Schuttevaer (1969) 35–37; Wagner (1973) 43; Klein-Wassink in Jongsma and Verburg *eds* (1975) 95; Loeckx and Van Dionant (1980) 99; Epstein (1986) *Soc Philos Pol* 51–54; Piek and Franzsen in Van Jaarsveld and Oosthuizen *eds* (1988) 904, 906–912; Franzsen LLD Thesis (1990) 10; Theron LLD Thesis (1994) 12, 17; Mack in Racheter and Wagner

Footnote continues on the next page

ideology was reinforced with the development of nation-states and an increased need for public revenue. This theory implies that an express provision conferring on a government a power to tax is not essential.¹⁵ The fiscal legislation need furthermore not conform to the “canons of taxation”.¹⁶ However, a government does not have unlimited powers as far as taxation is concerned in view of the modern idea that a government should be accountable to its citizens, requiring fiscal legislation to comply with the relevant country’s constitutional restrictions.¹⁷ The concept of accountability is significant in the realm of taxation, if one considers that taxation, as a means of oppression, has played an important role in numerous revolts, revolutions and wars.

2.2.1.2 Description of Taxation

Providing a comprehensive definition of taxation is challenging. It can best be described as a monetary-based¹⁸ compulsory contribution¹⁹ payable by the public as a whole or a

eds (2002) 11; Brennan and Buchanan (2006) 4, 10; Moore in Brautigam, Fjelstad and Moore *eds* (2008) 37.

¹⁵ Croome PhD Thesis (2008) 9 refers to a quotation from Hyatali CJ in *Attorney General of Trinidad and Tobago v Ramesh Dipraj Kumar Mootoo* (1976) 28 WIR 326: “The power to tax rests upon necessity, and it is inherent in any sovereignty. The legislature of every free State will possess it under the general grant of legislative power, whether particularly specified in the Constitution among the powers to be exercised or not. No constitutional government can exist without it.”

¹⁶ In *Partington v Attorney-General* (1869) LR 4 HL 100, 21 LT 370 it was stated that: “[I]f a person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be, even though the so-called ‘canons of taxation’ as propounded by Adam Smith in *The Wealth of Nations*, namely equity, neutrality, certainty and administrative efficiency, have not been observed.” See par 2.4.2 for a discussion on the “canons of taxation”.

¹⁷ Epstein (1986) *Soc Philos Pol* 50; Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 116. See also Hettich and Winer (1985) *Natl Tax J* 432.

¹⁸ Some of the ancient taxes were, however, levied in kind. See Adriani and Van Hoorn Vol 1 (1954) 101; Loeckx and Van Dionant (1980) 70; Franzsen LLD Thesis (1990) 12 n 17 and accompanying text; Theron LLD Thesis (1994) 25; Thuronyi (2003) 48; Moore in Brautigam, Fjelstad and Moore *eds* (2008) 35.

¹⁹ Buehler (1948) 320; Adriani and Van Hoorn Vol 1 (1954) 100; Loeckx and Van Dionant (1980) 70; O’Brien Report (1982) 67; Franzsen LLD Thesis (1990) 12; Theron LLD Thesis (1994) 25; Thuronyi (2003) 48; Messere, De Kam and Heady (2003) 7; Croome PhD Thesis (2008) 30; Moore in Brautigam, Fjelstad and Moore *eds* (2008) 35.

substantial sector thereof²⁰ to a government (at a national or sub-national level).²¹ Its primary purpose is to defray government expenditures,²² but it can also serve as an instrument to attain socio-economic and political objectives.²³ Taxes are levied in terms of specific legal rules,²⁴ which should comply with the constitutional law of the relevant jurisdiction.²⁵ They are not levied as a *quid pro quo* for specific defined benefits provided by the government,²⁶ but should rather be utilised for public benefit.²⁷

2.2.1.3 The Development of the Various Tax Bases

Seligman refers to the development of five traditional faculties or “tax bases”²⁸ throughout history. In primitive communities, where there were no very rich and no very poor and where individual revenue was derived from individual exertion, polls (numbers) formed a satisfactory test of ability in taxation. The development of private property and the differentiation of economic classes led to the second stage of faculty development,

²⁰ *Maize Board v Epol (Pty) Ltd* 2009 (3) SA 110 (D) 120G.

²¹ Loeckx and Van Dionant (1980) 69; O’Brien Report (1982) 67; Franzsen LLD Thesis (1990) 12; Theron LLD Thesis (1994) 25; Thuronyi (2003) 45; Messere, De Kam and Heady (2003) 7; Moore in Brautigam, Fjelstad and Moore *eds* (2008) 35.

²² Adriani and Van Hoorn Vol 1 (1954) 101; Loeckx and Van Dionant (1980) 71; Theron LLD Thesis (1994) 26.

²³ Franzsen LLD Thesis (1990) 12; Theron LLD Thesis (1994) 26.

²⁴ Loeckx and Van Dionant (1980) 70; Franzsen LLD Thesis (1990) 13; Theron LLD Thesis (1994) 25; Croome PhD Thesis (2008) 30.

²⁵ Croome PhD Thesis (2008) 1.

²⁶ Contributions to the government that are levied for specific benefits are called redistributions or consumption levies. See Buehler (1948) 319–320; Adriani and Van Hoorn Vol 1 (1954) 106; Loeckx and Van Dionant (1980) 70; O’Brien Report (1982) 67; Franzsen LLD Thesis (1990) 13 n 22 and accompanying text, 13–14; Theron LLD Thesis (1994) 26–29; Thuronyi (2003) 46; Messere, De Kam and Heady (2003) 7; Croome PhD Thesis (2008) 1; Moore in Brautigam, Fjelstad and Moore *eds* (2008) 35.

²⁷ *Maize Board v Epol (Pty) Ltd* 2009 (3) SA 110 (D) 120H.

²⁸ A “tax base” can be described as the collective value of taxable assets or taxable activities subject to the levying of taxation. According to the Margo Report (1986) par 5.1 this is “either a flow or a stock of wealth to which the public sector can lay partial claim”. Doyle (2008) par 1.5.3 describes a tax base as “some quantifiable collection of like items upon which tax is levied”. The asset(s) in respect of which a tax applies within a tax base is referred to as the “tax object(s)”. See Franzsen LLD Thesis (1990) 14–15.



namely property. A third development was the notion to tax expenditure. The fact that a tax on expenditure became an increasingly heavy burden on the least wealthy classes contributed to the development of the next stage, namely the notion of taxing the produce of property, irrespective of who owned the property. This development was a forerunner of the taxation of net profits, or income.²⁹

Although taxes can be classified and categorised in various ways, the following paragraphs provide a general overview of the three main tax bases contained in modern tax systems, namely the taxation of income, wealth and consumption.

2.2.2 The Taxation of Income

Broad-based income taxation is a relatively modern innovation. Apparently, the first true progressive direct income tax was introduced in Britain by William Pitt the Younger in 1799, to pay for weapons and equipment in preparation for the Napoleonic wars.³⁰ It developed in the early nineteenth century principally in England, Sweden and some of the German and American states.³¹ Many industrialised countries imposed an income tax only towards the end of the nineteenth century or early in the twentieth century.³²

²⁹ Seligman (1921) 5–18; Seligman (1969) 10–18. See also Piek and Franzsen in Van Jaarsveld and Oosthuizen *eds* (1988) 904–905.

³⁰ Sabine (1980) 115–117; Holmes PhD Thesis (2000) 154. See Sabine (2006) for a discussion on the history of the income tax in England from its beginning in 1799 to the present day.

³¹ Thuronyi (2003) 231.

³² Thuronyi (2003) 231. E.g. the first US income tax was imposed in July 1862. See also Vivian (2006) *SA Journal of Economics* 82.

2.2.2.1 *The Income Tax: Various Approaches*

Historically, two distinctly different notions of *legal* income developed, namely the English source-based concept (influenced by the trust concept) and the American accretion-based concept.³³

According to the “source concept”,³⁴ which originated in an English agricultural economy, income is described as the fruits produced by capital.³⁵ According to this approach a receipt is considered to be income only if it is periodic in nature and derived from personal exertion, activities or capital.³⁶ The capital itself, namely the source of the income, is excluded from the tax base. Under this approach, income includes salaries, wages, interest, rent, trade profits, royalties and dividends.³⁷ According to Seligman, inheritances are irregular returns and “in a logical [source-type] income tax there is no room for such accidental or fortuitous revenues”.³⁸

The source-based notion of income was adopted in continental European systems such as the ones in the Netherlands, France, Germany, Italy and Spain.³⁹ The distinction between income and capital under the source concept was furthermore influenced by principles of English trust law, when the idea developed that landowners could limit their heirs to the enjoyment of the property only.⁴⁰ The understanding of income, as opposed to capital, in

³³ Holmes PhD Thesis (2000) Ch 5; Thuronyi (2003) 235–240; Lang in Essers and Rijkers *eds* (2005) 18.

³⁴ The Margo Report (1986) par 5.26 refers to the “production flow concept of income”.

³⁵ Holmes PhD Thesis (2000) 174; Thuronyi (2003) 236 n 18, 237. Apparently this concept was based on the theory of the classical economists. See Vivian (2006) *SA Journal of Economics* 90.

³⁶ Thuronyi (2003) 27.

³⁷ Holmes PhD Thesis (2000) 174.

³⁸ Seligman (1969) 133–134. See also Holmes PhD Thesis (2000) 434 and Thistle (2007) *Ga J Int & Comp L* 715–716. There are some exceptions. Apparently, Denmark includes the receipt of a gift as taxable income in the hands of the recipient. See Holmes PhD Thesis (2000) 434 n 46.

³⁹ Thuronyi (2003) 27, 236–237, 240.

⁴⁰ Holmes PhD Thesis (2000) 174. Thuronyi (2003) 233 refers to a third “trust concept” of income. It is submitted that the trust concept is not a separate category of income. Principles of trust law merely influenced the differentiation between income (separated from the source) and capital (the source).



the earlier decisions of the English Courts on the subject of trust law was transposed to the interpretation of the concept of income under the income tax law in 1921.⁴¹ The trust law distinguishes between income received by beneficiaries (life tenants), and capital held by the holders of the remainder interest (remainder-men).⁴² This development influenced the judicial interpretation of legal income in the United Kingdom, Canada and Australia in particular.⁴³

The dramatically different accretion-based concept originated in the United States.⁴⁴ This notion of income does not contain the sharp distinction between income and capital that originated in England and Europe.⁴⁵ Holmes explains that this is attributable to the fact the “[o]wnership of land did not carry the same social prestige that it did in England and Europe ... Wealth accumulation in England would traditionally have been retained as a means of deriving a stream of rental or farming income”,⁴⁶ whereas in America “gains from the sale of capital assets [often] constituted the profit contemplated from a transaction”.⁴⁷ As a result, this concept of income has also included capital gains and profits in the carrying out of business operations.⁴⁸ The judiciary, however, consistently held that unrealised increases in the value of assets do not constitute income for purposes of the United States income tax.⁴⁹ Although inheritances and gifts were conceptually

⁴¹ See Holmes PhD Thesis (2000) 179–193 for a detailed discussion on this transposition.

⁴² Holmes PhD Thesis (2000) 174; Thuronyi (2003) 238.

⁴³ Thuronyi (2003) 236, 240.

⁴⁴ Thuronyi (2003) 236.

⁴⁵ See Holmes PhD Thesis (2000) 221–228 for a comprehensive discussion of the development of the concept of income in the US.

⁴⁶ Holmes PhD Thesis (2000) 221.

⁴⁷ Holmes PhD Thesis (2000) 222.

⁴⁸ Arnold and Edgar (1995) *Can Publ Pol* 61. Holmes PhD Thesis (2000) 226 quotes from the Supreme Court decision *Eisner v Macomber* (1920) 252 US 189 (206–207): “Income may be defined as the gain derived from capital, from labour, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.”

⁴⁹ Holmes PhD Thesis (2000) 227 refers to e.g. the decision of *Town v Eisner* (1918) 245 US 418.



included in the tax base,⁵⁰ these accretions were statutorily excluded from the income tax base from 1913.⁵¹

Income taxes (whether source-based or accretion-based) are usually structured on either a global or a schedular basis. In a global income tax income consists of all types of income, whatever its nature or source, and deductions are allowed irrespective of the type of income in respect of which they were incurred, producing a taxable amount to which a tax rate is applied. On the other hand, a schedular income tax provides for various categories of income, often taxed at different rates and in terms of different rules. It is also common for income tax systems to evince elements of both a global and a schedular system.⁵²

In South Africa, nearly 60 percent of national revenue is currently derived from a direct income tax,⁵³ currently levied in terms of the Income Tax Act of 1962.⁵⁴ In view of the fact that the first income tax enacted for the South African Union in 1914 was based on the Land and Income Tax Assessment Act of 1895 from New South Wales,⁵⁵ which was in turn based on English income tax legislation, the South African concept of income was formulated on the English source-based concept of income. Under the current act, “gross income” consists of receipts and accruals other than receipts and accruals of a capital

⁵⁰ Eisenstein (1956) *Tax Law Rev* 227 n 22; McCaffery (1999) *Tax Notes* 1430; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 14.

⁵¹ Apparently the US Congress concluded in 1913 that the common man-on-the-street understanding of income probably does not include gifts. See Kornhauser (1992) *Conn Law Rev* 12; Holmes PhD Thesis (2000) 447–448; Darnell (2004) *Seton Hall Law Rev* 671 n 51.

⁵² Thuronyi (2003) 233–235.

⁵³ See the statistics available at <http://www.treasury.gov.za/documents/national%20budget/default.aspx> (accessed on 17 March 2009). For the 2007/2008 year of assessment, taxes from income contributed to 57.9% of the total tax revenue. See National Treasury (Republic of South Africa) *2009 Estimate of National Revenue* 3, available at <http://www.treasury.gov.za/documents/national%20budget/2009/enr/enr.pdf> (accessed on 17 March 2009).

⁵⁴ Act 58 of 1962.

⁵⁵ Vivian (2006) *SA Journal of Economics* 82.

nature.⁵⁶ Although the current income tax can predominantly be classified as a global income tax, providing for the application of a tax rate to a taxpayer's taxable income (consisting of all types of income), the system has over the years adopted elements of schedular taxation (such as the provision for the separate taxation of capital gains within the income tax system, as will be discussed more fully below).⁵⁷

2.2.2.2 *Comprehensive Income Tax*

In 1966, the Canadian Royal Commission on Taxation, chaired by K LeM Carter (the "Carter Commission"), conceded that the essence of ability-to-pay is founded on the changes in the economic or spending power of a taxpayer and proposed that the existing Canadian (English-based) legal concept of income should be broadened and based on the *economic* Haig-Simons concept of income, which is even broader than the American accretion-concept.⁵⁸ According to the Haig-Simons concept of income (sometimes referred to as "S-H-S income"), "income" is defined as "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question".⁵⁹ In short, income equals consumption plus change in net wealth. This formulation of income, which has widely been accepted in economic theory,⁶⁰ is very broad and conceptually includes market income (business income), such as earnings derived from trade profits

⁵⁶ Income Tax Act s 1.

⁵⁷ See par 2.2.3.3.2.

⁵⁸ See in general Carter Report Vol 1 (1966) 6 and Vol 3 (1966) Ch 8 and Meade Report (1978) 127–147 for a discussion on the basic features of a comprehensive income tax.

⁵⁹ Simons (1938) 50. This concept of income was initially developed by the German economist Georg von Schanz (in 1896) and further developed by the American economists Robert Haig and Henry Simons in the 1920s and 1930s. See Musgrave (1967) *Harv Law Rev* 44 47 n 7; Goode in Pechman *ed* (1977) 1–30 and Holmes PhD Thesis (2000) 55–74.

⁶⁰ Goode in Cnossen and Bird *eds* (1990) 62; Holmes PhD Thesis (2000) 35; Lang in Essers and Rijkers *eds* (2005) 18; Steenekamp *Income Taxation* in Black, Calitz and Steenekamp *eds* (2008) 154–155.

and the fruits of capital,⁶¹ unrealised accrued capital gains,⁶² imputed income⁶³ and income from gifts and inheritances (i.e. “transfer income”).⁶⁴

The Carter Commission’s proposal attracted wide support under theorists and policy-makers,⁶⁵ and was also considered by various official tax review commissions.⁶⁶ Three ways of treating gifts and inheritances in a comprehensive income tax base were identified. In terms of the first approach, inheritances and gifts received would be perceived as additions to taxable capacity and would be included as income in the hands of the recipient, whereas the gift or bequest would not be deductible in the transferor’s hands (constituting a form of voluntary consumption).⁶⁷ Although, according to the second approach, a gift or bequest would also be included as income in the recipient’s hand, the making of the gift or bequest would not be regarded as consumption in the hands of the transferor, due to the fact that it does not involve an expenditure on

⁶¹ “Market income” includes all gains derived from market transactions, either through the use of skills or labour or through the investment of capital. Market income would therefore encompass any gain derived through an action of a taxpayer executed with the intention to make a profit. For inclusion in economic concept of income see Carter Report Vol 1 (1966) 13–14; Lang in Essers and Rijkers *eds* (2005) 18 and Freedman in Essers and Rijkers *eds* (2005) 193.

⁶² Goode in Pechman *ed* (1977) 19; Holmes PhD Thesis (2000) 379.

⁶³ “Imputed income” comprises the value of benefits derived from non-market transactions, such as a taxpayer’s enjoyment of his own assets and self-performed services. For inclusion in economic concept of income see Goode in Pechman *ed* (1977) 19; Holmes PhD Thesis (2000) 521; Lang in Essers and Rijkers *eds* (2005) 19 and Roxan *Imputed Income* in Essers and Rijkers *eds* (2005) 249.

⁶⁴ Carter Report Vol 3 (1966) 465; Goode in Pechman *ed* (1977) 19; Meade Report (1978) 137; Holmes PhD Thesis (2000) 421; Lang in Essers and Rijkers *eds* (2005) 20.

⁶⁵ See e.g. Wagner (1973) 44, 52; Musgrave (1967) *Harv Law Rev* 44; Pechman (1967) *Harv Law Rev* 63; Bittker (1967) *Harv Law Rev* 925; Galvin (1968) *Harv Law Rev* 1016; Goode in Pechman *ed* (1977) 19 n 40 and 29; Dodge (1978) *Harv Law Rev* 1177; Davies (1984) *Rutgers Law J* 849; Popkin (1986) *Indiana Law J* 63; Epstein (1986) *Soc Philos Pol* 60; Goode in Cnossen and Bird *eds* (1990) 62; Holmes PhD Thesis (2000) 242; Dodge (2003) *SMU Law Rev* 554.

⁶⁶ The Meade Report (1978) 31 praised the concept in principle, but observed that it may lead to some strange results. The O’Brien Report (1982) 31, 117 endorsed and adopted the idea as a key element of its tax reform proposals.

⁶⁷ This was the approach preferred by the Carter Report. See Ch 3 par 3.2.3 n 54. See also Bittker (1967) *Harv Law Rev* 945–946; Musgrave (1967) *Harv Law Rev* 100; Meade Report (1978) 41, 42 table 3.2 (approach no 2), 137; Dodge (1978) *Harv Law Rev* 1177, 1186; McIntyre in Cnossen and Bird *eds* (1990) 151; Thuronyi (1990) *Tax Law Rev* 73–74, 150–151; Holmes PhD Thesis (2000) 452.

marketable consumer goods or marketable savings. The gift or bequest would therefore qualify as a deduction against income in the hands of the transferor.⁶⁸ According to the third approach, the gift or bequest would not be included in the tax base of the recipient and would also not be deductible in the hands of the transferor.⁶⁹

However, practical difficulties, such as inflation,⁷⁰ fluctuating income⁷¹ and whether to tax accretions when they accrue or when they are realised,⁷² as well as socio-economic and political policy considerations, have prevented Canada and other countries from adopting a pure comprehensive income tax approach.⁷³ Legislators have, nonetheless, over the years broadened their respective tax bases by adjusting the traditional concept of income or by imposing additional taxes on capital gains,⁷⁴ thereby reforming in the direction of a comprehensive income tax.⁷⁵ Although the Carter Report's recommendations were never

⁶⁸ McIntyre and Oldman (1977) *Harv Law Rev* 1598 n 90; Meade Report (1978) 41, 42 table 3.2 (approach no 1); McIntyre in Cnossen and Bird *eds* (1990) 151–153; Rose in Essers and Rijkers *eds* (2005) 66.

⁶⁹ Meade Report (1978) 41, 42 table 3.2 (approach no 3); Thuronyi (1990) *Tax Law Rev* 76.

⁷⁰ Inflation can erode capital gains. See Roxan *Influence of Inflation* in Essers and Rijkers *eds* (2005) 223 *et seq* for a comprehensive discussion.

⁷¹ Hettich and Winer (1985) *Natl Tax J* 423.

⁷² The comprehensive concept of income conceptually recognises economic gains when they accrue on an unrealised basis, whereas the traditional legal concepts of income concentrate on cash inflows. See O'Brien Report (1982) 205 and Holmes PhD Thesis (2000) 291. Commentators and policy-makers generally agree that the taxation of gains should rather be provided for on a realisation basis. See Meade Report (1978) 129; O'Brien Report (1982) 33, 205–206; Holmes PhD Thesis (2000) 379; Freedman in Essers and Rijkers *eds* (2005) 198–199 and Lang in Essers and Rijkers *eds* (2005) 30. Even Henry Simons, one of the fathers of the comprehensive concept of income, has claimed that “[t]he realization criterion is not only indispensable to a feasible income-tax system but relatively unobjectionable in principle where it results only in postponement of assessment, or in cancellation of earlier ‘paper profits’ against subsequent paper losses”. See Simons (1938) 162 (also quoted by Holmes PhD Thesis (2000) 379 n 1).

⁷³ Messere (1993) 219. Doyle (2008) par 1.6 mentions that the O'Brien Report's proposal for a comprehensive base for Ireland was largely ignored. See also Gassner in Essers and Rijkers *eds* (2005) 35.

⁷⁴ See par 2.2.3.3.2 for a discussion on the taxation of capital gains.

⁷⁵ Sandford (2000) 43; Thuronyi (2003) 240. The provision for debt forgiveness as a capital gain is an example of a selective application of the comprehensive concept of income. See Holmes PhD Thesis (2000) 460.

adopted, it made a worldwide impact on international tax policy. Sandford mentions that “[n]o other official report on taxation has ever been so widely considered or acclaimed”.⁷⁶

The Margo Commission considered, but rejected, a comprehensive income tax for the South African tax system.⁷⁷ The Katz Commission did not even consider the possibility.

2.2.3 The Taxation of Wealth

Historically, property taxes have been divided into two basic categories, namely the taxation of the ownership of property and the taxation of the movement or transfer thereof.⁷⁸ A third category developed alongside the modern income tax, whereby the net increase in the monetary value of a taxpayer’s property, or wealth,⁷⁹ is subjected to taxation.

2.2.3.1 Property Taxation

The property tax base includes real property as well as personal property.⁸⁰ A contemporary form of the taxation of property ownership is what is commonly referred to as a recurrent tax on immovable property or “property tax”, which embraces a periodic

⁷⁶ Sandford (1987) *Br Tax Rev* 164.

⁷⁷ Margo Report (1986) pars 5.19 and 12.10.

⁷⁸ Riley (1991) 2.

⁷⁹ The fiscal term “wealth” is used interchangeably with the word “capital”, meaning the net monetary value of assets owned. Sandford (2000) 94 explains that: “Economists tend to think of capital as a stock of assets to be used for future production and wealth as a stock of assets to be drawn on for consumption – but the assets are the same.” When the terms “capital” and “wealth” are used in the sphere of taxation, they refer to fixed capital (as opposed to circulating capital) and generally embrace all kinds of property and rights in and to property. See also Riley (1991) 2 and Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp eds (2008) 184.

⁸⁰ Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp eds (2008) 187.

tax charged upon the owner (or in some instances the occupier) of immovable property.⁸¹ These taxes have crystallised as an ideal way to finance local government expenditures.⁸²

In South Africa, “rates” are levied at the local government sphere in terms of the recently introduced Local Government: Municipal Property Rates Act.⁸³ This form of taxation is a major source of revenue for municipalities. Nearly R22.5 billion was generated for the 2006/2007 local government fiscal year, representing approximately 44 percent of the cash receipts of municipalities.⁸⁴

2.2.3.2 Transfer Taxation

Unlike property taxation, the taxation of the acquisition or alienation of property requires something more than mere ownership. A chargeable event, for example a transfer on death or in consequence of a sale or donation, imposes a liability upon the taxpayer. These taxes, commonly referred to as transfer taxes, can be classified as property transfer taxes or wealth transfer taxes.

2.2.3.2.1 Property Transfer Taxes

Property transfer taxes apply to the gross value of the assets transferred, without taking any liabilities into account.⁸⁵ Taxes on the acquisition of immovable property are commonly encountered. Common-law countries generally tend to levy a stamp duty on

⁸¹ See in general Thuronyi (2003) 330–331; Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp eds (2008) 187–194.

⁸² This has occurred particularly in English-influenced countries. See Bird (1991) *Can Publ Pol* 322; Messere, De Kam and Heady (2003) 173; Thuronyi (2003) 330.

⁸³ Act 6 of 2004.

⁸⁴ Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp eds (2008) 187.

⁸⁵ Rudnick and Gordon in Thuronyi ed Vol 1 (1996) 293 n 5.

the deed of sale, usually at rates below 2 percent.⁸⁶ Civil-law countries, on the other hand, usually levy a tax on the acquisition of the immovable property at rates often exceeding six percent.⁸⁷ Transfer taxes can also extend to the transfer of property other than immovable property. A transfer tax or duty is often levied on the transfer of securities in companies and similar corporate entities.

In South Africa, a tax (“transfer duty”) is levied on the transfer of immovable property in terms of the Transfer Duty Act.⁸⁸ The transfer of listed and unlisted securities is taxed under the Securities Transfer Tax Act.⁸⁹

2.2.3.2.2 *Wealth Transfer Taxes*

Wealth transfer taxes are taxes on inheritances, gifts and estates. These taxes have been known at different places and times by a great variety of names.⁹⁰ They are usually levied directly and on a net basis, by taking the accompanying liabilities and special circumstances of the taxpayer or recipient into account.⁹¹

Some countries impose a tax on the acquisition of an inheritance or a gift in the hands of a beneficiary, at rates which typically differ depending on the relation between the transferor and the beneficiary. These taxes are usually referred to as a “succession duty”, an “inheritance tax” an “acquisitions tax” or an “accessions tax”.⁹² Broadly speaking, the

⁸⁶ SARS *Transfer Duty Handbook* (2007) 6.

⁸⁷ SARS *Transfer Duty Handbook* (2007) 6.

⁸⁸ Act 40 of 1949. See in general Franzsen LLD Thesis (1990) for a comprehensive and critical discussion on transfer duty in South Africa.

⁸⁹ Act 25 of 2007.

⁹⁰ For example, “death duty,” “probate duty,” “legacy duty,” “succession duty,” “estate duty,” “estate tax,” “capital transfer tax,” “inheritance tax” etc.

⁹¹ Rudnick and Gordon in Thuronyi *ed* Vol 1 (1996) 293 n 5; Thuronyi (2003) 330.

⁹² However, the “inheritance tax” currently levied in the UK is a transferor-based tax. See Ch 8 for further reading on the UK inheritance tax.

reference to an “accessions tax” refers to a tax where the aggregate value of all inheritances and gifts are taxed on an annual basis in the hands of the recipient, usually at progressive rates. On the other hand, a reference to an “inheritance tax” usually entails the taxation of the acquisition of individual gifts or inheritances (in the hands of the recipient), which is not measurable over a fixed period of time.⁹³

Other countries levy a charge on the transferor, namely a deceased estate or a donor. Where the charge is levied on a deceased estate, the tax is commonly referred to as an “estate tax”. As pointed out earlier, South Africa levies currently transferor-based wealth transfer taxes on *inter vivos* transfers and transfers on death. The historical development of wealth transfer taxation will be more fully discussed in Chapter 3 below.

2.2.3.3 Net Increase in Wealth Taxation

The modern approach to subject a taxpayer’s net increase in wealth or “capital profit” to taxation has been established through net wealth taxation and capital gains taxation. A net wealth tax is a tax on unrealised capital gains, whereas a capital gains tax is usually imposed on a realisation basis.

2.2.3.3.1 Net Wealth Taxes

The first modern net wealth tax, taking debts into account in the valuation of the property, was enacted in Prussia in 1893.⁹⁴ The tax is generally levied annually on the accrual in the value of a taxpayer’s assets, usually above a specified exemption limit.⁹⁵ Although a net wealth tax was very common in European countries,⁹⁶ many have recently abolished or

⁹³ O’Brien Report (1982) 443; Rudnick and Gordon in Thuronyi *ed* Vol 1 (1996) 293; Dodge (2009) *Hastings Law J* 998.

⁹⁴ Lehner (2000) *Tax Law Rev* 672.

⁹⁵ Sandford (1971) 177; Thuronyi (2003) 329.

⁹⁶ Lehner (2000) *Tax Law Rev* 618. Joulfaian (2005) *Tax Notes* 951 refers to “the most draconian wealth tax ever envisaged”. In 1942 a wealth tax was imposed in Turkey in respect of which neither the tax rate nor

Footnote continues on the next page

transformed such taxes.⁹⁷ It has been retained by only a few European countries.⁹⁸ Numerous countries have decided against its implementation, mainly because of the administrative difficulties and problems relating to cost efficiency, valuations and concerns over liquidity constraints.⁹⁹ The global trend is to move away from net wealth taxation.¹⁰⁰ The notion to tax the net increase in a taxpayer's capital by virtue of a realisation-based capital gains tax has probably contributed to the demise of net wealth taxation. It is arguable that a net wealth tax is not required if capital income already attracts tax under a comprehensive tax system which includes capital gains.¹⁰¹

the taxable base was made public. Tax assessments were arrived at in secret. The tax was primarily envisaged to apply to assets and immovable property. The tax was payable within two weeks with no provision for appeal. Taxpayers were classified as Muslim and non-Muslim and the burden of the tax fell predominantly on the non-Muslims (Christians and Jews). If non-Muslims failed to pay their taxes within a month, their property was confiscated and they were deported to forced labour camps in Eastern Turkey. Apparently, the tax was implemented to control prices during the inflationary early years of World War II.

⁹⁷ E.g. in Denmark (abolished), Germany (abolished), The Netherlands (transformed), Austria (abolished), Ireland (abolished) and Luxembourg (abolished). See Messere, De Kam and Heady (2003) 174; Thuronyi (2003) 329 and http://www.estv.admin.ch/e/dokumentation/zahlen_fakten/dok/inter/2007/vermoegennat.pdf (accessed on 30 June 2008).

⁹⁸ E.g. Norway, Sweden, Switzerland, France and Spain. According to Kessler and Pestieau (1991) *Can Publ Pol* 309, the decline of net wealth taxes in the (then) EEC can be attributed to the fact that European governments have become increasingly more profit- and free market-orientated and sensitive about hurting capital formation.

⁹⁹ The possible introduction of net wealth taxation was considered and rejected by various official commissions and committees in various countries such as Canada (Carter Report Vol 3 (1966) 28); Australia (Asprey Report (1975) 510), UK (Tiley (2008) 1260 n 11 refers to the Committee on a Wealth Tax), Ireland (O'Brien Report (1982) 41–42, 58) and Zimbabwe (Chelliah Report (1986) 199). Although the Meade Committee proposed the implementation of an annual wealth tax for the UK (Meade Report (1978) 363, 514, 518), it was never implemented. Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 51 do not advocate the introduction of a regular wealth tax for the UK, although it is mentioned that an additional annual local government property tax targeted at very high value residential property (with no reduction for debt) may be an option that could be explored in the future.

¹⁰⁰ Sandford (2000) 103; Messere, De Kam and Heady (2003) 174.

¹⁰¹ Third Interim Katz Report (1995) par 6.1.6.

Although the introduction of a net wealth tax into the South African tax system was considered by the Margo Commission, it was rejected on grounds of administrative difficulties.¹⁰² This proposition was supported by the Katz Commission.¹⁰³

2.2.3.3.2 *Capital Gains Taxes*

With the development of the American notion to tax realised capital profits under the legal concept of income, capital gains have been taxed under the United States income tax system since 1913. On the other hand, continental Europe, England and the other common-law countries generally applied a legal concept of income in terms of which no provision was made for capital profits.¹⁰⁴ However, many of these countries imposed a net wealth tax on capital assets.¹⁰⁵ The taxation of capital gains therefore barely existed prior to 1950, but was introduced between 1958 and 2000 in most OECD¹⁰⁶ countries,¹⁰⁷ mainly to improve the equity, neutrality and redistributive justice of the tax systems.¹⁰⁸ Some

¹⁰² Margo Report (1986) par 20.42.

¹⁰³ Third Interim Katz Report (1995) par 7.1.11.

¹⁰⁴ See par 2.2.2.1.

¹⁰⁵ See par 2.2.3.3.1.

¹⁰⁶ The Organisation for Economic Co-operation and Development (OECD) is an international organisation of thirty countries committed to the principles of a free economy and a representative democracy. It originated in 1948 to assist with the reconstruction of Europe after World War II. The membership was later extended to non-European countries. The OECD provides a forum where governments and policy makers can compare policy experiences on various economic, social and environmental issues. See <http://www.oecd.org> (accessed on 3 September 2008). South Africa is currently not a member country of the OECD. However, the OECD's statistics and publications are a reliable source on comparable economic and social data, trends, analyses and forecasts.

¹⁰⁷ Messere, De Kam and Heady (2003) 23. It was introduced in the UK in 1965 (following the recommendations of a Royal Commission Report in 1955), Canada in 1971 (following a political process) and Australia in 1985 (following the recommendations of the Asprey Report). See Arnold and Edgar (1995) *Can Publ Pol* 60.

¹⁰⁸ Hepker (1973) 182; Margo Report (1986) par 12.34; Third Interim Katz Report (1995) pars 6.4.1–6.4.8.

countries provided for capital gains taxation within the existing income tax legislative framework,¹⁰⁹ whereas other countries have elected to introduce separate legislation.¹¹⁰

Unlike a net wealth tax, a capital gains tax is usually imposed on a realisation basis, whereby only the gains that have accrued to a taxpayer on the disposal (usually by way of a sale or exchange) of his or her capital assets during the year of assessment are taxed.¹¹¹

A capital gain is generally assessed as the difference between the (1) original acquisition price (or value) plus value enhancement expenditures and (2) the consideration received for the asset on disposal.¹¹² It is therefore a tax levied on the “profit” made by the taxpayer on the disposal of his or her capital assets.¹¹³

A problematic event for purposes of capital gains tax is the death of a wealth holder, because such a person will have no future opportunity to realise a capital asset. The unrealised gains may be captured in the tax base in one of two ways. Firstly, the wealth holder’s assets may be deemed to have been realised on the date of death resulting in the deceased being taxed as if he or she had disposed of the assets to his or her deceased

¹⁰⁹ Such as Australia, Canada, France, Japan, Sweden and Spain. See Arnold and Edgar (1995) *Can Publ Pol* 61 and Messere, De Kam and Heady (2003) 177. Although this has often been justified on the grounds that capital gains are actually akin to income (Asprey Report (1975) 18; Third Interim Katz Report (1995) pars 6.1.1, 6.1.5), it has been stated this has occurred instead because of administrative convenience (Messere, De Kam and Heady (2003) 179).

¹¹⁰ Such as the UK, Italy and Ireland. See Arnold and Edgar (1995) *Can Publ Pol* 61 and Messere, De Kam and Heady (2003) 177.

¹¹¹ Arnold and Edgar (1995) *Can Publ Pol* 61. Most OECD countries apply capital gains tax on a realisation rather than an accrual basis. See Report of the OECD *Taxation of Capital Gains of Individuals* (2006) 104. The realisation approach has the advantages of the existence of liquidity and the avoidance of costly valuations. See Bittker (1967) *Harv Law Rev* 968–969; O’Brien Report (1982) 205–06; Margo Report (1986) par 5.25; Chelliah Report (1986) 200; Third Interim Katz Report (1995) pars 6.3.4, 6.3.10; Holmes PhD Thesis (2000) 381; Lang in Essers and Rijkers *eds* (2005) 30; Kavelaars in Essers and Rijkers *eds* (2005) 128–134 and Freedman in Essers and Rijkers *eds* (2005) 200. However, some commentators concede that the problems related to valuation and liquidity are not strong enough to reject the accrual method. See Shakow (1986) *Univ Pennsylvania Law Rev* 1111 *et seq* and Kavelaars in Essers and Rijkers *eds* (2005) 130–133.

¹¹² Third Interim Katz Report (1995) par 6.3.5; Arnold and Edgar (1995) *Can Publ Pol* 61.

¹¹³ First Franzsen Report (1968) par 281; Riley (1991) 2; Steenekamp *Income Taxation* in Black, Calitz and Steenekamp *eds* (2008) 180.

estate.¹¹⁴ This method will be referred to as the “deemed realisation” approach in this thesis. Secondly, the liability in respect of the unrealised gains may be deferred until the heir actually disposes of the asset. In these cases the heir takes over the acquisition cost, hereafter referred to as the “base cost”, from the deceased. The heir will be liable for capital gains tax on the total gain only upon the eventual disposal of the property.¹¹⁵ This method will be referred to as the “carry-over” approach.

It is, however, possible that the unrealised gains may be excluded from capital gains tax altogether, where the system provides that the heir takes over the asset at base cost equal to market value on the date of death of the deceased. This method will be referred to as the “stepped-up” approach.

To extend the South African tax base to include capital profits, the Franzsen Commission recommended the introduction of a realisation-based capital gains tax.¹¹⁶ Both the Margo Commission and the Katz Commission considered, but rejected, the proposition.¹¹⁷ However, capital gains tax was introduced into the South African tax system by means of the inclusion of the Eighth Schedule to the Income Tax Act, which applied with effect from 1 October 2001.¹¹⁸ It was decided that capital gains tax would be incorporated as an integral part of the income tax system, because a tax on capital gains “is regarded as a tax on income”.¹¹⁹ On the practical side, it was stated that such an approach has

¹¹⁴ Maloney (1988) *Ottawa Law Rev* 606; Arnold and Edgar (1995) *Can Publ Pol* 68.

¹¹⁵ Report of the OECD *Taxation of Capital Gains of Individuals* (2006) 111.

¹¹⁶ First Franzsen Report (1968) par 312. A minority report by HS Mabin contended that a capital gains tax should not be introduced (at 65–67).

¹¹⁷ Margo Report (1986) par 12.38 (only two of the commissioners supported the introduction of a capital gains tax on equitable grounds and requested that the majority report of the Franzsen Commission on this aspect be reaffirmed (par 12.39)); Third Interim Katz Report (1995) pars 6.6.1–6.7.1.

¹¹⁸ The Minister of Finance announced in his budget speech of 23 February 2000 that a tax on capital gains was to be introduced into the South African tax system, thereby bringing the system more into line with the international position. The design of the Eighth Schedule was influenced by the tax legislation of especially Australia and the UK, and to a lesser extent, the US and Canada. See Williams (2005) 1.

¹¹⁹ Explanatory Memorandum to the Taxation Laws Amendment Bill (2001) 7.



administrative advantages, as the existing procedures and provisions of the Income Tax Act relating to matters such as returns, assessments, payment and recovery of the tax and objection and appeals could be utilised for purposes of capital gains tax.¹²⁰

Section 26 of the Income Tax Act includes the taxable capital gain of a person (in a year of assessment) in such person's taxable income and is therefore subject to normal tax at the normal tax rates published under the Act. A person's taxable gain is, however, separately determined in terms of the rules and provisions of the Eighth Schedule and basically consists of a certain percentage of a person's net capital gain (determined by multiplying the net capital gain with a certain inclusion rate). In the case of a natural person or special trust, the inclusion rate is 25 percent and in the case of most corporate entities and ordinary trusts the inclusion rate is 50 percent. Since a person's taxable gain is added to other taxable income and subject to normal tax, the effective maximum rate of tax payable on capital gains is less than in the case of other taxable income.¹²¹

The interaction between capital gains tax and wealth transfer taxation on the transfer of wealth will be highlighted in various chapters below (where pertinent).

¹²⁰ Explanatory Memorandum to the Taxation Laws Amendment Bill (2001) 7.

¹²¹ For the 2010 year of assessment, the maximum rates payable on capital gains are as follows: $25\% \times 40\% = 10\%$ for natural persons and special trusts; $50\% \times 40\% = 20\%$ for ordinary trusts and $50\% \times 28\% = 14\%$ for corporate entities such as companies and close corporations.

2.2.4 The Taxation of Consumption

2.2.4.1 Taxes on Goods and Services

The earliest taxes on consumption were customs¹²² and excise duties.^{123 124} General sales taxes, where governments charge a tax at the point of purchase of goods and services on the total value of the exchange, were first introduced in France and Germany around the middle of World War I.¹²⁵ It became a popular method for governments to raise tax revenue between 1930 and 1965.¹²⁶ A modern development in the area of indirect consumption taxes is the value-added tax (VAT), which is levied on the added value which results from each taxable transaction.¹²⁷ VAT was invented by the French economist, Maurice Laure, in 1954, and has been adopted in the member states of the European Union, the Nordic countries, New Zealand, Australia, Canada and Japan. The only member of the OECD that continues to resist the introduction of VAT is the United States.¹²⁸ VAT has also been adopted by the majority of countries in Africa.¹²⁹

¹²² Customs are levies charged on the importation or exportation of products. Smith (1776) book v ch ii pt ii art 4, available at <http://www.adamsmith.org> (accessed on 20 June 2008), explains that customs derived its name from “customary payments which had been in use from time immemorial”. See in general Thuronyi (2003) 335–337.

¹²³ Excise duties are levies charged on specific goods and services produced, sold or delivered within a country and on licences granted for certain activities. These duties are typically based on the physical characteristic of a product – for example, the weight of salt or tobacco, the strength of alcohol and the volume of fuel or oils. See Sandford (2000) 68 and Thuronyi (2003) 328–329.

¹²⁴ Smith (1776) book v ch ii pt ii art 4, available at <http://www.adamsmith.org> (accessed on 20 June 2008); Messere, De Kam and Heady (2003) 138.

¹²⁵ Messere, De Kam and Heady (2003) 138.

¹²⁶ Messere, De Kam and Heady (2003) 138.

¹²⁷ See Sandford (2000) 75–93 for a discussion on the various forms of general sales taxes and a comparison between a general sales taxes and VAT. Messere, De Kam and Heady (2003) 22 mention that VAT is probably the most important development in taxation during the last fifty years. See Thuronyi (2003) ch 8 for a brief comparative overview of VAT systems.

¹²⁸ Messere, De Kam and Heady (2003) 139; Thuronyi (2003) 303 n 5.

¹²⁹ See Krever *ed* (2008) 1–7.

The taxation of goods and services has represented a fundamental part of the South African tax system over the years. The earliest taxes, namely customs and excise duties, have remained part of the system. Currently excise duties are levied on, for example, wine, spirits, beer, tobacco, other fermented beverages, fuel, diesel, plastic bags, international air travel and various other products.¹³⁰ A diamond export levy is also levied.¹³¹ In 1978 a general sales tax (GST) was introduced, following the international example. This tax, with its single-stage collection system, was replaced by a value-added tax in 1991, when the Value-Added Tax Act¹³² was implemented. Besides the income tax, value-added tax is currently the second-largest revenue raiser in South Africa.¹³³

2.2.4.2 Personal (Direct) Consumption Tax

In 1651, long before the development of the income tax, Thomas Hobbes proposed that the criterion of equity demands that people should be taxed on what they consume.¹³⁴ Hobbes's idea of a direct consumption tax was taken up by some distinguished economists in the United States and the United Kingdom.¹³⁵ The tax base was formulated as a taxpayer's income minus savings plus spending out of capital.¹³⁶ Investments and

¹³⁰ Customs and Excise Act 91 of 1964. See in general Cnossen (2006) for a comparative overview of excise taxation in Southern African countries.

¹³¹ Diamond Export Levy Act 15 of 2007.

¹³² Act 89 of 1991.

¹³³ For the 2007/2008 year of assessment, VAT contributed to approximately 26% of the total tax revenue. See National Treasury (Republic of South Africa) *2009 Estimate of National Revenue* 3, available at <http://www.treasury.gov.za/documents/national%20budget/2009/enr/enr.pdf> (accessed on 17 March 2009).

¹³⁴ See the reference to Hobbes's book, *Leviathan*, in O'Brien Report (1982) 259. Hobbes's proposition was restated by John Stuart Mill in his book *Principles of Political Economy* (1848). See O'Brien Report (1982) 259 and quotation by Musgrave (2000) 152.

¹³⁵ E.g. Alfred Marshall (*Principles of Economics* 1890), Arthur Cecil Pigou (*A Study in Public Finance* 1962) and Nicholas Kaldor (*An Expenditure Tax* 1958) in the UK, and Irving Fischer (*Constructive Income Taxation* 1942) in the US. See O'Brien Report (1982) 259.

¹³⁶ Sandford (2000) 38. See in general Bradford (2000) for a comprehensive discussion of the basic concepts and broad policy issues of a consumption tax, as well as a broad comparison with an income tax.

savings are therefore excluded from the tax base, which would arguably soften the economic distortions caused by taxation.

Tax policy-makers and economists have been exceptionally interested in the idea of a personal (direct) consumption tax.¹³⁷ While some official tax review commissions have indicated a willingness to accept such a tax base,¹³⁸ others have considered but rejected the proposal.¹³⁹ The consumption/income tax debate has attracted a lot of attention among United States commentators in particular.¹⁴⁰ This debate has arguably been intensified by the absence of value-added tax in that country.

Similar to the position under a comprehensive income tax,¹⁴¹ there were three ways identified in theory to deal with inheritances and gifts in a direct consumption tax. In terms of the first approach, the making of a gift or bequest would be regarded as a form of consumption (and not savings) and the gift or bequest would be included in the tax base of the consumer, namely the transferor. For the recipient the tax would be postponed

¹³⁷ See Steenekamp *Taxes on Goods and Services* in Black, Calitz and Steenekamp eds (2008) 205–206 for a discussion on the advantages and the disadvantages of a personal consumption tax.

¹³⁸ E.g. Blueprints for Basic Tax Reform, available at <http://www.ustreas.gov/offices/tax-policy/library/blueprints/full.pdf> (accessed on 30 June 2008); Meade Report (1978) 44, 502, 517; O'Brien Report (1982) 51, 277. See also Hettich and Winer (1985) *Natl Tax J* 425; Sandford (2000) 37.

¹³⁹ E.g. Carter Report Vol 1 (1966) 10 and Vol 3 (1966) 25–26; Asprey Report (1975) 15; Chelliah Report (1986) 144.

¹⁴⁰ See e.g. Andrews (1972) *Harv Law Rev* 309; Andrews (1974) *Harv Law Rev* 1113; Warren (1975) *Harv Law Rev* 931; Andrews (1975) *Harv Law Rev* 956–958; Graetz (1979) *Harv Law Rev* 1575; Kelman (1979) *Stanford Law Rev* 831; Warren (1980) *Yale Law J* 1081; Kelman (1983) *Stanford Law Rev* 649; Strnad (1985) *Stanford Law Rev* 1023; Strnad (1986) *Indiana Law J* 73; Epstein (1986) *Soc Philos Pol* 64–67; Zodrow in Cnossen and Bird eds (1990) 85; Halperin (1992) *Florida Tax Rev* 1; Fried (1992) *Stanford Law Rev* 961; McCaffery (1992) *Texas Law Rev* 1145; Knoll (1994) *UCLA Law Rev* 1791; Bankman and Fried (1998) *Georgia Law Rev* 539; Schenk (1999) *Chaplin Law Rev* 133; Musgrave (2000) 152–154; McNulty (2000) *Calif Law Rev* 2095; Graetz (2002) *Yale Law J* 261; Banks (2003) *Michigan Law Rev* 2238; Goldberg (2003) *Tax Lawyer* 1; Messere, De Kam and Heady (2003) 28–29; McCaffery (2005) *Michigan Law Rev* 807; Lang in Essers and Rijkers eds (2005) 31; Rose in Essers and Rijkers eds (2005) 53–76; McCaffery (2005) *Can J Law Jur* 153; Bankman and Weisbach (2006) *Stanford Law Rev* 1413; Avi-Yonah (2006) *Tax Law Rev* 1.

¹⁴¹ See par 2.2.2.2.

until he or she consumes the gift or bequest.¹⁴² Under the second approach, a gift or bequest would be omitted from the tax base of the transferor and only included in the tax base of the recipient when consumed.¹⁴³ In terms of the third approach, gifts and inheritances would be excluded from the tax base of the transferor and the recipient.¹⁴⁴

Although numerous countries' tax systems contain consumption-type elements, no country has (as far as could be ascertained) adopted a pure direct consumption tax yet.¹⁴⁵ However, the choice between a traditional income tax and a consumption tax "would probably affect little more than the timing" of the taxes.¹⁴⁶ It is submitted that the twenty-first century would rather see the introduction of some consumption-type elements to the existing universally preferred income tax base model, for example the exemption of interest, the deductibility of mortgage interest payments, contributions to private pension schemes, premiums on life assurance policies, and the provision of tax incentives for the purchase of employee participation shares and the starting-up or expanding of a business.

In considering the proposition of a direct consumption tax for the South African tax system in 1986, the Margo Report concluded that "if South Africa were to take this step, it would be accepting a pioneering role that seems inappropriate to the present socio-political climate within the country and South Africa's standing in the international

¹⁴² Meade Report (1978) 41, 42 table 3.2 (approach no 2); O'Brien Report (1982) 275; Mintz (1991) *Can Publ Pol* 259; Zelenak (1996) *Tax Law Rev* 601; Dodge (1996) *Tax Law Rev* 558–559; Burke and McCouch (1998) *Virginia Tax Rev* 662; Musgrave (2000) 155.

¹⁴³ This was the approach preferred by the US report Blueprints for Basic Tax Reform. See Ch 3 par 3.2.3 n 50. See also Meade Report (1978) 41, 42 table 3.2 (approach no 1); O'Brien Report (1982) 275; Verbit (1980) *Boston Univ Law Rev* 39; Burke and McCouch (1998) *Virginia Tax Rev* 662, 705; Rakowski (2000) *Tax Law Rev* 374; Graetz (2002) *Yale Law J* 261 n 109.

¹⁴⁴ This was the approach preferred by the Meade Report. See Ch 3 par 3.2.3 n 40. See also Meade Report (1978) 41, 42 (approach no 3) and Burke and McCouch (1998) *Virginia Tax Rev* 705–708.

¹⁴⁵ Although Croatia imposed a business-based tax that was close to a consumption-type income tax, it was abolished in 2000. See Thuronyi (2003) 233 n 8 and accompanying text.

¹⁴⁶ Andrews (1974) *Harv Law Rev* 1124. See also Carter Report Vol 3 (1966) 26 and Musgrave (2000) 207.

community”.¹⁴⁷ The Katz Report did not even consider the possibility. However, the income tax contains many traces of consumption-based taxation, for example the provision for the deduction of retirement annuities and pension fund contributions. It seems likely that, instead of a total conversion to a direct consumption tax, the trend would instead be to increasingly provide for deductions in respect of savings and investments.

2.2.5 Miscellaneous Taxes

Stamp duties are often levied on documents such as lease agreements, bonds, sureties and wills. Social security levies are also commonly encountered. Although South Africa used to levy stamp duties on a plethora of different forms and documents, most of these duties were eliminated over the last 20 years. Stamp duty was abolished from the system altogether with the repeal of the Stamp Duty Act¹⁴⁸ with effect from 1 April 2009. Social security contributions such as a skills development levy¹⁴⁹ and an unemployment insurance contribution¹⁵⁰ have also been imposed.

2.2.6 Tax Systems: A Mix of Various Taxes

Although the income tax is the universally preferred tax base today, most countries have hybrid systems, typically comprising a combination of direct and indirect taxes on income, wealth and consumption.¹⁵¹ From 1950 to 1980, there was an enormous world-wide shift from consumption taxes to income taxes, but since then there has been a

¹⁴⁷ Margo Report (1986) par 5.39. See also pars 5.35–5.36 and 5.40–5.41.

¹⁴⁸ Act 77 of 1968.

¹⁴⁹ Levied in terms of the Skills Development Levy Act 9 of 1999.

¹⁵⁰ Levied in terms of the Unemployment Insurance Contributions Act 4 of 2002.

¹⁵¹ Loeckx and Van Dionant (1980) 82; Margo Report (1986) par 6.1; Theron LLD Thesis (1994) 32; Sandford (2000) 36; Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 117, 118.

growing reliance on value-added tax and social security contributions.¹⁵² It was realised that an income tax should be complemented with taxes on consumption and capital, so that tax systems can achieve optimal fairness.¹⁵³ In the words of Sandford, the tax bases “each tax a different facet of ability-to-pay and it can be argued that the fairest tax system will utilise them all”.¹⁵⁴

2.3 OBJECTIVES OF TAXATION

The objectives of taxation can be categorised into two main parts. Firstly, taxation is an important fiscal tool to provide for the financing of public expenditures. Secondly, taxation can be utilised to accomplish numerous socio-economic and political objectives. Taxation is therefore a central component of state-building.¹⁵⁵

2.3.1 Revenue

Almost all social policy efforts require expenditure, which can be financed through loan capital, user charges, administrative fees, government-induced inflation or taxation.¹⁵⁶ An important purpose of taxation is therefore to generate sufficient revenue to assist in the financing of government activities.¹⁵⁷

¹⁵² See Messere, De Kam and Heady (2003) 9–12 and 20–29 for a summary of the trends in taxation and fiscal policy in the OECD countries over the period 1950–2000.

¹⁵³ Asprey Report (1975) 14; Gammie Report (1994) 7; Sandford (2000) 37.

¹⁵⁴ Sandford (1995) 49, as quoted by the Third Interim Katz Report (1995) par 7.1.6.

¹⁵⁵ See collection of essays in Brautigam, Fjelstad and Moore (eds) *Taxation and State-Building in Developing Countries* (2008) on this topic (with special reference to developing countries).

¹⁵⁶ See Steenekamp *Introduction* in Black, Calitz and Steenekamp eds (2008) 115–116 for further discussion.

¹⁵⁷ Adriani and Van Hoorn Vol 1 (1954) 102–103, 183; Wagner (1973) 3; Margo Report (1986) par 3.11; Stevens (1989) 5; Sandford, Pond and Walker (1980) 1; Gammie Report (1994) 6; Interim Katz Report (1994) par 1.5.4 (c); Third Interim Katz Report (1995) par 2.6.1; Rakowski (1996) *Tax Law Rev* 438; Paper by Bird and Zolt *Tax Policy Design and Development* (2003) 6; Graetz and Shapiro (2005) 266; Rose in Essers and Rijkers eds (2005) 53; Vivian (2006) *SA Journal of Economics* 83–84; Doyle (2008) par 1.4.1.

In South Africa, the actual total (gross) tax revenue collected for the 2007/2008 year of assessment was R572.81 billion. The non-tax revenue collected amounted to R11.67 billion.¹⁵⁸ Revenue collected through taxation has contributed a substantial 98 percent of total gross revenue for that year of assessment.

2.3.2 Socio-economic Objectives

Taxation can also be used as an instrument of social and economic policy.¹⁵⁹ Taxes can for instance assist socio-economic objectives such as the redistribution of resources, economic growth and reprising.

2.3.2.1 Redistribution of Resources

According to liberal thought, a legal system should value political liberty, equality of opportunity and fairness in distribution so that all people may have an equal opportunity to pursue their economic dreams.¹⁶⁰ The redistribution of resources can assist these values by reducing the economic and political power that is concentrated in the hands of the wealthy and by raising the socio-economic standards of the poor.¹⁶¹ It can also mitigate political tension, in view of the fact that the wide disparity of wealth in developing countries in particular has been a definite cause of racial and ethnic tension.¹⁶² Redistribution can, for example, be effected through increased taxation on the more wealthy members of society, especially through progressive taxation and wealth taxes.¹⁶³

¹⁵⁸ National Treasury (Republic of South Africa) *2009 Estimate of National Revenue 2*, available at <http://www.treasury.gov.za/documents/national%20budget/2009/enr/enr.pdf> (accessed on 17 March 2009).

¹⁵⁹ Sandford, Pond and Walker (1980) 4; Chelliah Report (1986) 67; Brautigam in Brautigam, Fjelstad and Moore *eds* (2008) 1.

¹⁶⁰ See in general Rawls (1971) and the Meade Report (1978) 15.

¹⁶¹ Meade Report (1978) 15; Duff (1993) *Can J Law Jur* 23–26; Kaplov in Gale, Hines and Slemrod *eds* (2001) 192; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 23.

¹⁶² Rudnick and Gordon in Thuronyi *ed* Vol 1 (1996) 297.

¹⁶³ O'Brien Report (1982) 442; Terreblanche (2004) *TGW* 233; Doyle (2008) par 1.4.2.

It has therefore become an increasingly important, widely accepted objective of taxation in a democratic society.¹⁶⁴ Some theorists argue that it has even become the primary objective of taxation.¹⁶⁵

Confiscatory taxation could, however, violate constitutionally protected property rights, increase tax avoidance and evasion, and have a negative impact on the economy. It could also encourage taxpayers to emigrate to other jurisdictions.¹⁶⁶ Capitalists concede that redistribution through taxation is an assault upon the capital system as such, because the system can lead to the concentration of wealth in the few, but by no means necessarily to the detriment of the many.¹⁶⁷

The extent to which the redistribution of resources should be an objective of a jurisdiction's tax system is therefore likely to depend on political considerations. Nonetheless, in developing countries such as in South Africa,¹⁶⁸ where poverty and inequality are extreme problems, the redistribution of income is a common goal of tax policy.

¹⁶⁴ Carter Report Vol 1 (1966) 6; O'Brien Report (1982) 101; Chelliah Report (1986) 68; Thuronyi (1990) *Tax Law Rev* 96; Ginsburg (1996) *Transformation* 89–99; Rakowski (1996) *Tax Law Rev* 438; Repetti (2001) *NY Univ Law Rev* 825; Bernstein (2004) *Cardozo J Int & Comp L* 187–188.

¹⁶⁵ Adriani and Van Hoorn Vol 1 (1954) 193; Loeckx and Van Dionant (1980) 84–85 refer to Wagner (1890–1944) and Neumark (1970).

¹⁶⁶ Carter Report Vol 3 (1966) 153; Duff (1993) *Can J Law Jur* 29; Lee (2007) *Legal Studies* 697 n 141 and accompanying text claims that this argument has been substantiated for the UK by a study conducted by Adam, Brewer and Shephard *The Poverty Trade-Off: Work Incentives and Income Redistribution in Britain* (London Institute for Fiscal Studies October 2006).

¹⁶⁷ See e.g. Editorial (1997) *Taxpayer* 67.

¹⁶⁸ According to a research paper on wealth inequality in South Africa, the poorest 40% of South African households, overwhelmingly black, earned only 4% of the total income earned by South Africans in 1991, while the richest 10%, predominantly white, earned more than 50% of the total income. About 17 million South Africans were living below the poverty line. See Ginsburg (1996) *Transformation* 89. A more recent study indicates that the situation has indeed worsened in recent years as approximately 22 million of the population, or 48.5%, were living below the poverty line in 2004. See Terreblanche (2004) *TGW* 213. Terreblanche's article provides a historical exposition of the development of poverty in South Africa. For commentaries on Terreblanche's article, see Brits (2004) *TGW* 241; Le Roux (2004) *TGW* 243 and Rossouw (2005) *TGW* 117.

The comment of the Katz Commission that the “actual and perceived redistributive effects” of the tax system are very significant¹⁶⁹ underlined the importance of redistributive justice for the South African context. Since the transition to a new political dispensation in 1994, tax reform in South Africa has especially been focused on the facilitation of the redistribution of resources.

2.3.2.2 *Economic Growth*

Adequate levels of investment and saving are essential for economic growth. Tax policy can be formulated to act as an incentive for economic growth and development,¹⁷⁰ the avoidance of inflation and unemployment¹⁷¹ and the promotion of saving and investment.¹⁷²

Both the Margo Report and the Katz Report considered the effect of tax incentives on the levels of saving and investment in the South African economy. Although taxation can serve as a fiscal tool to enhance a favourable climate for investment, the Margo Report concluded that fiscal incentives would not have a large positive effect on personal saving.¹⁷³ However, it was emphasised that no justification exists for maintaining fiscal disincentives to save.¹⁷⁴ Instead of specific tax incentives, the report favoured the international trend of a broad-based system with lower tax rates. This proposition was

¹⁶⁹ Third Interim Katz Report (1995) par 7.1.4. See also Interim Katz Report (1994) pars 1.2.2–1.2.3, where it was noted that “[t]he disparities between the wealthy and the poor in South Africa rank amongst the greatest in the world ... This legacy of poverty and inequality constitutes a moral issue of the gravest dimension. Its continuation undermines the stability of South African society and thereby weakens the prospects for confident economic recovery. Unless these problems are urgently addressed, the prognosis for South Africa is bleak.”

¹⁷⁰ Carter Report Vol 1 (1966) 32; Interim Katz Report (1994) par 1.5.4 (c); Third Interim Katz Report (1995) 4; Stevens (1989) 6 refers for example to the function of import taxes to protect the local markets.

¹⁷¹ Sandford (1970) 8.

¹⁷² Chelliah Report (1986) 68.

¹⁷³ Margo Report (1986) par 4.24.

¹⁷⁴ Margo Report (1986) par 4.40.

supported in the Interim Katz Report with the statement that “[t]ax incentives aimed specifically at raising the aggregate level of investment and saving do not make much economic sense”.¹⁷⁵

In respect of taxation’s relation to employment, the Margo Report stated that the short-term manipulation of taxes would be unlikely to successfully encourage employment. It suggested that efforts to encourage employment should rather be directed at the long term.¹⁷⁶

2.3.2.3 Reprising

The encouragement or discouragement of certain types of activities (referred to as “reprising”) can be addressed by means of taxation.¹⁷⁷ The so-called “sin taxes”, levied on products such as alcohol and tobacco, were initially implemented to discourage people from consuming these products.¹⁷⁸ The criticism against reprising through taxation flows from the principle of non-discrimination, which requires the government to be neutral towards all kinds of activities.¹⁷⁹ However, the counter-argument is that these taxes can assist in the raising of revenue towards the social cost associated with the misuse or abuse of these products, which justifies discriminatory taxation. South Africa levies excise duties on a variety of products.¹⁸⁰

¹⁷⁵ Interim Katz Report (1994) par 15.6.1 (see also pars 15.6.2–15.6.16 for further discussion), endorsed by Third Interim Katz Report (1995) par 17.1.4.

¹⁷⁶ Margo Report (1986) par 4.6.

¹⁷⁷ Rakowski (1996) *Tax Law Rev* 438; Sandford (2000) 70; Bernstein (2004) *Cardozo J Int & Comp L* 189; Doyle (2008) par 1.4.3.

¹⁷⁸ Smith (1776) book v ch ii pt ii art iv, available at <http://www.adamsmith.org> (accessed on 20 June 2008), mentions that “[i]t has for some time past been the policy of Great Britain to discourage the consumption of spirituous liquors, on account of their supposed tendency to ruin the health and to corrupt the morals of the common people.”

¹⁷⁹ Wagner (1973) 44.

¹⁸⁰ See par 2.2.4.1.



2.4 TAX POLICY CONSIDERATIONS

2.4.1 General

The manner in which a tax jurisdiction imposes taxes to achieve its goals depends upon criteria such as the economic policy and level of development, the rate of inflation, the levels of employment, any budget deficit, history and culture, the tax structures of neighbouring countries, the administrative capacity to levy and administer taxes and political policy.¹⁸¹ However, taxes should be coherent with the composition of the relevant tax system, which is largely the product of political decision-making. The importance of tax policy considerations is therefore to provide some non-political guidelines to policy-makers and legislators, founded on rational grounds.¹⁸² The essential tax policy principles, referred to as the “canons of taxation”, are discussed in paragraph 2.4.2 below.

However, the essential policy principles of taxation cannot be considered in isolation. Over the past two centuries, the pursuit of a true democracy has resulted in the development of the concept of a constitution, setting out the structure and rules within which a government may operate within a jurisdiction and entrenching fundamental rights and values consistent with a true democracy to which the laws of the jurisdiction should adhere. The constitutional law and principles of a jurisdiction should therefore also be taken into account in the design and reform of its tax legislation and the interpretation thereof. Institutional processes are furthermore of extreme importance for the scrutiny of tax proposals and for the enactment of proper tax legislation in accordance with the constitutional principles and the general ideals of fair taxation. The South African constitutional considerations applicable to the realm of taxation are considered in paragraph 2.4.3 below.

¹⁸¹ Paper by Bird and Zolt *Tax Policy Design and Development* (2003) 4–5; Croome PhD Thesis (2008) 5.

¹⁸² Gutmann in Essers and Rijkers *eds* (2005) 97.

2.4.2 The “Canons of Taxation”

In his 1776 treatise, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, the Scottish classical economist, Adam Smith, outlined four criteria of a good tax system, commonly referred to as the “canons of taxation”.¹⁸³ The principles of equity, certainty, convenience and cost efficiency were also accepted and restated by other classical economists¹⁸⁴ and have become the most enduring and widely acknowledged principles of taxation.¹⁸⁵

2.4.2.1 *The First Canon: Equity*

Smith stated that the principle of equity demands that taxpayers ought to contribute towards the fiscal coffers in proportion to the revenue which they respectively enjoy under the protection of the state.¹⁸⁶ In order to apply equal treatment to taxpayers, it is firstly necessary to determine some method of measuring equity. This has been attempted by two different approaches, namely the benefit principle and the principle of ability-to-pay.¹⁸⁷

¹⁸³ Smith referred to the “maxims” of taxation, although these are commonly referred to by other commentators as the “canons” of taxation.

¹⁸⁴ Such as Jeremy Bentham (1748–1832), David Ricardo (1772–1823) and John Stuart Mill (1806–1873).

¹⁸⁵ See e.g. Buehler (1948) 321; Adriani and Van Hoorn Vol 1 (1954) 206–208; Hepker (1973) 7; Klein-Wassink in Jongsma and Verburg *eds* (1975) 99; Loeckx and Van Dionant (1980) 83; O’Brien Report (1982) 85; Gutman (1983) *Virginia Law Rev* 1216–1217; Holmes PhD Thesis (2000) viii; Musgrave (2000) 137 n 2 and accompanying text; Morse and Williams (2000) 5; Paper by Bird and Zolt *Tax Policy Design and Development* (2003) 5; Sabine (2006) 49; Doyle (2008) par 1.3. These principles have been supported in a South African context, see Margo Report (1986) pars 4.42–4.50, Interim Katz Report (1994) par 1.5.4 (a); Fourth Interim Katz Report (1997) pars 1.4–1.5 (equity and equality); Croome PhD Thesis (2008) 6 and Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 119–120.

¹⁸⁶ Smith (1776) book v ch ii pt ii, available at <http://www.adamsmith.org> (accessed on 20 June 2008).

¹⁸⁷ Buehler (1948) 318–324; Carter Report Vol 3 (1966) 3; Asprey Report (1975) 12; Margo Report (1986) par 4.43; Third Interim Katz Report (1995) par 6.1.4; Stevens (1989) 3–4; Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 120.

2.4.2.1.1 *The Benefit Principle*

According to the benefit principle, a person should pay taxes in accordance with the benefits that he or she receives from government-provided goods and services.¹⁸⁸ A major advantage of the benefit principle is that the expenditure side of the budget is linked to the revenue side.¹⁸⁹ The allocative procedures of market behaviour are furthermore approximated, thereby ensuring that resources are efficiently allocated.¹⁹⁰ Benefit taxes, also referred to as user charges, are commonly levied in the form of tolls for roads and bridges, admission charges to museums and parks, licence fees and certain tuition and school fees.¹⁹¹

However, the application of the benefit principle is rather restricted. Firstly, taxation based on benefits received cannot assist in the redistribution of resources, an important objective of taxation.¹⁹² Secondly, there are many instances where benefits enjoyed from government services cannot be allocated to the users of such services in a generally acceptable manner.¹⁹³ The third issue is the difficulty of assigning indirect benefits amongst the taxpayers, because some of the indirect beneficiaries may even reside outside the tax jurisdiction.¹⁹⁴

¹⁸⁸ Carter Report Vol 3 (1966) 3; O'Brien Report (1982) 83; Stevens (1989) 3–4; Steenekamp *Introduction in Black, Calitz and Steenekamp eds* (2008) 120. This principle was developed by English philosophers Thomas Hobbes (1588–1679), John Locke (1632–1704) and by Dutch jurist Hugo Grotius (1583–1645). See <http://www.economyprofessor.com/economictheories/benefit-approach-principle.php> (accessed on 28 April 2008).

¹⁸⁹ Steenekamp *Introduction in Black, Calitz and Steenekamp eds* (2008) 120.

¹⁹⁰ Steenekamp *Introduction in Black, Calitz and Steenekamp eds* (2008) 120.

¹⁹¹ Steenekamp *Introduction in Black, Calitz and Steenekamp eds* (2008) 121.

¹⁹² Carter Report Vol 3 (1966) 4; Theron LLD Thesis (1994) 21; Steenekamp *Introduction in Black, Calitz and Steenekamp eds* (2008) 121. See par 2.3.2.1 for a discussion on the redistribution of resources as an objective of taxation.

¹⁹³ Buehler (1948) 319; Carter Report Vol 3 (1966) 4; Theron LLD Thesis (1994) 20; Steenekamp *Introduction in Black, Calitz and Steenekamp eds* (2008) 116, 121.

¹⁹⁴ Buehler (1948) 319; Carter Report Vol 3 (1966) 4.



2.4.2.1.2 *The Ability-to-Pay Principle: Horizontal Equity and Vertical Equity*

The criterion of ability-to-pay, the underlying idea of which is that taxation is a sacrifice levied upon some kind of “personal economic well-being”, has been the more widely accepted approach, although it is a difficult concept to define.¹⁹⁵ It has become customary to define the two dimensions of ability-to-pay, namely horizontal equity, requiring taxpayers with equal capacity to contribute in equal proportions, and vertical equity, requiring taxpayers with greater capacity to pay more taxes.¹⁹⁶ Appropriate measures of taxable capacity include income, consumption, wealth and utility.¹⁹⁷ In the design of fiscal legislation, the principle of ability-to-pay requires the choice of the appropriate

¹⁹⁵ Seligman (1921) 4; Buehler (1946) *Tax Law Rev* 243; Buehler (1948) 321; Carter Report Vol 1 (1966) 5, 9 Vol 3 (1966) 3 (the report refers to “economic power”); Van Nispen and Schuttevaer (1969) 45; Asprey Report (1975) 12, 13; Meade Report (1978) 14 (the report refers to “taxable capacity”); Dodge (1978) *Harv Law Rev* 1183 (Dodge refers to “economic well-being”); O’Brien Report (1982) 83–84; Chelliah Report (1986) 68; Margo Report (1986) par 4.43; Stevens (1989) 3 (Stevens refers to the “leer van het evenredige nutsoffer”); Gammie Report (1994) 7; Theron LLD Thesis (1994) 19; Holmes PhD Thesis (2000) 21; Morse and Williams (2000) 6; Authority cited by Lang in Essers and Rijkers *eds* (2005) 8 n 29; Vivian (2006) *SA Journal of Economics* 84; Kay: Mirrlees Review (2008) 8; Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 122. The modern principle was expounded by the Swiss philosopher Jean-Jacques Rousseau (1712–1778), the French political economist Jean-Baptiste Say (1767–1832) and the English economist John Stuart Mill (1806–1873). See Holmes PhD Thesis (2000) 22 n 40 and accompanying text and <http://www.Economyprofessor.com/economictheories/ability-to-pay-principle.php> (accessed on 28 April 2008). One of the first documentary references to the principle can be found in the French declaration of 1791, where it was demanded that the public financial requirements should be equally distributed among the citizens in proportion to their ability to pay. See Lang in Essers and Rijkers *eds* (2005) 9 n 30 and accompanying text and Vivian (2006) *SA Journal of Economics* 86.

¹⁹⁶ Carter Report Vol 1 (1966) 4–5; Asprey Report (1975) 12; Meade Report (1978) 12; O’Brien Report (1982) 83; Margo Report (1986) par 4.44; Franzsen LLD Thesis (1990) 20; Gammie Report (1994) 7; Theron LLD Thesis (1994) 19; Morse and Williams (2000) 6; Holmes PhD Thesis (2000) 19; Paper by Bird and Zolt *Tax Policy Design and Development* (2003) 11; Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 122.

¹⁹⁷ Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 122.

taxpayer¹⁹⁸ and the tax period¹⁹⁹ wherein the circumstances of the taxpayers should be compared.²⁰⁰

The criterion of vertical equity has undergone dramatic changes over the years. The idea was unknown to the natural law theorists such as John Locke.²⁰¹ Although some commentators have interpreted Adam Smith's first maxim as the foundation of progressive taxation,²⁰² it is submitted that Smith felt uneasy about progressive taxation and the redistribution of resources.²⁰³ Smith instead supported proportional taxation, providing for fixed tax rates, as a fair way to distribute the burden.²⁰⁴

¹⁹⁸ There are two fundamentally different approaches to the measurement of ability-to-pay. Firstly, an individual's resources can be measured over a lifetime, regardless of how they are used ("lifetime endowment"). This approach supports the individual as the appropriate taxpayer (sometimes referred to as "tax unit"). Secondly, resources can be measured in a multi-generational (family) context ("dynastic equity"). See Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 16. Consequently, the main taxpayers are (a) the individual, (b) the married (or cohabitating) couple and (3) the married (or cohabitating) couple with dependants. See Bittker (1967) *Harv Law Rev* 925, 973; Asprey Report (1975) 131; Meade Report (1978) 15, 377; Gutman (1983) *Virginia Law Rev* 1218; Musgrave (2000) 207. Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 122 n 2 refers to the debate in a South African context (Margo Report (1986) 106–154 and Interim Katz Report (1994) 67–84).

¹⁹⁹ Ideally, the notion of horizontal equity dictates that taxpayers should as far as practically possible be compared on the basis of a lifetime of circumstances. See Carter Report Vol 3 (1966) 241; Asprey Report (1975) 14; Blueprints for Basic Tax Reform (1977) 25; Zodrow in Cnossen and Bird *eds* (1990) 93; Riley (1991) 25; Lang in Essers and Rijkers *eds* (2005) 17; Rose in Essers and Rijkers *eds* (2005) 63–66.

²⁰⁰ Margo Report (1986) par 4.43; Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 122.

²⁰¹ Adriani and Van Hoorn Vol 1 (1954) 219; Musgrave (2000) 182.

²⁰² See e.g. Adriani and Van Hoorn Vol 1 (1954) 222; Dobris (1984) *Syracuse Law Rev* 1219.

²⁰³ Musgrave (2000) 138–139 explains that "[i]n the *Wealth of Nations*, he [Smith] argues that economic progress created by the market system greatly advances the welfare not only of the rich but also of the poor. Their position, while below the extravagance of the rich, 'exceeds that of many an African King.' Moreover, as argued in *The Theory of Moral Sentiments*, the gain from riches is largely a fiction. The wealthy landlord, in imagination, may consume his whole harvest, but 'the capacity of his stomach bears no proportion to the immensity of his desires, and will receive no more than that of the meanest peasant'". See also Vivian (2006) *SA Journal of Economics* 88.

²⁰⁴ Buehler (1948) 325; Hepker (1973) 3; Musgrave (2000) 139, 183; Lang in Essers and Rijkers *eds* (2005) 9.

The principle of vertical equity has, nonetheless, evolved to encompass the value of distributive justice through taxation. The initial idea developed in the utilitarian school of thought. Jeremy Bentham (1748–1832) defended the idea of distribution by proposing that the primary goal of a government is the maximum aggregate welfare of the society and that total happiness increases with equality of wealth.²⁰⁵ The first phase of development was the granting of an exemption of a specific amount of income, justified by John Stuart Mill (1806–1873) in view of the fact that there is a minimum amount which is essential to provide for the necessities of life. Modern commentators and policy-makers generally concede that, in the measurement of a taxpayer's ability-to-pay, basic necessities should be taken into account.²⁰⁶

Bentham's proposition was restated almost a century later by the economic theorists Edgeworth (1897) and Pigou (1928).²⁰⁷ Edgeworth took the idea one step further and developed the idea of progressive tax rates, namely the idea that higher levels of income, property, wealth or whatever the tax is applied to should be charged at higher marginal rates, compared to a flat proportional rate that is applicable to all taxpayers.²⁰⁸

A third practice of progressive taxation developed in the differentiation between various kinds of income, for example earned income (labour income) and unearned or investment

²⁰⁵ Adriani and Van Hoorn Vol 1 (1954) 219; Musgrave (2000) 140, 184.

²⁰⁶ Shehab (1953) 2; Seligman (1921) 25–29; Buehler (1948) 323. Rose in Essers and Rijkers *eds* (2005) 57 refers to a reduced form of ability-to-pay, a concept which he names “social or humane ability-to-pay”. The Carter Report Vol 1 (1966) 5, 9 and Vol 3 (1966) 5, 32 refers to “discretionary economic power”. Vivian (2006) *SA Journal of Economics* 85–88 points to the fact that people who fall below the tax threshold will contribute to the state coffers through indirect taxes.

²⁰⁷ Edgeworth and Pigou developed the theory of “equal marginal sacrifice”. See Goode in Cnossen and Bird *eds* (1990) 75 and Musgrave (2000) 142.

²⁰⁸ When the rates increase with the amount of income, we refer to progressive taxation. When the rate decreases when the income decreases, we have regressive taxation. There may also be progression up to a certain level, with proportional (fixed) rates thereafter. This is referred to as degressive taxation. See Seligman (1921) 30; Hepker (1973) 2–3; Loeckx and Van Dionant (1980) 74; Franzsen LLD Thesis (1990) 25–26; Theron LLD Thesis (1994) 84; Bernstein (2004) *Cardozo J Int & Comp L* 189 n 13 and Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 117, 118.

income.²⁰⁹ This developed from the idea that recipients of earned income have greater needs to satisfy at a higher cost than recipients of more permanent investment income.²¹⁰ While earned income used to be taxed at the same or lower rates than unearned income, the reverse has become the modern trend, namely that unearned income is subject to lower rates for reasons based on efficiency.²¹¹

Although it has commonly been accepted that the rich should pay more taxes, the controversial question is: how much more should the rich pay? Is the criterion of vertical equity sufficiently satisfied by proportional taxation, or does it require some level of progressive taxation? Furthermore, if progressive taxation is desirable, what is the desired level of progressivity? It has often been observed that these questions are some of the most contentious issues in taxation.²¹² Progressive taxation has been challenged and criticised on the one hand,²¹³ and justified on the other.²¹⁴ Proponents of proportional taxation argue that it constitutes a fairer approach to vertical equity than progressive taxation, and that it results in better work effort, less complexity and better compliance.²¹⁵ Nonetheless, and although it has been submitted that political support for progressive taxation has diminished,²¹⁶ theorists and tax policy-makers generally prefer some level of progressive taxation within the tax system, especially to achieve the goal of redistribution

²⁰⁹ Seligman (1921) 22–25; Shehab (1953) 5; Sandford (2000) 54.

²¹⁰ Shehab (1953) 5–6.

²¹¹ Sandford (2000) 54; Thuronyi (2003) 15; Lang in Essers and Rijkers *eds* (2005) 3.

²¹² Carter Report Vol 1 (1966) 19; Asprey Report (1975) 23; O'Brien Report (1982) 101; Interim Katz Report (1994) par 1.8.1; Coetzee (1998) *Tax Planning* 90.

²¹³ See Blum and Kalven (1952) *Univ Chicago Law Rev* 417; Von Hayek (1960) 306–323; Blum (1982) *Taxes* 16; Epstein (1986) *Soc Philos Pol* 69–70; Brennan and Buchanan (2006) 196–198 (advocating constitutional restrictions on rate structures).

²¹⁴ Modern theorists such as John Rawls explains the desire for progressive taxation from the perspective of fairness, which calls for each person to do to others as he would have others do to him (Musgrave (2000) 144). See also Graetz (1983) *Yale Law J* 274–278 and Maloney (1988) *Ottawa Law Rev* 611–622.

²¹⁵ Buehler (1948) 325–326; Bankman and Griffith (1987) *Calif Law Rev* 1966.

²¹⁶ Goode in Clossen and Bird *eds* (1990) 75.

of resources in a democratic society.²¹⁷ The appropriate approach to vertical equity is essentially political and involves basic value judgments about the nature of a good society.²¹⁸ As a consequence, it would influence tax policy on aspects such as rate structures, choice of tax bases and special provisions.²¹⁹ This study will not attempt to address this debate, but will merely accept that vertical equity through some level of progressive taxation is of special importance in South Africa to assist in the redistribution of resources.²²⁰

2.4.2.1.3 *Equity through Objectives: A Better Approach?*

The criterion of ability-to-pay has been criticised as having no independent normative content.²²¹ Some commentators therefore advocate its abandonment in favour of distributive justice, so that the choice of taxation depends upon its primary purpose²²² or the optimal utility for the society.²²³ Others have cautioned that the notion of using taxation to achieve socio-economic goals, by providing for exemptions and special tax treatment for certain taxpayers, thereby treating “equal taxpayers differently”, is in conflict with the basic principle of equity and argue that tax laws should ideally be protected against political motives and abuse.²²⁴

²¹⁷ Buehler (1948) 328; Carter Report Vol 3 (1966) 153; Bankman and Griffith (1987) *Calif Law Rev* 1905; Report of the Joint Standing Committee on Finance on the Interim Katz Report (1995) 4.

²¹⁸ Third Interim Katz Report (1995) par 7.1.4.

²¹⁹ See Hettich and Winer (1985) *Natl Tax J* 426–432. The society’s view of the extent to which distribution should be effected through taxation would e.g. determine whether taxes should be proportional, progressive or regressive. See Musgrave (1967) *Harv Law Rev* 45 n 2 and Sandford (2000) 37.

²²⁰ Coetzee (1998) *Tax Planning* 89.

²²¹ See e.g. Kaplov (1989) *Natl Tax J* 139; McDaniel and Repetti (1993) *Florida Tax Rev* 607; Banks and Diamond: Mirrlees Review (2008) 2, 8, 102.

²²² Davies (1984) *Rutgers Law J* 869; Lang in Essers and Rijkers eds (2005) 11 n 38, n 39 and accompanying text; Gassner in Essers and Rijkers eds (2005) 40–42.

²²³ Banks and Diamond: Mirrlees Review (2008) 2.

²²⁴ Essers and Rijkers in Essers and Rijkers eds (2005) xxiii–iv.

Lang's statement that "the ability-to-pay principle is the most adequate guide to optimise the tax equity and equality, because each branch of the law needs basic principles",²²⁵ deserves support. Ability-to-pay will always be susceptible to social change and is a dynamic concept, which can be shaped to fit into any tax system. It connotes the objectives of fairness and equality, values that are unmistakably part of a democratic society that abides by the "rule of law".²²⁶

2.4.2.2 *The Second Canon: Certainty and Simplicity*

Smith's second maxim dictates that the tax which a person is bound to pay ought to be certain, and not arbitrary, which implies that the time, manner and amount of payment should be clear and ascertainable to the taxpayer.²²⁷ Furthermore, the enforcement thereof should be consistent and universal.²²⁸ Certainty of law is closely linked to legality, both principles of adherence to the rule of law,²²⁹ and is an essential quality of a true democracy where the taxing authorities are accountable to the electorate.²³⁰ Reliance on, for example, selective enforcements might leave too much power to the discretion of the

²²⁵ Lang in Essers and Rijkers *eds* (2005) 13.

²²⁶ The "rule of law" is fundamentally the principle that no one is above the law. Foldvary in Racheter and Wagner *eds* (2002) 191–192 explains as follows: "The supreme law of an organized society makes up its constitution, such that all other laws must adhere to that highest-level framework. In any society, there is always a constitution, whether explicit in writing or implicit in custom and authority. The stability and constraints implied by the rule of law imply a constitution that is itself more stable than operating laws, and thus that the requirements for changing constitutional law are broader, such as requiring supermajorities and wider ratification requirements such as consent also by the voters or by other levels of government. The rule of law is not an end in itself, but a means to something greater."

²²⁷ Smith (1776) book v ch ii pt ii, available at <http://www.adamsmith.org> (accessed on 20 June 2008). See also Meade Report (1978) 18–19; Chelliah Report (1986) 72; Gammie Report (1994) 7; Margo Report (1986) par 4.47; Morse and Williams (2000) 7.

²²⁸ Morse and Williams (2000) 7.

²²⁹ Lang in Essers and Rijkers *eds* (2005) 4.

²³⁰ O'Brien Report (1982) 85.



taxing authorities.²³¹ Certainty is also required for economic purposes, because a lack thereof would undermine confidence in markets, which can impede economic growth.²³²

Certainty also involves simplicity, requiring that taxes should be simple in concept, collection and administration.²³³ It is for example desirable that the taxpayer should ascertain his or her tax liability according to operations and records that he or she needs to perform and preserve anyway.²³⁴ Another aspect is the number of taxpayers: the fewer taxpayers per revenue raised, the simpler the tax system.²³⁵ The problem is, the simpler the rules, the less fair they are, but the fairer they are, the more complex they are.

2.4.2.3 The Third Canon: Convenience

Smith's third maxim provides that every tax ought to be levied at a time, or in a way, most convenient to the taxpayer.²³⁶ This principle touches upon the proposition that taxes should preferably be levied in cash rather than in kind.²³⁷ Furthermore, taxes should ideally be levied in a way that takes cognisance of a taxpayer's liquidity. If a tax is levied on the value of unrealised assets, the assets need to be valued, which opens the door for inconsistencies and tax avoidance through discretionary valuations.

²³¹ Banks and Diamond: Mirrlees Review (2008) 76.

²³² O'Brien Report (1982) 85.

²³³ Meade Report (1978) 18–20; O'Brien Report (1982) 85; Chelliah Report (1986) 72–73; Margo Report (1986) par 4.47.

²³⁴ Asprey Report (1975) 15; O'Brien Report (1982) 85.

²³⁵ As stated by the Asprey Report (1975) 15: "The sheikdom that can raise all the revenue it requires (and maybe much more) from a single tax on a single oil company has what is unquestionably the simplest tax system of all". See also O'Brien Report (1982) 85.

²³⁶ Smith (1776) book v ch ii pt ii, available at <http://www.adamsmith.org> (accessed on 20 June 2008). See also Chelliah Report (1986) 72 and Stevens (1989) 5, where the author refers to "het beginsel van de minste pijn".

²³⁷ Epstein (1986) *Soc Philos Pol* 58.

2.4.2.4 *The Fourth Canon: Cost Effectiveness and Efficiency*

The economic function of a tax in a market economy is to transfer resources from the private sector to the public sector. Smith's fourth maxim requires that the costs of a tax should not be a disproportionately high percentage of the revenue yield.²³⁸ There are three major components of costs, namely collection costs, "dead-weight" market costs and unproductive costs.

2.4.2.4.1 *Collection Costs*

The first component is the collection costs of the system, which consists of (1) administrative costs, namely the cost of establishing and maintaining a tax collection system, and (2) compliance costs, namely the cost for taxpayers to comply with their tax liabilities (in terms of time, money and effort).²³⁹ An efficient collection system requires that "the resources available for public use be as nearly as possible equal to the resources withdrawn from the private sector: that is, that the process by which resources are transferred involve minimal 'waste.'"²⁴⁰ Both costs will be less if the taxpayers' tax liability can be easily established. Efficiency will therefore be enhanced by a certain and simple tax system.²⁴¹

2.4.2.4.2 *Dead-Weight Market Costs and Neutrality*

A tax has an efficiency cost in that it influences the economic decisions of taxpayers. Taxation perceived as being unfair and a penalty to the economically active may

²³⁸ Smith (1776) book v ch ii pt ii, available at <http://www.adamsmith.org> (accessed on 20 June 2008). See also Margo Report (1986) par 4.49; Epstein (1986) *Soc Philos Pol* 56; Stevens (1989) 5.

²³⁹ Meade Report (1978) 20; Margo Report (1986) par 4.48; Morse and Williams (2000) 8; Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 142.

²⁴⁰ Asprey Report (1975) 16. See also Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 142. As stated by Jean-Baptiste Colbert: "[t]he art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least amount of hissing" (quoted by Theron LLD Thesis (1994) 18).

²⁴¹ Asprey Report (1975) 15; Meade Report (1978) 20.

discourage work effort and savings²⁴² and may encourage tax avoidance.²⁴³ This involves the cost to the society of the misallocation of resources (referred to as “dead-weight losses”), resulting in the underlying economic activity being distorted or even destroyed.²⁴⁴

Although it is inevitable that taxation distorts economic decision-making to some extent and discourages certain economic behaviour,²⁴⁵ the criterion of efficiency requires that taxes should ideally be designed to redistribute purchasing power with the least distortion to the market economy.²⁴⁶ This underlines the criterion that the tax system should be neutral: a taxpayer should therefore not be influenced by the tax system to choose one course of action above another predominantly because its tax position is better.²⁴⁷ The objective presupposes the fact that, before a system of taxation is imposed, individuals order their preferences in a discrete and particular way. It cannot be presumed, however, that taxpayers will consume wisely. Government intervention is sometimes required to influence consumer behaviour, and efficiency may even be improved by a departure from neutrality.²⁴⁸ It can have important effects on, for example, incentives to save or work and the allocation of resources to uses that best serve the needs of society.²⁴⁹ As a

²⁴² Coetzee (1998) *Tax Planning* 91.

²⁴³ Banks and Diamond: *Mirrlees Review* (2008) 76.

²⁴⁴ A classic example of a tax that destroyed economic activity is the French “gabelle”, an excise duty on salt that destroyed the salt trade and yielded no income. See Margo Report (1986) par 4.49.

²⁴⁵ Schmalbeck (2000) *Cleve State Law Rev* 754; Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 137.

²⁴⁶ Carter Report Vol 1 (1966) 24–26; O’Brien Report (1982) 84; Chelliah Report (1986) 71; Gammie Report (1994) 6; Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 137. This principle is sometimes referred to as the principle of “least price distortion”. See Sandford (1970) 8; Sandford (1971) 24 and Rose in Essers and Rijkers eds (2005) 55.

²⁴⁷ Asprey Report (1975) 16; O’Brien Report (1982) 84; Margo Report (1986) pars 4.41–4.42; Epstein (1986) *Soc Philos Pol* 55; Gammie Report (1994) 6–7; Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 137.

²⁴⁸ Asprey Report (1975) 16; O’Brien Report (1982) 84; Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 137.

²⁴⁹ Meade Report (1986) 7–11.

consequence, economic theory has developed some rules to maximise social welfare, collectively referred to as the principles of “optimal taxation”.²⁵⁰

2.4.2.4.3 Unproductive Costs

A third component is the costs of tax planning and tax advisors, resulting in resources being employed in the unproductive activity of finding loopholes and tax-free alternatives, which may even further distort the allocation of resources.²⁵¹ An efficient tax system therefore dictates that tax avoidance and evasion be kept to a minimum, which requires simple tax laws.²⁵²

2.4.2.5 Other Considerations

The Meade Report mentions that a good tax structure should be flexible for economic and political reasons, especially in a democratic society where one government succeeds another.²⁵³

The Margo Report refers to the criterion of invisibility, relating to the view that the best taxes are those paid by other people. The Report, however, remarked that “[s]trictly speaking, invisibility is an approach to rather than a canon of taxation”.²⁵⁴

²⁵⁰ See in general Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 137–142 for a comprehensive discussion, which involves rules derived in relation to the magnitude of the excess burden, price elasticities and tax rates.

²⁵¹ Margo Report (1986) par 4.50; Morse and Williams (2000) 8; Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 142.

²⁵² Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 143.

²⁵³ Meade Report (1978) 21. See also Steenekamp *Tax Efficiency* in Black, Calitz and Steenekamp eds (2008) 144.

²⁵⁴ Margo Report (1986) par 4.46. See Franzsen LLD Thesis (1990) 22 for criticism on this statement.



Morse and Williams add that the rules of the system should be workable in the international arena.²⁵⁵

2.4.2.6 Principles in Conflict

The criteria are frequently in conflict with one another. In endeavouring to achieve one criterion more fully, another is less adequately realised.²⁵⁶ Musgrave correctly states that “[t]ax equity, as with all good things in life, carries its costs”.²⁵⁷ Compromises are therefore inescapable and the relative importance that should be allocated to each of these principles will have to be established by virtue of political processes.²⁵⁸

History illustrates that the criterion of equity (“equitable taxation”) dominated tax policy during the 1950s and 1960s,²⁵⁹ whereas the criterion of efficiency gained importance only during the 1970s and 1980s with the development of the theory of “optimal taxation”, which uses simple econometric models to draw inferences about how taxes should be set in order to strike a balance between equity and efficiency concerns.²⁶⁰ Distributive justice, as a function of vertical equity, is currently gaining relative importance in developing countries, including South Africa.

²⁵⁵ Morse and Williams (2000) 9.

²⁵⁶ Carter Report Vol 1 (1966) 3; O’Brien Report (1982) 86.

²⁵⁷ Musgrave (2000) 209.

²⁵⁸ Meade Report (1978) 23.

²⁵⁹ Hettich and Winer (1985) *Natl Tax J* 424–426. The Carter Report Vol 1 (1966) 4 concluded that “[w]e are convinced that scrupulous fairness in taxation must override all other objectives where there is a conflict among objectives”. See also Bird (1991) *Can Publ Pol* 330.

²⁶⁰ Holmes PhD Thesis (2000) viii.

2.4.3 Constitutional Considerations: A South African Perspective

2.4.3.1 *The Constitutional Transformation*

In a South African context, coercive taxation has certainly evolved to a level of accountable taxation, especially with the constitutional transformation and democratisation since 1994. From 1910, when the Union of South Africa was established, to 1994, the South African parliament was mainly elected by South Africa's white minority. The parliamentary system was based on the English Westminster system of parliamentary supremacy.²⁶¹ In the absence of a bill of rights, taxpayers could not challenge fiscal legislation or the revenue authorities' powers in a court of law.²⁶² Although members of the coloured races were generally not permitted to participate in elections, they were still required to pay taxes in the era prior to 1994.²⁶³ This situation has caused several rebellions, such as the Bambatha rebellion in 1906.²⁶⁴

²⁶¹ Croome PhD Thesis (2008) 7 n 12 refers to s 34(3) of the Republic of South Africa Constitution Act 110 of 1983: "No Court of Law shall be competent to enquire into or pronounce upon the validity of an Act of Parliament." Legislation could only be invalidated if it did not comply with the legal procedures set out in the Act.

²⁶² Croome PhD Thesis (2008) 8 (except for some narrow common-law grounds based on administrative justice).

²⁶³ Various poll and "hut taxes" were levied on natives in the colonial era by the colonial governments. To consolidate and amend the law relating to the taxation of natives, the Natives Taxation and Development Act 41 of 1925 was enacted. It provided for the levying of an annual general poll tax on every adult male native domiciled in the Union of South Africa (s 2(1)). An additional local tax was payable by the native occupier of every hut or dwelling in a native location within the Union (s 2(2)). This Act was repealed by the Bantu Taxation Act 92 of 1969, which provided for the levying of an annual graduated income tax on the taxable income of any Black as well as a fixed poll tax, payable by any Black male who has attained the age of 18 years in the year of assessment. This Act also imposed a local ("hut") tax on the occupier of every hut or dwelling. The Act was repealed in 1984. See in general Trevor (1936) *Rev of Econ Studies* 217 *et seq* and Redding (2006) for an extensive historic discussion on the taxation of non-white South Africans for the period 1880–1963.

²⁶⁴ During this revolt, which resulted from the imposition of a new poll tax, between 3 000 and 4 000 Zulus were reportedly killed and more than 7 000 imprisoned in the former Natal Colony. See Redding (2006) Ch 4 for a comprehensive discussion.



In 1994 the first democratic elections were held. The unbearable situation of “taxation without representation” was rectified with the institution of the first democratically elected government on 27 April 1994. On this date the first Interim Constitution came into force by virtue of Act 200 of 1993 (hereafter “Interim Constitution”).²⁶⁵ One of its main purposes was to redefine the public values in the light of newly defined common interests by guaranteeing certain fundamental rights in the Bill of Rights (chapter 3), such as a person’s right to equality, privacy and property, and access to information and justice. The Interim Katz Report, published later in the year, noted that “[w]hereas millions of citizens have in the past regarded the tax system to a lesser or greater degree as a mechanism to fund their oppression, South Africa now enters an era in which taxation becomes a legitimate instrument of achieving national, democratic objectives”.²⁶⁶ The commission declared its intention to bring about equality of taxation in the South African tax system.

Following the enactment of the Interim Constitution and the subsequent recommendations by the Katz Commission,²⁶⁷ some of the discriminatory provisions in fiscal statutes were deleted or amended.²⁶⁸ On 4 February 1997, the Constitution of the Republic of South Africa 1996 (hereafter “the Constitution”) replaced the Interim Constitution.²⁶⁹ Chapter 2 of the Constitution contains the Bill of Rights similar to the Bill of Rights contained in chapter 3 of the Interim Constitution.

²⁶⁵ South Africa became a constitutional state, i.e. a state where the Constitution is the supreme law of the land. Legislation breaching the constitutional principles may not remain in force. See Croome PhD Thesis (2008) 8.

²⁶⁶ Interim Katz Report (1994) par 1.4.2 (b).

²⁶⁷ See Interim Katz Report (1994) Ch 6 entitled “Implications of the Constitution of the Republic of South Africa”.

²⁶⁸ See summary and discussion by Croome (2002) *Acta Juridica* 3–6 and Croome PhD Thesis (2008) 11–14.

²⁶⁹ The Constitution was adopted on 8 May 1996, amended on 11 October 1996, promulgated on 18 December 1996 and implemented on 4 February 1997. See Croome PhD Thesis (2008) 15 n 52.

The founding provisions of the Constitution states that the Republic of South Africa is one, sovereign, democratic state founded on fundamental values such as human dignity, the achievement of equality, the advancement of human rights and freedoms, non-racialism, non-sexism, the supremacy of the constitution, the rule of law, universal adult suffrage, a national voters' roll, regular elections and a multi-party system of democratic government.²⁷⁰ The principle of "supremacy of the constitution" indicates that legislation should primarily abide by the principles set out in the Constitution. Any legislative provision in conflict with the Constitution may be declared unconstitutional, in which case such provision will be of no force and effect.

2.4.3.2 The Power to Impose Taxes

The government's power to impose a tax should be inferred from the general grant of legislative and executive authority and the limitations on that authority imposed by the provisions of the Constitution.²⁷¹ The Constitution distinguishes between three spheres of government, namely national, provincial and local spheres of government.²⁷² The legislative authority of the national sphere vests in Parliament, which consists of the National Assembly and the National Council of Provinces.²⁷³ The legislative authority of the provincial sphere vests in the different provincial legislatures²⁷⁴ and the local sphere

²⁷⁰ Constitution Ch 1 s 1(a)–(d). See Michelman in Woolman, Roux and Bishop *eds* Vol 1 (2007) Ch 11 and Roederer in Woolman, Roux and Bishop *eds* Vol 1 (2007) Ch 13 for a discussion of the founding provisions.

²⁷¹ Croome PhD Thesis (2008) 15. Sections 228 and 229 explicitly limit the rights to tax of the provincial and local spheres of government respectively. See Swart (1996) *SA Public Law* 446 *et seq* for a discussion on the delegation of the power to tax under the Interim Constitution. See Budlender in Woolman, Roux and Bishop *eds* Vol 1 (2007) Ch 17 and Madlingozi in Woolman, Roux and Bishop *eds* Vol 1 (2007) Ch 18 for a discussion of the national and provincial legislative authority and processes.

²⁷² Constitution Ch 3 s 40(1).

²⁷³ Constitution Ch 4 s 42 and 43(a).

²⁷⁴ Constitution Ch 4 s 43(b) and Ch 6 s 104. The Republic has the following nine provinces: Eastern Cape, Free State, Gauteng, KwaZulu-Natal, Limpopo, Mpumalanga, Northern Cape, North West and Western Cape.

of government vests in the municipal councils.²⁷⁵ The national legislative authority, as vested in Parliament, confers on the National Assembly the power to amend the Constitution and to pass legislation in respect of any matter, including a matter listed within the functional areas of concurrent national and provincial legislative competence listed in schedule 4, but excluding any matter within the functional areas of exclusive provincial competence listed in schedule 5.²⁷⁶ However, the National Assembly has the power to assign any of its general legislative powers, except the power to amend the Constitution, to any legislative body in another sphere of government.²⁷⁷

The area of taxation is not listed in either schedule 4 or 5, which means that the National Assembly primarily has the exclusive authority to pass tax legislation, unless such authority has been assigned to a sub-national sphere of government, or unless the Constitution expressly confers some power on another sphere of government. Section 228 provides that a provincial legislature may impose (a) taxes, levies and duties other than income tax, value-added tax, general sales tax, rates on property or customs duties and (b) flat-rate surcharges on any tax, levy or duty that is imposed by national legislation, other than corporate income tax, value-added tax, rates on property or customs duties. However, no province in South Africa has yet exercised the right to introduce a new provincial tax.²⁷⁸ Section 229 confers on a municipality the right to impose (a) rates on property and surcharges on fees for services provided by or on behalf of the municipality, and (b) other taxes, levies and duties appropriate to local government, but only if sanctioned by national legislation and excluding income tax, value-added tax, general sales tax or customs duty.

²⁷⁵ Constitution Ch 4 s 43(c) and Ch 7 s 156.

²⁷⁶ Constitution Ch 4 s 44(1)(a)(i) and (ii).

²⁷⁷ Constitution Ch 4 s 44(1)(a)(iii).

²⁷⁸ Croome PhD Thesis (2008) 15–16. The Western Cape has mentioned the possible introduction of a provincial fuel levy.



2.4.3.3 Substantive Limitations

2.4.3.3.1 The Bill of Rights

The most important substantive limitations to the government's taxing power is the Bill of Rights contained in chapter 2 of the Constitution, which is applicable to all law and binds the legislature, the executive, the judiciary and all organs of state.²⁷⁹ It is, however, important to note that the fundamental rights are not absolute and may be restricted. Section 36 provides that a right may only be limited in terms of:

“law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, taking into account all relevant factors, including (a) the nature of the right, (b) the importance of the purpose of the limitation, (c) the nature and extent of the limitation, (d) the relation between the limitation and its purpose and (e) less restrictive means to achieve such purpose.”²⁸⁰

In the realm of taxation, and especially the imposition of a tax, the fundamental rights enshrined in section 9 (equality) and section 25 (property) deserve consideration.

2.4.3.3.2 Right to Property

Section 25(1) provides that “[n]o one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property”. Although a comprehensive description of “property” is difficult to achieve for purposes of section 25, the term has a wide meaning.²⁸¹ The levying of a tax on a taxpayer's

²⁷⁹ Constitution Ch 2 s 8(1).

²⁸⁰ A number of articles have been written on the limitation clause, e.g. De Ville (1994) *SA Public Law* 287; Woolman (1997) *SA J for Human Rights* 102; Devenish (1998) *Obiter* 256; Rautenbach (2001) *THRHR* 617.

²⁸¹ In *First National Bank of SA Ltd t/a Wesbank v CSARS* (2002 (7) BCLR 702 (CC), 64 SATC 471) the court stated (at par 51) that “at this stage of our constitutional jurisprudence it is ... practically impossible to furnish – and judicially unwise to attempt – a comprehensive definition of property for purposes of s 25. Such difficulties do not, however, arise in the present case. Here it is sufficient to hold that ownership of

Footnote continues on the next page

“entitlement to certain benefits or rights” would generally constitute a deprivation of property as envisaged in section 25 of the Constitution.²⁸²

In *First National Bank of SA Ltd t/a Wesbank v CSARS*²⁸³ Conradie J (at 449) commented that:

“[T]axation does not amount [in principle] to a deprivation of property. Nor is there anything which is expropriated. No one would think of claiming compensation for having been taxed. Freedom from taxation is not a fundamental right. Nothing protects the subject against taxation. Not even death ... It may be different where the impugned tax is oppressive or partial and unequal in its operations ... If its reach seems broader than it need be, that is no ground for a constitutional challenge.”

This line of thinking is also in accordance with the internationally accepted viewpoint.²⁸⁴ Croome therefore concludes that where a taxing measure applies equally to all citizens of South Africa, a taxpayer will generally fail to challenge its constitutionality merely because it constitutes a violation of the right to property.²⁸⁵

2.4.3.3.3 Right to Equality

Section 9 provides that “[e]veryone is equal before the law and has the right to equal protection and benefit of the law”.²⁸⁶ It furthermore directs that the state may not unfairly discriminate against anyone on grounds such as race, gender, sex, pregnancy, marital

corporeal movable property must – as must ownership of land – lie at the heart of our constitutional concept of property”.

²⁸² Croome PhD Thesis (2008) 28.

²⁸³ 2001 (7) BCLR 715 (C), 63 SATC 432.

²⁸⁴ Croome PhD Thesis (2008) 32–36 discusses the approaches of the European Convention on Human Rights and the constitutional law of Australia, Switzerland, Trinidad and Tobago, India, the US, Ireland and Canada.

²⁸⁵ Croome PhD Thesis (2008) 36.

²⁸⁶ Constitution Ch 2 s 9(1).

status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, culture, language or birth,²⁸⁷ unless it is established that the discrimination is fair.²⁸⁸ It is therefore not lawful, for example, to impose a tax that applies exclusively to a section of the community.²⁸⁹ Croome argues that the fiscal statutes that levy taxes in South Africa constitute laws of general application and do not currently discriminate unfairly on the grounds set out in section 9 of the Constitution.²⁹⁰

2.4.3.4 *Procedural Limitations*

The Constitution provides that a national bill that imposes a tax is defined as a “money bill”.²⁹¹ Money bills must be considered in accordance with a special detailed procedure, which enhances the level of parliamentary scrutiny.²⁹²

The power of a provincial legislature or a municipality to impose a tax or levy may not be exercised in a way that materially and unreasonably prejudices national economic policies, economic activities across provincial borders and the mobility of services, goods, capital or labour.²⁹³ Any provincial tax must comply with the provisions of the Provincial Tax Regulation Process Act²⁹⁴ and any municipal tax with the Municipal Fiscal Powers and Functions Act.²⁹⁵

²⁸⁷ Constitution Ch 2 s 9(3).

²⁸⁸ Constitution Ch 2 s 9(5).

²⁸⁹ Croome PhD Thesis (2008) 17.

²⁹⁰ Croome PhD Thesis (2008) 31.

²⁹¹ Constitution Ch 4 s 77(1). See also Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 116.

²⁹² Constitution Ch 4 s 77(3). The special procedure is set out in s 75. See also Steenekamp *Introduction* in Black, Calitz and Steenekamp *eds* (2008) 116.

²⁹³ Constitution Ch 13 ss 228(2)(a), 229(2)(a).

²⁹⁴ Act 53 of 2001. See Croome PhD Thesis (2008) 15 n 53 and accompanying text.

²⁹⁵ Act 12 of 2007 (to be read with Constitution Ch 13 s 229(2)(b)).

2.4.3.5 *The Power to Collect Taxes*

In 1997, the South African Revenue Service Act²⁹⁶ (“SARS Act”) established the South African Revenue Service (“SARS”) as an organ of state within the public administration, but as an institution outside the public service.²⁹⁷ The Commissioner of SARS is primarily responsible for the administration of fiscal legislation, as well as the efficient and effective collection of revenue, customs and excises at the national sphere of government.²⁹⁸ Under fiscal legislation the Commissioner has extensive powers to collect taxes effectively and efficiently.²⁹⁹ These powers should comply with constitutional standards, as they could violate the taxpayer’s fundamental rights, such as the right to property, privacy, access to information, administrative justice and access to the courts.³⁰⁰

2.5 CONCLUSIONS

- (a) This chapter provided a brief historic overview of taxation in general.³⁰¹ It was shown that modern tax systems typically comprise a variety of taxes on income, consumption and wealth, which is also the position in South Africa.³⁰² The discussion illustrated that the taxation of wealth transfers

²⁹⁶ Act 34 of 1997.

²⁹⁷ SARS Act s 2 (the Act became effective on 1 October 1997).

²⁹⁸ SARS Act ss 3, 4. Previously, revenue was primarily collected and administered by the Commissioner for Inland Revenue (CIR) and the Controller of Customs and Excise. See Croome PhD Thesis (2008) 17.

²⁹⁹ These powers have been the subject of constitutional attack. See *Metcash Trading Limited v CSARS and the Minister of Finance* 2001 (1) BCLR (1) CC, 63 SATC 13 (the case dealt with some powers of SARS in terms of the Value-Added Tax Act 89 of 1991).

³⁰⁰ For further reading on the constitutionality of the Commissioner’s powers, see Solomon (1995) *Annual Survey of SA Law* 690; Silke (1997) *Tax Planning* 17; Croome (1999) *Tax Planning* 80; Erasmus (2001) *Without Prejudice* 16; Silke (2001) *Tax Planning* 50; Olivier (2001) *TSAR* 193; Williams (2001) *SALJ* 418; Williams (2001) *SALJ* 242; Croome (2002) *Acta Juridica* 1; Silke (2002) *Acta Juridica* 282; Silke (2003) *Tax Planning* (I) 44; Silke (2003) *Tax Planning* (II) 50; Louw (2003) *THRHR* 292; Olivier (2004) *TSAR* 273; Croome (2005) *Without Prejudice* 7. See also Croome PhD Thesis (2008) for a comprehensive discussion of the extent to which the powers of SARS comply with the taxpayer’s constitutional rights to property, privacy, administrative justice, access to information and access to courts.

³⁰¹ See par 2.2.1.

³⁰² See pars 2.2.2, 2.2.3 and 2.2.4.



may conceptually be accommodated under a comprehensive income tax,³⁰³ a direct consumption tax³⁰⁴ or a wealth transfer tax.³⁰⁵

- (b) In the realm of capital gains tax, it was shown that there are a variety of ways to deal with the unrealised gains on the death of a wealth holder. The gains may either be subjected to taxation by treating death as a taxable event (referred to as the “deemed-realisation” approach) or by deferring the tax liability to the moment when the heir realises the asset (referred to as the “carry-over” approach). On the other hand, unrealised gains may escape taxation where the system provides that the base cost is stepped up in the hands of the heir (referred to as the “stepped-up” approach).³⁰⁶
- (c) This chapter also outlined the objectives and essential policy considerations of taxation in general. Taxes are levied by tax jurisdictions to achieve various goals, the most prominent of which are the collection of revenue to fund government activities.³⁰⁷ Taxes can also assist the accomplishment of certain socio-economic objectives such as the redistribution of resources.³⁰⁸ In drafting the legislation to levy taxation, legislatures should not restrict their policy considerations to these socio-economic and political goals, but should ideally adhere to the “canons of taxation”, which are rational policy considerations based on principles of

³⁰³ See par 2.2.2.2.

³⁰⁴ See par 2.2.4.2.

³⁰⁵ See par 2.2.3.2.2.

³⁰⁶ See par 2.2.3.3.2.

³⁰⁷ See par 2.3.1.

³⁰⁸ See par 2.3.2.

equity, certainty, convenience, efficiency and neutrality. These principles reflect general ideals of justice in taxation.³⁰⁹

- (d) Although a government has a fundamental right to levy taxation, it was pointed out that such a right should be exercised within the constitutional framework of the relevant jurisdiction, the principles of which may require accountability on the part of such government and taxing authorities.³¹⁰
- (e) In a South African context, taxes of national application should generally be levied on the national sphere of government in accordance with certain procedures. Although the general ideals of taxation (“canons of taxation”) are not enshrined in the Constitution, tax laws should adhere to the general constitutional values and should not violate the bill of rights. Although the administrative powers of SARS have been under constitutional attack, the levying of taxation as an infringement on property rights has received little attention in the South African courts. It was, however, explained that a taxpayer would generally not be able to challenge fiscal legislation in South Africa merely because it constitutes a violation of the right to property, unless it can be shown that the tax is confiscatory. Because fiscal statutes in South Africa constitute laws of general application, they do not currently discriminate unfairly.³¹¹

The next chapter will provide a brief overview of the historical development of the taxation of wealth transfers.

³⁰⁹ See par 2.4.2.

³¹⁰ See par 2.2.1.1.

³¹¹ See par 2.4.3.

CHAPTER 3

THE HISTORICAL DEVELOPMENT OF THE TAXATION OF WEALTH TRANSFERS

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3.1 INTRODUCTION

This chapter briefly explores the historical development of the taxation of wealth transfers from its earliest inception in the ancient civilisations and the Roman Empire, to the contemporary position in the South African law. To provide the reader with a general



understanding of the international position, the discussion explores aspects of the historical development in the United Kingdom, the Netherlands, United States, Ireland, Canada and Australia.

3.2 THE INTERNATIONAL HISTORICAL DEVELOPMENT OF WEALTH TRANSFER TAXATION IN SELECTED COUNTRIES: A BRIEF OVERVIEW

3.2.1 The Ancient Civilisations and the Roman Empire

The origin of the taxation of inheritances has historically been attributed to the Emperor Augustus, who is known to have established a tax called the *vicesima hereditatium* on Roman citizens in 6 CE.¹ Apparently, the Romans borrowed the idea from the Egyptians, who had taxed the transfer of property as early as the seventh century BCE.² Unlike the Egyptians, the Romans taxed the property received.³ It is unknown when the *vicesima* was finally repealed, but it definitely occurred before the time of the Code of Justinian, somewhere between the third century and the middle of the sixth century CE.⁴

¹ West (first published in 1893 and reprinted in 2004) 11–14; Buehler (1948) 388; Coffield (1970) 24–26; Schuttevaer and Zwemmer (1998) v3; Zwemmer (2001) *Mededelingen* 9. These regulations were codified in the *Lex Iulia de Vicesima Hereditatium*. The main characteristics of this tax codification can still be found in the works of the historian Cassius Dio *Dio's Roman History* (Vol vi), with an English translation by E Cary, London, New York 1917. See Beckham LLM Thesis (1993) 15.

² A papyrus roll (of *circa* 117 BCE) was found which records that a certain Hermias was sentenced to pay a heavy penalty for failing to pay the tax on the house he inherited from his father. See West (2004) 11; Kartiganer and Sedlaczek in Atherton *ed* (2003) 117 n 7 and Adriani and Van Hoorn Vol 1 (1954) 317; Van Nispen and Shuttevaer (1969) 124 n 3 and accompanying text; Schuttevaer and Zwemmer (1998) v3; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 12 n 19 and accompanying text.

³ West (2004) 12.

⁴ West (2004) 13, 15; Beckham LLM Thesis (1993) 15.



3.2.2 The Middle Ages

In the Middle Ages the taxation of inheritances was governed by the principles of the *relief* and *heriot* of feudal origin. The *relief* was payable on the death of a tenant by the heir to the landlord, due to the principle that the property escheated to the landlord, for which he requested a contribution in permitting the heir to take possession of the property. The *heriot*, established in England by the Danes, was a contribution of the best beast or chattel by the estate of a deceased tenant to the lord on the death of a tenant. The *heriot*, unlike the *relief*, did not extend to land. An important difference is that the *heriot* was considered to be a payment by the deceased tenant's estate, whereas the *relief* was imposed on the tenant's heir.⁵

3.2.3 The Modern Era (from 1500 CE)

The recipient-based *relief* formed the basis of the first inheritance taxation that was introduced in France in 1553.⁶ To finance the wars with Spain, the different provinces of the Netherlands started to levy succession duties at the end of the sixteenth century. Holland, for example, introduced a recipient-based duty (the *Collaterale Impost*) on immovable property in 1598, which was extended to movables in 1653.⁷ A stamp tax on wills was also introduced in 1624.⁸ These taxes were of a feudal nature and were therefore charged on individual assets.⁹ The Dutch taxes formed the basis of numerous other European inheritance taxes initiated in the sixteenth and seventeenth centuries, such as the German *erbkauf*. It was also common for countries to introduce accompanying

⁵ West (2004) 14–15.

⁶ West (2004) 16; Adriani and Van Hoorn Vol 1 (1954) 318.

⁷ West (2004) 20; Adriani (1925) 4; Shuttevaer and Zwemmer (1998) v5; Zwemmer (2001) *Mededelingen* 9.

⁸ West (2004) 20.

⁹ Adriani (1925) 5.



taxes on gifts. These European taxes continued to develop mainly as a charge on the recipients.¹⁰

England borrowed the idea of a stamp tax from Holland, by introducing a probate duty in 1694. This duty was essentially a stamp duty on probates and letters of administration. The publication of Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776 made the Dutch inheritance taxes better known and led England to introduce some additional taxes on inherited wealth. In the two hundred years thereafter, four other duties were developed and simultaneously imposed. Legacy duty (introduced in 1780) and succession duty (introduced in 1853) were duties imposed on the heirs of personal property and real estate respectively. To counter the avoidance of probate duty by gifting property in the period shortly before death, account duty was introduced in 1881. A short-lived temporary estate duty was implemented in 1889 to act as a supplement to the other co-existing duties. Probate duty, account duty and temporary estate duty were levied on the transferor, whereas legacy duty and succession duty were imposed on the beneficiaries.¹¹ This complicated system of five collateral death duties needed reform. In 1894, a modern transferor-based estate duty replaced the old probate, account and temporary estate duties, but the recipient-based legacy and succession duties were initially retained.¹² For purposes of estate duty, gifts were only included if they were made in a certain period before death (the "gifts period").¹³ The introduction of the direct income tax in the United Kingdom in 1799 did not disturb the existence of the well-

¹⁰ See West (2004) 20–36 for a comprehensive discussion of the historical development of these taxes in Europe. See also Hauser (1999) *Real Prop Prob & Tr J* 371–374 and Sonneveldt (2004) *WPNR* 314. The levying of *Schenkingsrecht* (gift tax) was introduced into the Dutch wealth transfer tax system only in 1917. See Adriani (1925) 32; Zwemmer (2001) *Mededelingen* 10.

¹¹ For further reading on the early English duties, see West (2004) 37–41; Sandford (1971) 64–65; Coombes (1977) 2–3; Tiley (2007) *Br Tax Rev* 306–317 and Wallington (2002) div A1.

¹² Coombes (1977) 2–3. The introduction of estate duty came at a time when the focus of tax policy moved away from consumption to income and wealth. The Victorian Era witnessed a growth in "new money". Those who worked hard for their income welcomed the taxation of "old money" in the hands of heirs who enjoyed a life of leisure. See discussion by Lee (2007) *Legal Studies* 681–682.

¹³ The "gifts period" was initially set at one year, but increased to three years in 1909, to five years in 1946 and eventually to seven years in 1946. See Coombes (1977) 5.



rooted death duties, because the English concept of income conceptually excluded inheritances and gifts.¹⁴

The early development of wealth transfer taxation in England had a significant influence on the development of this type of taxation in a number of international jurisdictions. The expansion of the British Empire in the eighteenth and nineteenth centuries resulted in the adoption of the English death duties in most of the former colonies.¹⁵

For example, in the United States a recipient-based duty, similar to the English legacy duty, was introduced on federal level in 1797.¹⁶ The tax was initiated to finance the undeclared naval war with France and was repealed in 1802.¹⁷ Since 1826, numerous states introduced death duties on a state level, most of which were charged on a recipient basis.¹⁸ Wealth transfer taxation was briefly reintroduced on federal level in 1862, but was repealed by *circa* 1872.¹⁹ Because the 1894 United States income tax legislation (which included inheritances and gifts in the tax base)²⁰ was declared unconstitutional in

¹⁴ See Ch 2 par 2.2.2.1.

¹⁵ See West (2004) 37–56 for a comprehensive discussion. In Australia, New South Wales introduced the first death duty in 1851. Tasmania followed in 1865, Victoria in 1870, South Australia in 1876, Queensland in 1886 and Western Australia in 1895. In New Zealand, an estate tax was first introduced in 1866. See Duff (2005) *Pittsburgh Tax Rev* 85 n 70. In Canada, the first succession duties were enacted in 1892 in Ontario, Nova Scotia and Quebec. See West (2004) 52–55. See also par 3.3.2.1 for a discussion on the first South African colonial succession duties.

¹⁶ West (2004) 57; Eisenstein (1956) *Tax Law Rev* 225; Morgan (1981) *Tax Notes* 340; Gale and Slemrod in Gale, Hines and Slemrod eds (2001) 14; Thistle (2007) *Ga J Int & Comp L* 710.

¹⁷ West (2004) 57; Gale and Slemrod in Gale, Hines and Slemrod eds (2001) 14; Thistle (2007) *Ga J Int & Comp L* 710.

¹⁸ Pennsylvania was the first state to impose a recipient-based inheritance tax in 1826. Numerous other states followed the example, such as Louisiana (in 1828), Virginia (in 1843), Maryland (in 1845), North Carolina (in 1847), Alabama (in 1848), Delaware (in 1869), Wisconsin (1868), Minnesota (in 1875), New Hampshire (in 1878), Illinois (in 1887), New York (in 1885), Connecticut (in 1889), Massachusetts (in 1889), Tennessee (in 1891), New Jersey (in 1892), Ohio (in 1893), Maine (in 1893) and California (in 1893). See West (2004) 62–94 for a comprehensive discussion.

¹⁹ West (2004) 57, 62; Eisenstein (1956) *Tax Law Rev* 225; Gale and Slemrod in Gale, Hines and Slemrod eds (2001) 14; Thistle (2007) *Ga J Int & Comp L* 710.

²⁰ See Ch 2 par 2.2.2.1.



1895,²¹ the need for some form of taxation on wealth transfers arose. As a consequence, a transferor-based estate tax was introduced on federal level in 1898. Because the estate tax was repealed in 1902²² and because the income tax legislation of 1913 expressly excluded wealth transfers from the concept of income,²³ the platform was set for the introduction of a modern federal transferor-based estate tax in 1916,²⁴ which continued to be levied collaterally with the succession duties at state level. In 1924 the estate tax was complemented by the introduction of a separate gift tax.²⁵

Unlike the United Kingdom, the levying of transferor-based taxation and recipient-based taxation operated on various levels of government in the United States. The notion of levying transferor-based wealth transfer taxation at federal level together with collateral succession duties at state level was also encountered in other federal countries, such as

²¹ The Act was declared unconstitutional in *Pollock v Farmers' Loan and Trust Company* 158 US 429 (1895) due to the fact that the gains from real property constituted a direct tax, which had to be apportioned amongst the states according to the census. This set the stage for the introduction of the sixteenth amendment to the United States Constitution, which expressly allows the federal government to impose an income tax without census apportionment. See Gale and Slemrod in Gale, Hines and Slemrod eds (2001) 14.

²² Eisenstein (1956) *Tax Law Rev* 227 n 23; Morgan (1981) *Tax Notes* 340; Rudnick (1945) *Tax Law Rev* 27; Gale and Slemrod in Gale, Hines and Slemrod eds (2001) 14; Thistle (2007) *Ga J Int & Comp L* 711.

²³ See Ch 2 par 2.2.2.1.

²⁴ The tax was originally enacted to fund the US' entry into World War I. See Dobris (1984) *Syracuse Law Rev* 1217; Bernstein (2004) *Cardozo J Int & Comp L* 189 n 16; Thistle (2007) *Ga J Int & Comp L* 711. For further reading on the historical development of the US federal estate tax, see Rudnick (1945) *Tax Law Rev* 27–30; Morgan (1981) *Tax Notes* 340; McCaffery (1999) *Tax Notes* 1429–1430; Gale and Slemrod in Gale, Hines and Slemrod eds (2001) 14; Graetz and Shapiro (2005) 8; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 11.

²⁵ After a brief period of repeal from 1926–1932, the tax was reintroduced to increase revenues that were decreasing as a result of the Depression. See McCaffery (1999) *Tax Notes* 1430; Gale and Slemrod in Gale, Hines and Slemrod eds (2001) 14; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 11; Thistle (2007) *Ga J Int & Comp L* 712.



Canada²⁶ and Australia.²⁷ In other countries, the multiple-duty system was adopted and operated on the same level of government, such as in Ireland upon its foundation of a state in 1922²⁸ and in the Union of South Africa upon the introduction of its first national wealth transfer tax legislation in the same year.²⁹ The complicated multiple-duty system (whether levied on the same or on different levels of government) became a focal point for tax reform in these countries in the latter part of the twentieth century. Several government-appointed law reform commissions considered the taxation of wealth transfers, but the recommendations were far from being uniform. The proposals put forward should be seen against the background of the evolution of the income tax (and the idea of a comprehensive income tax), the development of a model for a direct consumption tax and the modern trend to impose a tax on realised capital gains.³⁰

In the United Kingdom, the Colwyn Committee suggested in 1927 that it might be plausible to develop the recipient-based legacy and succession duties, so that a recipient-based tax would occupy a more prominent position in the death duty system. This committee's recommendations were not acted upon and the abolition of these duties in 1949 precluded any such development.³¹ The abolition was a means of simplification, leaving the transferor-based estate duty as the sole death duty.³² What is noteworthy is that the respective merits of a transferor-based tax and a recipient-based tax were

²⁶ The federal government introduced a federal estate tax in 1935 and a federal succession duty in 1941. At that point in time, provincial succession duties were levied in most of the provinces. Although some provinces abolished their succession duties in consequence of the introduction of the federal taxes, British Columbia, Ontario and Quebec continued to levy and collect their own duties. See Maloney (1988) *Ottawa Law Rev* 605; McKie (1991) *European Taxation* 243 and Duff in Tiley *ed* (2007) 316 n 50.

²⁷ Duff (2005) *Pittsburgh Tax Rev* 88.

²⁸ O'Brien Report (1982) 68–69, 424; Doyle (2008) pars 1.2.2 and 1.2.4. See also Bohan and McCarthy (2008) 3–4 for a general discussion on the old English duties that applied in Ireland.

²⁹ See par 3.3.2.2.1 for further reading.

³⁰ See Ch 2 pars 2.2.2, 2.2.3.3.2 and 2.2.4.2.

³¹ Report by Chancellor of the Exchequer *Cmnd 4930* (1972) 2.

³² Report by Chancellor of the Exchequer *Cmnd 4930* (1972) 2.



apparently not properly considered.³³ According to the literature, the estate duty concept was chosen above the legacy and succession duties in view of its administrative simplicity and the fact that estate duty was paid within a few months after death, whereas the other duties were collected only on the finalisation of the estate administration.³⁴ Another explanation offered for the preference for a transferor-based charge was the difficulty of fitting trusts into a recipient-based tax, in view of the fact that a trust is a mechanism whereby the acquisition of vested rights in the trust property by the beneficiaries could be deferred until some future date or event.³⁵ A third theory is rooted in the difference of the estate administration approaches. Anglo-American law provides for a process of probate, where an executor finalises the administration of an estate before it is distributed among the heirs. The executor (as the representative of the deceased) is burdened with the payment of all the outstanding liabilities and taxes. Conversely, the civil-law jurisdictions generally follow a process where the liabilities and outstanding tax charges are carried over to the heirs.³⁶

The introduction in 1965 of capital gains tax into the United Kingdom tax system, providing for death as an occasion of charge, led to a public perception of double taxation because estate duty was charged on the value of a deceased estate.³⁷ This culminated in the replacement of the deemed-realisation approach with a stepped-up base-cost approach in 1971 (which is still in force today).³⁸ In 1975, estate duty was replaced with an

³³ Sandford, Willis and Ironside (1973) 1.

³⁴ Tiley (2007) *Br Tax Rev* 305.

³⁵ Jones in Jones, Harris and Oliver *eds* (2008) 220.

³⁶ Rudnick and Gordon in Thuronyi *ed* Vol 1 (1996) 320; Sonneveldt (2004) *WPNR* 314; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 6.

³⁷ Sandford, Willis and Ironside (1973) 96; Lee (2007) *Legal Studies* 703.

³⁸ Sandford, Willis and Ironside (1973) 96; Kerridge (1990) *Br Tax Rev* 75; Lee (2007) *Legal Studies* 703. In view of the absence of a general gift tax at that time, a gift remained as an occasion of charge. See Ch 2 par 2.2.3.3.2 for the meaning of “stepped-up” approach and “deemed-realisation” approach.



improved transferor-based tax on gifts and donations, namely “capital transfer tax”.³⁹ In 1978, reform of the current tax system was once again on the table when the Meade Committee released a comprehensive report on the existing tax system, dealing *inter alia* with wealth taxation. The report favoured a direct consumption tax (without gifts and inheritances) together with a recipient-based progressive annual wealth accessions tax (PAWAT).⁴⁰ However, the recommendations were never implemented. In 1979 a Treasury inquiry was set up to examine the system of capital taxes, and, in 1986, the capital transfer tax was replaced by yet another transferor-based tax on wealth transfers, referred to as “inheritance tax”.⁴¹ In 1988 the Capital Taxes Group of the Institute for Fiscal Studies produced two commentaries on capital tax reform. The second report, entitled “Death: the Unfinished Business”, recommended the reintroduction of the CGT charge at death. According to the report, the main reason for the restriction of CGT at the moment of death seemed to be the fact that the taxpayer was also responsible for the payment of inheritance tax, the heavier of the two taxes.⁴² Nonetheless, the report’s recommendation fell on death ears. In 1994 the Gammie Report reviewed the existing system and concluded that the combination of transferor-based wealth transfer taxation and capital gains tax lacked a rational basis and could barely be described as fair.⁴³ As a consequence, the report favoured the implementation of an accessions tax and the

³⁹ A reform of the existing structure was called for in 1972. For further reading on the political process, see Lee (2007) *Legal Studies* 683 n 34 and Chapman (1980) 2. Coombes (1977) 10 discusses the lack of public discussion and consultation with interested parties, which lead to a lot of criticism against the legislation. See also Thistle (2007) *Ga J Int & Comp L* 716–717.

⁴⁰ Meade Report (1978) 318, 320–330, 513, 518. As an alternative, the committee (at 330–336) suggested a linear annual wealth accessions tax (LAWAT). See Verbit (1980) *Boston Univ Law Rev* 30–35 and Jones in Jones, Harris and Oliver *eds* (2008) 221–225 for a comprehensive discussion and explanation of the Meade Committee’s proposals. See also Tiley (2008) 1261.

⁴¹ Thistle (2007) *Ga J Int & Comp L* 717; Chapman (1980) 2–3. The term “inheritance tax” has been criticised as being a misnomer in view of the fact that the term has acquired a more precise meaning in tax literature – referring to a recipient-based tax (as opposed to a transferor-based estate tax). See Sandford (1986) *Br Tax Rev* 141, who suggests that the term was used to “camouflage a return to the old estate duty of 1974”. See also Lee (2007) *Legal Studies* 681; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 24. See Ch 8 for further reading on the UK inheritance tax.

⁴² Kerridge (1990) *Br Tax Rev* 77.

⁴³ Gammie Report (1994) 52.



application of the capital gains tax regime on the death of a wealth holder.⁴⁴ These proposals were never legislated.

In the United States, the US Law Institute proposed in the 1960s that the existing federal estate tax be replaced by a recipient-based tax.⁴⁵ This proposal was largely ignored.⁴⁶ In 1976, the federal estate and gift tax system was replaced by a unified transfer tax and a new tax on generation-skipping transfers was introduced to curb tax avoidance through the use of trusts.⁴⁷ This year also saw the replacement of the stepped-up base-cost approach for purposes of capital gains tax (which had been applied since the introduction of the 1913 income tax legislation) with a carry-over approach.⁴⁸ In 1977, a Department of the Treasury report entitled *Blueprints for Basic Tax Reform* endorsed the taxation of wealth transfers in principle. However, the report favoured a comprehensive (direct) cash-flow consumptions tax to the Carter Report's comprehensive income tax⁴⁹ within the United States tax system. In respect of gifts and inheritances, the report favoured their inclusion in the tax base of the recipient (once consumed), but proposed a deduction from the tax base of the transferor.⁵⁰ These recommendations were never implemented. In fact, although significant changes were effected to the estate tax, the gift tax and the generation-skipping transfer tax in 1981,⁵¹ the basic framework of the legislation has

⁴⁴ Gammie Report (1994) 52–53.

⁴⁵ Graetz (2002) *Yale Law J* 267 and n 30.

⁴⁶ Graetz (2002) *Yale Law J* 267.

⁴⁷ Graetz (1983) *Yale Law J* 260; Schmalbeck (2000) *Cleve State Law Rev* 751; Thistle (2007) *Ga J Int & Comp L* 712.

⁴⁸ Schmalbeck (2000) *Cleve State Law Rev* 753 n 27; Graetz (1983) *Yale Law J* 262 n 22 and accompanying text.

⁴⁹ See Ch 2 par 2.2.2.2.

⁵⁰ *Blueprints for Basic Tax Reform* (1977) 12, 113, 137, available at <http://www.ustreas.gov/offices/taxpolicy/library/blueprints/full.pdf> (accessed on 30 June 2008).

⁵¹ The changes were introduced in terms of the Economic Recovery Tax Act of 1981 (ERTA). See Graetz (1983) *Yale Law J* 262 n 26 and n 28; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 15. For a detailed discussion on the introduction and impact of ERTA, see Gutman (1983) *Virginia Law Rev* 1197–1216.



essentially remained unchanged. It is significant, however, that a stepped-up base-cost approach was re-introduced for purposes of capital gains tax in 1980 because of the difficulties involved in establishing base-cost valuations and the perception of double taxation.⁵²

In Canada the Carter Report (1966), which was inspired by the broad economic definition of income,⁵³ recommended that the existing federal estate tax and provincial recipient-based duties should be repealed in favour of a comprehensive income tax in terms of which gifts and bequests should be included as income in the hands of the recipient (and not be deductible in the hands of the transferor).⁵⁴ In addition, the report proposed that all capital gains and losses, of which there was no provision at that time, should be included on a realisation basis, irrespective of whether it accrued by way of sale, gift or inheritance.⁵⁵ Although the report was praised by numerous Canadian commentators,⁵⁶ the reaction of the public and business spokesmen was overwhelmingly negative.⁵⁷ Following a period of governmental press releases and public responses, the government finally repealed the federal estate tax in 1972. This was in essence a trade-off to gain acceptance by the public and organised interest groups for the introduction of a capital gains tax, which included the taxation of unrealised capital gains at death.⁵⁸ This trade-off meant that the repeal of the estate tax was not followed by an inclusion of wealth transfers in the

⁵² Schmalbeck (2000) *Cleve State Law Rev* 753 n 27; Graetz (1983) *Yale Law J* 262 n 22 and accompanying text.

⁵³ See Ch 2 par 2.2.2.2.

⁵⁴ Carter Report Vol 3 (1966) 147, 465–466.

⁵⁵ Carter Report Vol 3 (1966) 369–370, 477.

⁵⁶ Duff in Tiley *ed* (2007) 318 n 59 refers to e.g. AC Harberger and JG Head.

⁵⁷ Sandford (1987) *Br Tax Rev* 148 156 stated that “[t]he recommendation that legacies and gifts should be treated as income was foreign, not to say repugnant, to many Canadians”. See also Duff in Tiley *ed* (2007) 318 n 59.

⁵⁸ McKie (1991) *European Taxation* 244; Richardson and Moore (1995) *Can Publ Pol* 85–87; Duff in Tiley *ed* (2007) 319–329 (see 324 n 112, n 113 and n 114 for a discussion of the parliamentary debates that preceded the enactment).



income tax base, as recommended by the Carter Commission. Furthermore, the government's decision to repeal the estate tax snowballed into the gradual abolition of all the provincial succession duties and, by the end of 1985, all these duties had been repealed.⁵⁹

In Australia (where a transferor-based federal wealth transfer tax was levied together with recipient-based provincial duties in much the same manner as the United States), a political campaign to abolish death taxes was launched in the 1970s.⁶⁰ The Asprey Committee Report, released in 1975, stated that death taxes had an essential role to play in the tax structure as a whole.⁶¹ The report expressed a preference for an estate tax and recommended substantial changes to the existing system.⁶² Apparently, the recommendations were too late to stop the gathering momentum of the repeal movement, especially among farming communities and small businesses.⁶³ In 1976, Queensland was the first state to abolish its succession duty.⁶⁴ The threat of the flight of capital was a concern for the five other states and this gave impetus to the repeal movement, which gained significant momentum.⁶⁵ During this time Australia experienced a constitutional crisis, resulting in the repeal movement being absorbed as a strategic weapon in a

⁵⁹ In view of the fact that British Columbia, Ontario and Nova Scotia were the only provinces that collected succession duties at the time when the federal estate tax was repealed, the government assisted the other provinces in the drafting of a model act for the uniform levying of succession duties. At the beginning of 1972, newly adopted succession duties were levied in Manitoba, Saskatchewan, Newfoundland, New Brunswick, Prince Edward Island and Nova Scotia. However, Alberta, did not levy any duties at all. The provinces gradually started to abolish the duties, starting with Prince Edward Island in 1972. Quebec was the last province to abolish its succession duty (it did so in 1985). See Duff in Tiley *ed* (2007) 326–330.

⁶⁰ The campaign was spearheaded by a skilled carpenter and building contractor from Western Australia, Sydney Negus, who then ran for public office and was elected to the federal senate. A senate committee was elected to examine the subject of wealth transfer taxation. Five of the eight senators on the committee recommended that the federal estate and gift duties be repealed. See Pedrick (1981) *Tax Lawyer* 114–118.

⁶¹ Asprey Report (1975) 440.

⁶² Asprey Report (1975) 441–477. See also Green and McKay (1980) *Victoria Univ Wellington Law Rev* 235 n 39.

⁶³ Duff (2005) *Pittsburgh Tax Rev* 112.

⁶⁴ Pedrick (1981) *Tax Lawyer* 115.

⁶⁵ Pedrick (1981) *Tax Lawyer* 115.



political war, as a consequence of which the federal estate tax was repealed in 1979.⁶⁶ Between 1980 and 1982, the other states followed the example of Queensland and the Commonwealth by abolishing their succession duties.⁶⁷

Although the Carter Commission's proposal for the inclusion of wealth transfers in the concept of income was not followed in Canada or in any other country, the reasoning that wealth transfers should primarily be taxable in the recipient's hands stimulated at least the law reform movement in Ireland, where the British transferor-based estate duty was replaced by a recipient-based tax, referred to as "capital acquisitions tax", in 1976.⁶⁸ At that time there was no example of a country with a common-law legal system that imposed a recipient-based tax.⁶⁹ Although a carry-over base-cost approach was initially applied on the death of a wealth holder when capital gains tax was introduced in 1975, a stepped-up base-cost approach was adopted in 1978 in imitation of the position in the United Kingdom.⁷⁰ When the Irish tax system was extensively reviewed by the O'Brien Commission in 1982, the comprehensive income tax base, as proposed in the Carter Report, was commended.⁷¹ However, the report contended that the existing capital acquisitions tax provided an adequate framework for wealth transfer taxation⁷² and the tax is still in force today.⁷³ Also, the Commission recommended that unrealised capital gains

⁶⁶ See discussion of the events by Pedrick (1981) *Tax Lawyer* 116–117 and Duff (2005) *Pittsburgh Tax Rev* 112.

⁶⁷ See Duff (2005) *Pittsburgh Tax Rev* 111 n 269–n 270.

⁶⁸ O'Brien Report (1982) 424; Doyle (2008) par 1.2.4.

⁶⁹ Doyle (2008) par 1.2.4.

⁷⁰ Taxes Consolidation Act 39 of 1997 Pt 19 Ch 3 s 573.

⁷¹ O'Brien Report (1982) 31, 117.

⁷² O'Brien Report (1982) 425.

⁷³ See Ch 10 for a discussion on wealth transfer taxation in Ireland.



should not escape taxation on death and that bequests should be treated as a disposal for purposes of the tax.⁷⁴ However, to date this recommendation has not been acted on.

3.2.4 Recent International Developments: A Tendency of Decline?

Wealth transfer taxation has, broadly speaking, experienced an increased unpopularity in the last few decades. In some countries, the unpopularity has culminated in the total or partial abolition of these taxes from the tax systems, such as in Canada and Australia. Commentators were in general taken by surprise.⁷⁵ The abolition of wealth transfer taxes in Australia caused shock waves in the Western industrialised nations, especially in view of the fact that Australia, at that stage, did not levy any form of a tax on capital in terms of an annual wealth tax or a capital gains tax.⁷⁶ Although wealth transfer taxes were in the process of being abolished in Canada, a capital gains tax was in place in that country. The abolition of all capital taxes certainly did not follow any trend in the United Kingdom, the United States, or any other member country of the OECD.⁷⁷ In fact, while the repeal movements were blooming in Canada and Australia, the taxation of wealth transfers were endorsed and modernised in other countries. The forecast is, nonetheless, that the current absence of wealth transfer taxation is likely to persist in Canada.⁷⁸ Although some

⁷⁴ O'Brien Report (1982) 49, 210.

⁷⁵ Duff (2005) *Pittsburgh Tax Rev* 114 n 291–n 293 and accompanying text refers to the Canadian economist Bird, who experienced the repeal in Canada as “strange”, the Australian economist John Head, who described the events in Australia as “totally incomprehensible” and the English economist Cedric Sanford, who noted that the disappearance “had an accidental element about it”. In Canada the general view was that the abolition was detrimental to the equity of the tax system and that a useful redistributive tool was lost. See e.g. Bucovetsky and Bird (1972) *Natl Tax J* 37; Carter (1973) *Can Tax J* 239; Bird (1978) *Osgoode Hall Law J* 144; Bird (1991) *Can Publ Pol* 325; Maloney (1991) *Can Publ Admin* 244; Mintz (1991) *Can Publ Pol* 260; Duff (2005) *Pittsburgh Tax Rev* 116–120.

⁷⁶ Pedrick (1981) *Tax Lawyer* 113, 117.

⁷⁷ At that stage, capital was taxed in all the 21 member countries, except for Australia. See Pedrick (1981) *Tax Lawyer* 119.

⁷⁸ Bird (1991) *Can Publ Pol* 331; Brown (1991) *Can Publ Pol* 349.



commentators have predicted its return to the Australian tax base,⁷⁹ this appears to be unlikely at present.

Wealth transfer taxation has not only been abolished in the Australian and the Canadian tax systems, but has also disappeared in Argentina, China, Columbia, Cyprus, the Czech Republic, Estonia, Hong Kong, India, Indonesia, Israel, Latvia, Lithuania, Malaysia, Malta, Mexico, Portugal, Russia, the Slovak Republic, Slovenia, Sweden, Switzerland, Thailand and New Zealand.⁸⁰ Although Italy's wealth transfer taxes were repealed in 2001, they were reinstated in 2007, but in a much weaker form.⁸¹ Furthermore, these taxes have come under increased pressure in the United States and the United Kingdom over the last twenty years.

In the United States, President George W Bush signed the Economic Growth and Tax Relief Reconciliation Act in 2001, providing for a decade-long phase-out of the estate and generation-skipping taxes, but not the gift tax.⁸² This process culminated in repeal scheduled for 1 January 2010.⁸³ Under the Act's "sunset provision" the entire Act expires on December 31, 2010. If the sunset provision is not repealed by then, the estate and generation-skipping taxes will be reinstated on 1 January 2011, in their pre-2001 form (at rates ranging from 41 percent to 60 percent).⁸⁴ The Act imposes a carry-over capital gains tax approach for the year 2010, instead of the present stepped-up cost of base system.⁸⁵ In

⁷⁹ E.g. Pedrick (1981) *Tax Lawyer* 141.

⁸⁰ See Special Report ACCF *New International Survey* (2007), available at <http://www.accf.org/pdf/sr-death-tax-survey.pdf> (accessed on 9 August 2008). See Duff (2005) *Pittsburgh Tax Rev* 113 for a comprehensive discussion on the abolition of wealth transfer taxes in New Zealand.

⁸¹ Sonneveldt and De Kroon (2008) *WFR* 595 n 22 and accompanying text.

⁸² Dodge (2001) *Tax Law Rev* 423 n 2 explains that the gift tax would be retained in view of the opportunities of possible income shifting.

⁸³ Graetz and Shapiro (2005) 4-5; Thistle (2007) *Ga J Int & Comp L* 713.

⁸⁴ Graetz and Shapiro (2005) 5; Thistle (2007) *Ga J Int & Comp L* 713.

⁸⁵ If the stepped-up approach were left intact for 2010, inherited wealth transfers as well as unrealised capital gains at death would have escaped taxation altogether.



2004, Bush's budget again called for permanent repeal, but it was also stated that estate tax was not the top priority.⁸⁶ In light of the fact that the forecasted budget surpluses had since 2001 fallen into large deficits, due to, for example, the unpredictable massive stock market decline that had begun in March 2000 and the increase in government spending that followed the attacks of 11 September 2001, the prospects of permanent repeal might be unlikely.⁸⁷ However, the future existence of the current wealth transfer tax system is highly uncertain and a popular subject for speculation. Some commentators favour the repeal movement,⁸⁸ whilst others argue for the restructuring of the current system,⁸⁹ the introduction of an accessions tax⁹⁰ or the accommodation of wealth transfers within the income tax base.⁹¹ Apparently, public opinion polls have shown little political support for the retention of the estate and generation-skipping taxes.⁹²

⁸⁶ Graetz and Shapiro (2005) 204.

⁸⁷ Graetz and Shapiro (2005) 144.

⁸⁸ E.g. Morgan (1981) *Tax Notes* 343; Dobris (1984) *Syracuse Law Rev* 1226–1227, 1233–1234; Galvin (1991) *Tax Notes* 1419; Donaldson (1993) *W&L Law Rev* 553; McCaffery (1999) *Tax Notes* 1443; McCaffery (1994) *Yale Law J* 364; Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 35; Paper by Robbins and Robbins *The Case for Burying the Estate Tax* (1999); Schlachter (2000) *Virginia Tax Rev* 824; Youdan in Atherton *ed* (2003) 134.

⁸⁹ E.g. Eisenstein (1956) *Tax Law Rev* 258–259; Gutman (1983) *Virginia Law Rev* 1185, 1271; Graetz (1983) *Yale Law J* 286; Stephan (1986) *Virginia Law Rev* 1484; Ascher (1990) *Michigan Law Rev* 150; Davenport and Soled (1999) *Tax Notes* 630; Ventry (2000) *Tax Notes* 1168–1169; Repetti (2000) *Tax Notes* 1510; Schmalbeck (2000) *Cleve State Law Rev* 769; Wampler (2001) *Seton Hall Legis J* 547; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 57; Graetz (2002) *Yale Law J* 267–268; Klooster (2003) *Drake Law Rev* 665; Waldeck (2005) *Virginia Tax Rev* 731; Mombrum (2006) *Taxes – The Tax Magazine* 29.

⁹⁰ E.g. Rudnick (1945) *Tax Law Rev* 25; Andrews (1967) *Tax Law Rev* 589, 589–591; Halbach (1988) *Real Prop Prob & Tr J* 211; Dodge (2009) *Hastings Law J* 1005.

⁹¹ E.g. McNulty (1976) *Tax Notes* 24; Dodge (1978) *Harv Law Rev* 1211; Kornhauser (1992) *Conn Law Rev* 1; Galvin (1993) *Vanderbilt Law Rev* 1528–1529; Darnell (2004) *Seton Hall Law Rev* 709; Dodge (2009) *Hastings Law J* 998.

⁹² Ventry (2000) *Tax Notes* 1159–1160.



Although the United Kingdom's last conservative government promised the repeal of the inheritance tax in 1996,⁹³ the historic political victory of the Labour Party in 1997 precluded any such possibility. However, after 20 years of relative stability, the inheritance tax has recently become a subject of intense political debate.⁹⁴ In 2006 the Forsyth Report of the Conservative Tax Reform Commission issued a controversial proposal for the government to repeal the inheritance tax, which the government refused to endorse.⁹⁵ The current campaign is directed instead at increasing the basic exemption to £1 million.⁹⁶ The continued existence of the tax is currently under tremendous public pressure. Some commentators have favoured repeal of the inheritance tax altogether,⁹⁷ whereas others have proposed that the current system should instead be reformed⁹⁸ or be replaced by a recipient-based accessions tax⁹⁹ or a comprehensive income tax.¹⁰⁰ However, commentators generally agree that the inheritance tax will in all probability remain a part of the tax system for many years to come.¹⁰¹ The recent Mirrlees Review (published in 2008) recommended that, although abolition seemed a possibility, the tax should rather be retained and reformed.¹⁰² The report highlighted the benefits of a

⁹³ See Lee (2007) *Legal Studies* 678 n 1 and Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 14 n 12 and accompanying text.

⁹⁴ Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 6 n 2 and accompanying text.

⁹⁵ Thistle (2007) *Ga J Int & Comp L* 706; Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 14.

⁹⁶ See e.g. Editorial "Tories Would Abolish Inheritance Tax under 1 Million Pounds" *Sky News* (27/02/2008).

⁹⁷ E.g. Bracewell-Milnes (2002) 15; Lee (2007) *Legal Studies* 708.

⁹⁸ One suggestion is to effectively restore the capital transfer tax regime by bringing lifetime gifts within the ambit of the system. See Goodhart (1988) *Br Tax Rev* 473–481.

⁹⁹ Riley (1991) 33.

¹⁰⁰ Goodhart (1988) *Br Tax Rev* 473–481. Lee (2007) *Legal Studies* 694 n 125 refers to the Commission on Taxation and Citizenship *Paying for Progress: A New Politics of Tax for Public Spending* (London Fabian Society 2000) and R Patrick and M Jacobs *Wealth's Fair Measure: The Reform of Inheritance Tax* (London Fabian Society 2003).

¹⁰¹ Thistle (2007) *Ga J Int & Comp L* 720.

¹⁰² Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 23.



recipient-based tax.¹⁰³ As a consequence, the report favoured a radical change-over to a recipient-based tax combined with some reform of relief and rates, and the reintroduction of a capital gains tax on death.¹⁰⁴ As an alternative, the imposition of a capital gains tax on death together with the abolition of the inheritance tax was proposed.¹⁰⁵

Although there has been a remarkable decline of wealth transfer taxation in numerous countries, it would be incorrect to conclude that the tendency resembles an international trend. In numerous countries, wealth transfer taxes play a vital role in the tax system, such as in most member-countries of the European Union.¹⁰⁶ The law reforms in these countries tend to focus instead on the improvement of the current legal structures. In the Netherlands, for example, the existing inheritance and gift tax has recently been subjected to a reform process.¹⁰⁷ Although a few Dutch scholars have briefly touched on (some) of the basic arguments for and/or against wealth transfer taxation in principle,¹⁰⁸ one senses that, in the words of Sonneveld and De Kroon, the time is not ripe for the abolition of wealth transfer taxation from the Dutch fiscal system yet.¹⁰⁹ It is evident from the Dutch literature that the attention of scholars is directed instead at improvements to the current regime.¹¹⁰ It is noteworthy, however, that the Council of States has, in reaction to the

¹⁰³ Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 2–3.

¹⁰⁴ Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 78.

¹⁰⁵ Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 78 stated that, although it is considered that a capital gains tax is conceptually different to a wealth transfer tax, any improvements to the existing inheritance tax would probably increase its inefficiency.

¹⁰⁶ See Paper by Sonneveldt and Zwemmer *Avoidance of Multiple Inheritance Taxation in Europe* (2001) for a comparative discussion on the legal structure of wealth transfer taxation in 15 European countries. See also the national reports delivered at the conference available at <http://www.eatlp.org/index.html> (accessed on 1 March 2009).

¹⁰⁷ See Ch 9 for further reading on the development of wealth transfer taxation in the Netherlands.

¹⁰⁸ See e.g. Sonneveldt and De Kroon (2008) *WFR* 593; Van Vijfeijken (2008) *WPNR* 425 and Juch (2008) *WFR* 655.

¹⁰⁹ Sonneveldt and De Kroon (2008) *WFR* 593.

¹¹⁰ See reference to textbooks and journal articles throughout Ch 9 below. The majority of Dutch scholars support recipient-based taxation. See Van Vijfeijken (2006) *Int Tax Rev* 152, 154; Van Vijfeijken (2004) Footnote continues on the next page



proposal for the amendment of the current legislation, remarked that more attention should be afforded to the justification of the tax.¹¹¹

3.3 THE HISTORICAL DEVELOPMENT OF WEALTH TRANSFER TAXATION IN SOUTH AFRICA: A BRIEF OVERVIEW

The following paragraphs will focus on the development of wealth transfer taxation in the South African law. This must be seen against the background of the development of the South African income tax and the introduction of capital gains tax in 2001.

3.3.1 Income Taxation

The South African income tax was largely premised on the English example, as a consequence of which inheritances and donations, being of a capital nature, were excluded from the ambit and scope of the income tax base.¹¹² This was the position for a *donatio non mera* or “donation properly so called” (a donation prompted by sheer liberality and benevolence)¹¹³ as well as a *donatio mera*, or so-called “remuneratory donation”, which is a donation made in recognition of benefits received or services rendered (and therefore “akin to an exchange or discharge of a moral obligation”).¹¹⁴

WPNR 322; Van Vijfeijken (2008) WPNR 425; Van Rijn (2008) WPNR 436; Van Bommel and Pagter (2008) WFR 501. However, some scholars have claimed that an estate tax may be a commendable alternative. See Oliemans and Stevens (2008) WFR 577.

¹¹¹ Advies W06.09.0081/III (3 April 2009) par 1, available at <https://www.raadvanstate.nl> (accessed on 5 July 2009).

¹¹² See Ch 2 par 2.2.2.1. See *SIR v Watermeyer* 1965 (4) SA 431 (A), 27 SATC 117, where the court (at 438) referred to the English cases *Stedeford v Beloe* [1932] AC 388 and *Blakiston v Cooper* [1909] AC 104.

¹¹³ See Ch 7 par 7.4.2 for further reading on the common-law meaning of a donation properly so called.

¹¹⁴ See *Avis v Verseput* 1943 AD 331 353; *CIR v Lunnon* 1924 AD 94, 1 SATC 7. In the *Lunnon* case Innes CJ held (at 97–98) that even a remuneratory donation does not possess the quality of income because it is not made in pursuance of a *legal obligation*. This viewpoint was also followed and affirmed in *Stander v CIR* 1997 (3) SA 617 (C), 59 SATC 212. In the words of Williams (1998) SALJ 770 “[t]his ... is the first manifestation of the lamentable development in South African income tax whereby judges cut our tax law adrift from the wisdom of the kindred disciplines of economics and accountancy and tried to develop

Footnote continues on the next page



Nevertheless, the legislature had included provisions to deem certain voluntary awards relating to services rendered in the definition of gross income, thereby attempting to bring remuneratory donations within the income tax base.¹¹⁵

3.3.2 Wealth Transfer Taxation

3.3.2.1 Pre-Union Legislation

The first appearance of a wealth transfer tax in South Africa was the introduction of a recipient-based succession duty in the Cape of Good Hope Colony in 1864, precedent for which came from England.¹¹⁶ Natal and the Orange Free State followed suit by introducing a similar succession duty by virtue of colonial legislation in 1905.¹¹⁷ By contrast, the former Zuid-Afrikaanse Republiek (ZAR) introduced a transferor-based estate duty in 1899.¹¹⁸

idiosyncratic ‘legal’ concepts as the basis of income tax law. These legal concepts often (as in *Lunnon*) share the nomenclature of economics but deviate in their meaning. Decades later we see the result – income tax lacks a secure foundation of concept and principle.”

¹¹⁵ The current provisions are contained in paragraphs (c), (d) and (i) to the definition of gross income in section 1 of the Income Tax Act 58 of 1962 and s 8A-8C of the Act. These accruals are therefore currently exempt from donations tax. See Ch 5 par 5.5.3.

¹¹⁶ The Act imposed a duty on legatees and heirs on the value of their legacies and inheritances. See Chaplin (1989) *SA Banker* 132 and West (2004) 52. The wording, however, differed so widely from that of the English legislation that the English case law was not of any use for reference purposes. See Howard (1924) vii.

¹¹⁷ Chaplin (1989) *SA Banker* 132.

¹¹⁸ Chaplin (1989) *SA Banker* 132.



3.3.2.2 National Legislation

3.3.2.2.1 Death Duties (1922-1955)

The first national wealth transfer tax was enacted with the promulgation of the Death Duties Act in 1922, repealing all the provincial laws.¹¹⁹ Due to the fact that the Cape of Good Hope Colony, Natal and the Orange Free State previously provided for succession-based duties, whereas the ZAR provided for a transferor-based estate duty, the unified 1922 Act levied both estate duty and succession duty on a parallel basis country-wide. The dual-duty approach that applied in England at that time¹²⁰ provided a foundation for the design of the legislation.

Estate duty, which was modelled on the provisions of the English estate duty, was chargeable upon the deceased estate of every person dying on or after the first day of July 1922.¹²¹ An estate consisted of all property of the deceased which passed on his or her death, and all property that was deemed to pass on his or her death,¹²² such as a *donatio*

¹¹⁹ Act 29 of 1922. See Howard (1924) for a comprehensive discussion on the provisions of this Act.

¹²⁰ In 1922, when the South African Death Duties Act was introduced, England levied a transferor-based estate duty in terms of the Finance Act of 1894 as well as a recipient-based legacy duty on personal estate and a recipient-based succession duty on real estate and settled property on the heirs or legatees. The recipient-based duties were abolished in 1949. See par 3.2.3.

¹²¹ Death Duties Act s 1.

¹²² Death Duties Act s 3(1).



mortis causa.^{123 124} Any property passing under a *donatio inter vivos*,¹²⁵ exceeding £100 in value, made by the deceased after the first day of July 1922, and which took effect within a period of two years immediately prior to his or her death, was also included as property deemed to be property of the deceased.¹²⁶ The period was extended to five years in 1951.¹²⁷ In the assessment of the dutiable estate, certain deductions were allowed,¹²⁸ as well as a rebate.¹²⁹

¹²³ Death Duties Act s 3(4)(d). This donation is made in contemplation of the death of the donor. The motive for this donation must be pure benevolence. The mere fact that the donation will only be implemented after the death of the donor does not necessarily characterise the donation as a *donatio mortis causa*. The expectation of the donor's death must be the motivating factor. Sometimes the property is delivered, subject to it being returned in case death should not actually occur, or sometimes the gift is made without delivery, on condition that the property shall not pass to the donee until the donor's death. However, the donor always retains the right to revoke the donation unilaterally. A valid *donatio mortis causa* should comply with all the formalities required for a will, which include signature by the donor and attestation by two witnesses. In addition, the donee should accept the donation before the death of the donor. Furthermore, the donation is only valid if the donee survives the donor. See Owens in *LAWSA* (2005) pars 316–320 (and the authority cited there); Stein (2004) 49; Meyerowitz (2007) par 27.43; Davis, Beneke and Jooste (2009) par 2.4.4.1; De Waal and Schoeman-Malan (2008) 218 (and the authority cited there) and Corbett *et al* (2001) 33, 35, 36.

¹²⁴ Death Duties Act s 3(4)(a)–(c) furthermore provides that the following are included as deemed property in the estate: life insurance policies effected by the deceased to the extent that the deceased paid the premiums, limited interests that were held immediately prior to death and annuities to which the deceased had an interest to the extent of any advantage accruing by “survivorship” on his or her death.

¹²⁵ A *donatio inter vivos* is “a donation made with the intention of granting the donee the benefit of the gift during the life of the donor (unlike a donation *mortis causa* which normally contemplates the donor retaining ownership until his death) and which, subject to a few exceptions, is irrevocable”. See Owens in *LAWSA* (2005) par 304.

¹²⁶ Death Duties Act s 3(4)(e). Donations that were made two years prior to death were not liable to duty.

¹²⁷ Editorial (1997) *Taxpayer* 66.

¹²⁸ Death Duties Act s 4(a)(i)–(x). Provision was made for the deduction of death and funeral expenses, debts due to persons ordinarily resident in the Union, administration and liquidation costs, foreign death duties, the balance of debts due to persons ordinarily resident outside the union that cannot be discharged from foreign property, the value of any limited interest that ceased upon the death of the deceased (where such interest was created under the terms of a bona fide transaction of purchase and sale entered into before 1 July 1922), the value of any usufruct over property which formed part of the estate of the predeceased spouse, the value of dispositions to public institutions, the value of dispositions to the union and the proceeds of certain life insurance policies.

¹²⁹ Death Duties Act s 4(b) (which amounted to £1 000 when the Act was first introduced).



Succession duty, which was modelled on the provisions of the English legacy and succession duties, was levied on the accrual of every succession by a person.¹³⁰ A succession was deemed to have been accrued whenever any person became entitled to, or to any interest in, any property,¹³¹ (a) by virtue of any disposition made by any predecessor, who died on or after the first day of July 1922, on his or her death, whereby property passed on the death of the predecessor, or (b) by reason of a cessation of an interest held by a predecessor, or (c) by reason of any advantage that accrued by “survivorship”, or (d) by devolution in accordance with the law on the death of such predecessor, or (e) by virtue of any disposition made by such predecessor whereby such property was deemed to have been passed on the death of the predecessor.¹³² The dutiable amount was calculated by allowing for a sliding abatement.¹³³ The rate upon which the duty was levied was determined according to the blood relationship between the predecessor and the successor.¹³⁴ Any accrual in respect of a surviving spouse was exempt from duty,¹³⁵ as well as any succession accruing to any public institution of a charitable, educational or ecclesiastical nature¹³⁶ or a provincial administration.¹³⁷ Although the successor was liable and ultimately responsible for the duty,¹³⁸ it was payable and recoverable from the executor of the estate of the predecessor,¹³⁹ who was entitled to

¹³⁰ Death Duties Act s 8.

¹³¹ Which property referred to “property” and “deemed property” as provided for in chapter 1 s 3(1) of the Death Duties Act that dealt with estate duty.

¹³² Death Duties Act s 10. A fideicommissary interest created by such disposition was expressly excluded.

¹³³ Death Duties Act s 14 (which amounted to £100 when the Act was first introduced).

¹³⁴ Death Duties Act s 8. See Howard (1924) 103.

¹³⁵ Death Duties Act s 15(a).

¹³⁶ Death Duties Act s 15(b).

¹³⁷ Death Duties Act s 15(c).

¹³⁸ Death Duties Act s 23(c).

¹³⁹ Death Duties Act s 24.



deduct the succession duty so paid from the amount of the succession paid over to the successor or to recover such duty in any other way.¹⁴⁰

3.3.2.2.2 *Donations Tax and Estate Duty (1955-)*

Donations tax, which was introduced in South Africa in 1955 by means of an amendment to the then existing income tax legislation, was aimed at inhibiting the avoidance of income tax and estate duty, and was never intended to raise revenue.¹⁴¹ The tax was made payable on the cumulative value of donations made by a taxpayer after 23 March 1955. The grafting of donations tax onto income tax legislation was presumably a convenient way to make many of the definitions and administrative provisions applicable to the new tax.¹⁴²

On 1 April 1955, the Death Duties Act was replaced by the Estate Duty Act (hereafter “the Act”).¹⁴³ Its structure is generally based on the part of the Death Duties Act that levied estate duty on the deceased estate. The provisions relating to succession duty were not re-enacted, although some of its characteristics were retained in the form of relief in respect of the surviving spouse and children as well as progressive tax rates. As a consequence, the Act levies a transferor-based estate tax on the decedent’s estate, not on the inheritance acquired by the heir. The introduction of the Act was therefore “a move

¹⁴⁰ Death Duties Act s 26.

¹⁴¹ See Hansard (Volksraad Debatte) 89 (1955) 7185; *Ogus v SIR* 1978 (3) SA 67 (T) 74 and Margo Report (1986) par 20.22.

¹⁴² Currently, the following provisions of the Income Tax Act 58 of 1962 are applicable to donations tax: the secrecy provisions contained in s 4, the provisions relating to the exercise of the Commissioner’s discretion contained in s 3, the provisions relating to representative taxpayers (as adapted by s 61), the provisions relating to the refund of excess payments contained in s 102, the provisions relating to non-disclosure of relevant information and penalties (as adapted by s 61), the general anti-avoidance provision contained in s 80A–L. See Meyerowitz (2007) par 1–4.

¹⁴³ Act 45 of 1955.



away from the succession duty dispensation introduced by the Death Duties Act 29 of 1922”.¹⁴⁴

This approach was motivated by administrative reasons. When the bill was read in parliament, the Minister of Finance said that:

“[d]ie belangrikste aspek van hierdie boedelwetsontwerp is die afskaffing van suksessieregte ... Dit is omrede die baie moeilike en ingewikkelde probleme wat gepaard gaan met die aanslaan, en die invordering van suksessieregte. Daar is ’n ernstige tekort aan personeel in die Meesterskantoor, waardeur ernstige vertraging plaasgevind het met die afhandeling van boedels, wat groot ongerief veroorsaak het, nie alleen vir die eksekuteurs nie, maar ook vir die erfgename.”¹⁴⁵

Without supplying any substantive reasons, the Minister remarked that he would personally have favoured the retention of the succession duty, rather than the estate duty. Apparently, numerous difficulties were experienced in the area of limited interests and bare *dominium* property.¹⁴⁶ Although objections were raised in respect of the implementation of the proposed legislation,¹⁴⁷ the bill was passed (effective for persons dying on or after 1 April 1955).¹⁴⁸

The move towards transferor-based taxation was arguably motivated by the abolition of the legacy and succession duties in the United Kingdom in 1949, leaving transferor-based estate duty as the sole death duty in that country.¹⁴⁹

¹⁴⁴ Van der Linde and Franzsen (2001) *TSAR* 827.

¹⁴⁵ Hansard (Volksraad Debatte) 89 (1955) 7236.

¹⁴⁶ This was informally mentioned by Gert van der Berg, an attorney specialising in deceased estates and estate planning, in a symposium on estate duty arranged by National Treasury on 18 November 2009.

¹⁴⁷ The arguments raised were that the tax erodes capital, provides a low revenue yield and has a destructive effect on small businesses and farmers. See Hansard (Volksraad Debatte) 89 (1955) 7239–7249, 7253.

¹⁴⁸ Estate Duty Act s 32.

¹⁴⁹ See par 3.2.3.



Both estate duty and donations tax were initially charged at progressive rates.¹⁵⁰ When estate duty was first introduced, donations made by the deceased after 23 March 1955 were included in the dutiable estate, providing for a set-off against estate duty of any donations tax that was payable by the deceased during his or her lifetime.¹⁵¹

When the income tax legislation was consolidated in 1962, the provisions dealing with the levying of donations tax were consolidated in sections 54–64, part V of chapter 2 of the Income Tax Act 58 of 1962, which is still in force today. Except for minor changes, the material provisions of the Estate Duty Act and Part V of the Income Tax Act have been kept intact over the years, notwithstanding the fact that they have been subjected to the examination of three official tax law reform commissions.

3.3.2.3 The Tax Law Reform Commissions

In its second report released in 1970, the Franzsen Commission recommended that estate duty should not be abolished, in view of the fact that it contributed to the overall fairness and balance of the South African tax system.¹⁵² Although it was stated that a recipient-based inheritance tax would be “a more equitable system in so far as the assessment could be made in accordance with the individual’s ability to pay”, the commission favoured a transferor-based estate tax for pure practical and administrative reasons and consequently endorsed the existing structure of estate duty as levied in terms of the Estate Duty Act.¹⁵³ The Commission proposed minor amendments, mostly in respect of the rate structure and rebates.¹⁵⁴

¹⁵⁰ The highest rate being 25% on the amount exceeding £45 000. See Editorial (1997) *Taxpayer* 66.

¹⁵¹ Editorial (1997) *Taxpayer* 66.

¹⁵² Second Franzsen Report (1970) par 364.

¹⁵³ Second Franzsen Report (1970) 371.

¹⁵⁴ Second Franzsen Report (1970) pars 372–376, 384–396.



As pointed out in Chapter 1, the Margo Commission recommended the implementation of a “capital transfer tax”, a combined death and gift tax which is imposed on dispositions of property for no or for inadequate consideration, a recommendation that was in principle supported by the government.¹⁵⁵ The name of the tax was probably derived from the corresponding United Kingdom legislation which was in force at that time. Although the commission noted that a recipient-based tax would better support the principle of ability-to-pay,¹⁵⁶ it nevertheless recommended a transferor-based tax for practical and administrative reasons.¹⁵⁷ In order to provide for interim relief in anticipation of the new legislation, the Commission provided some recommendations in respect of rebates, the rate schedule, spousal relief, tax-avoidance, instalment-payments and valuation.¹⁵⁸ Most of these recommendations were accepted and introduced by the Taxation Laws Amendment Act of 1988, which provided for amendments to the Estate Duty Act (in respect of estate duty) and the Income Tax Act (in respect of donations tax).¹⁵⁹ The progressive rate structure was replaced by a flat rate. Another significant amendment was the exclusion of donations (except for donations *mortis causa*) from the estate duty tax base.¹⁶⁰ Donations tax, which was previously charged on the cumulative value of non-exempt donations, was amended to be charged on each individual non-exempt donation (made after 16 March 1988).¹⁶¹

Critics commented that “this ‘interim relief’ [brought] the existing legislation so close to what the Commission recommended should be contained in a capital transfer tax that one

¹⁵⁵ See Ch 1 par 1.1.

¹⁵⁶ Margo Report (1986) pars 20.44–20.45.

¹⁵⁷ Margo Report (1986) pars 20.44 and 20.50.

¹⁵⁸ See Margo Report (1986) par 20.68 for a summary of the recommendations. See also Eskinazi (1988) *Ins & Tax* 26 *et seq.*

¹⁵⁹ See RDJ (1987) *Income Tax Reporter* 260–265 and Editorial (1988) *Taxpayer* 120(d) for a summary of the amendments affected in consequence of the recommendations.

¹⁶⁰ Editorial (1997) *Taxpayer* 66.

¹⁶¹ King and Victor (2008/2009) par 12.2.



wonders whether there is any need for entirely new legislation, other than a desire to change names”.¹⁶² This forecast proved to be true. The proposal for the new integrated Act never culminated in legislation.

Nearly a decade later, the Katz Commission supported the Margo Commission’s proposal for a capital transfer tax,¹⁶³ also favouring a transferor-based tax.¹⁶⁴ Although the commission conceded that a recipient-based tax would better adhere to the principle of ability-to-pay, it was maintained that an estate tax would be easier to administer than a recipient-based tax, which involved a greater number of taxpayers. In addition, it was noted that an estate-type tax has for many years been in place in South Africa. As a consequence, the principles are well-documented and have been the subject of numerous court decisions. The Commission furthermore stated that the administrative systems in place in the Master’s Office and revenue collectors had the competence to administer such a tax.¹⁶⁵ The Commission addressed aspects such as rates, rebates, the problem of interest-free loans and preference shares, generation-skipping trusts, anti-avoidance measures, spousal relief, charitable dispositions and the possible expansion to a residence-basis of charge.¹⁶⁶ Regrettably, the recommendations were ignored to a large extent. To date, the proposal for the combined estate and donations tax has not been taken any further by the government.

3.3.3 Comprehensive Income Tax and Comprehensive Consumption Tax

As pointed out earlier, the Margo Commission did not consider the introduction of a comprehensive income tax or a direct consumption tax (both of which could conceptually

¹⁶² Editorial (1988) *Taxpayer* 120(d).

¹⁶³ See Ch 1 par 1.1.

¹⁶⁴ Fourth Interim Katz Report (1997) par 5.8.

¹⁶⁵ Third Interim Katz Report (1995) par 7.3.3.

¹⁶⁶ See Fourth Interim Katz Report (1997) Ch 14 for a summary of the main recommendations.



include the taxation of wealth transfers) to be appropriate for the South African tax system. The Katz Commission did not even consider the possibilities.¹⁶⁷

3.3.4 Capital Gains Taxation

As pointed out earlier, capital gains tax was introduced into the South African tax system in 2001 despite the fact that the Margo Commission and the Katz Commission rejected the proposal for the introduction of such a tax.¹⁶⁸ For the purposes of the capital gains tax regime, a donation of an asset constitutes a disposal.¹⁶⁹ Also, a deceased person is deemed to dispose of all his or her assets (except for those transferred to a spouse and for assets consisting of domestic life insurance policies or retirement savings) to the deceased estate for an amount received or accrued to equal to the market value of the assets on the date of death.¹⁷⁰ A deemed-realisation approach is therefore applied on the death of a wealth holder.

Unlike the Canadian experience, the introduction of a deemed realisation-approach on death did not uproot the estate duty and donations tax regimes. However, in view of the fact that the imposition of both capital gains tax and estate duty may have had a negative impact on the liquidity of an estate, the estate duty rate was reduced with effect from 1 October 2001, the date on which capital gains tax became operative.¹⁷¹

¹⁶⁷ See Ch 2 par 2.2.2.2 and Ch 2 par 2.2.4.2.

¹⁶⁸ See Ch 1 par 1.1 and Ch 2 par 2.2.3.3.2.

¹⁶⁹ See Ch 5 par 5.8.

¹⁷⁰ See Ch 6 par 6.8.

¹⁷¹ See Ch 5 par 5.1.



3.4 CONCLUSIONS

- (a) Wealth transfer taxes have been imposed in fiscal jurisdictions since the earliest civilisations. An interesting phenomenon that occurred over the centuries is that civil-code countries have traditionally developed and imposed recipient-based taxation on wealth transfers, whereas Anglo-American common-law countries have indicated a preference for transferor-based taxation. Although the earliest taxes were imposed on inheritances only, gift taxes were introduced in the course of time.¹⁷²
- (b) Although inheritances and gifts are conceptually included in the economic concept of income, the rise of the modern income tax did not disturb the well-rooted wealth transfer taxes in view of the fact that the popular English source-based concept of income excluded fortuitous gains. In addition, these gains had been statutorily removed from the American accretion concept of income since 1913. Nonetheless, the academically acclaimed Carter Report, published in 1966, urged the introduction of a comprehensive income tax for the Canadian tax system, the adoption of which would have rendered wealth transfers taxable in terms of ordinary broad-based income taxation. Although the Carter Report's recommendations were not adopted in Canada or any other country, they at least stimulated an academic debate on the possible accommodation of wealth transfers in an income tax base. Also, the report influenced the wealth transfer tax reform in countries such as Ireland, which constitutes the first (and only) common-law jurisdiction that successfully replaced its transferor-based estate duty with a recipient-based acquisitions tax.¹⁷³

¹⁷² See pars 3.2.1, 3.2.2 and 3.2.4.

¹⁷³ See par 3.2.3.



- (c) When thoughts on the possible implementation of a direct consumption tax surfaced in the international arena in the 1970s, an alternative structure for the taxation of wealth transfers was once again on the table. The *Blueprints for Basic Tax Reform* Report, published in the United States in 1977, and the Meade Report, published in the United Kingdom in 1978, recommended that inheritances and gifts be taxed under a direct consumption tax. These proposals never culminated in law reform. Although the idea of a direct consumption has received much academic support over the years, it has not (as far as could be ascertained) been implemented in any country in the world.¹⁷⁴
- (d) In view of the fact that income taxation and consumption taxation have not developed to successfully account for the taxation of inheritances and gifts, wealth transfer taxes are still commonly encountered in modern tax systems. However, these taxes have experienced a decline in some leading international jurisdictions over the past four decades. They have been abolished in Canada, Australia, New Zealand and a number of other countries. Furthermore, the United States estate tax is currently being phased out over a decade-long period with a reinstatement scheduled for 2011. The United Kingdom inheritance tax is also under tremendous public pressure.¹⁷⁵ Seligman's prediction (in 1969) that "[w]ith all the variations in detail, it is clear that the democratic trend is in one general direction; and it is more than probable that progressive inheritance taxes will play by no means an insignificant role in the fiscal systems of the future"¹⁷⁶ turned out to be partly incorrect.

¹⁷⁴ See par 3.2.3.

¹⁷⁵ See pars 3.2.3 and 3.2.4.

¹⁷⁶ Seligman (1969) 141.



- (e) The abolition of wealth transfer taxes from significant tax systems and the current pressure experienced in the United States and United Kingdom in particular have stimulated a debate on the conceptual justification of these taxes in modern tax systems. It is of special significance that the decline of wealth transfer taxes in OECD countries has in fact been much greater among countries with transferor-based taxation than in countries which levy recipient-based taxes.¹⁷⁷
- (f) It is noteworthy that numerous official tax reform commissions have recommended a transition to recipient-based taxation for common-law countries that levy transferor-based wealth transfer taxes.¹⁷⁸ However, these recommendations fell on death ears.
- (g) It is evident that the interaction between wealth transfer taxation and capital gains taxation has played a significant role in the development of wealth transfer taxes. The United States and the United Kingdom introduced a stepped-up approach for purposes of capital gains tax (on the death of a wealth holder) because of the fact that a combination of transferor-based taxation and capital gains taxation produces double taxation in the hands of the transferor. The experience in Canada, where wealth transfer taxation was actually replaced by the introduction of capital gains tax (and more specifically a deemed-realisation approach) contributes to the realisation that the interaction between these two forms

¹⁷⁷ Duff (2005) *Pittsburgh Tax Rev* 120; Duff in Tiley *ed* (2007) 334.

¹⁷⁸ E.g. in the US the Special Committee of the US Law Institute (1960) and in the UK the Colwyn Committee (1927), the Meade Report (1978), the Gammie Report (1994) and the Mirrlees Review (2008). See pars 3.2.3 and 3.2.4.



of taxation is significant in a tax system.¹⁷⁹ This aspect will be explored more fully in the next chapter.¹⁸⁰

- (h) Since the initial inception of provincial succession duties *circa* 1864 in South Africa, wealth transfer taxation has remained a part of the South African tax system. The adoption of the English source-based concept of income, which excludes inheritances and donations from a taxpayer's gross income because of their capital nature, precluded the taxation of wealth transfers under ordinary income taxation in South Africa. This was the position not only for inheritances and donations properly so called, but also for remuneratory donations. The income tax legislation has since been adapted to include most remuneratory donations in the gross income of the recipient (allowing a corresponding exemption from wealth transfer taxation).¹⁸¹ A comprehensive income tax and a comprehensive (direct) consumption tax have never been officially considered for the South African tax system.¹⁸²
- (i) It is clear that, with the introduction of estate duty and donations tax in 1955, South Africa moved away from recipient-based taxation. Although all three of the official tax reform commissions supported the transferor-based approach, it would seem that the merits of recipient-based taxation were not properly considered. What is also noteworthy is that the commissions were not confronted with the double taxation produced by transferor-based wealth transfer taxation and capital gains taxation, because capital gains tax was introduced into the South African tax system

¹⁷⁹ See par 3.2.3.

¹⁸⁰ See Ch 4 par 4.4.1.2.

¹⁸¹ See par 3.3.1.

¹⁸² See par 3.3.3.



only in 2001. Both the Margo Report and the Katz Report rejected the idea of a capital gains tax for the South African tax system.¹⁸³

- (j) Since the introduction of capital gains tax in 2001, South Africa has applied a deemed-realisation approach for the purposes of the unrealised gains on a wealth holder's death. With reference to the Canadian experience, the question may be posed whether the simultaneous imposition of capital gains taxation and wealth transfer taxation on a transferor is justifiable in a tax system. This issue is bolstered if one considers the disappearance or imminent disappearance of these taxes in some countries.

The conceptual justification for wealth transfer taxation in the context of the South African tax system will be considered in the next chapter.

¹⁸³ See pars 3.3.2 and 3.3.4.

CHAPTER 4

THE CONCEPTUAL JUSTIFICATION FOR THE TAXATION OF WEALTH TRANSFERS

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4.1 INTRODUCTION

It is evident from Chapter 3 that wealth transfer taxes have been in decline in a number of prominent countries over the last four decades. The main reasons for the disappearance of these taxes in Australia and Canada, as well as their unpopularity in the United States and the United Kingdom, include the following: (a) the failure of a government to adjust the basic exemption for inflation, (b) the hardship on farms and family businesses caused by the forced liquidation of assets in order to pay the tax liabilities, (c) the relative ease with which these taxes could be avoided, (d) the low revenue yield, (e) high tax rates, (f) the perception of “double taxation” in the case where a wealth transfer tax was levied together with a capital gains tax upon death, (g) the failure to integrate the dual-system of estate and succession duties (i.e. at state and federal level) that were imposed in the United States, Canada and Australia and (h) the high political costs of these taxes.

The demise of wealth transfer taxation has, especially among scholars in the United States, reawakened an interest in the debate about whether or not this type of taxation is conceptually justifiable. Opponents have used the factors listed above as well as other pleas – based on tax policy and socio-economic considerations – in the formulation of their calls for the abolition of wealth transfer taxation. The purpose of this chapter is to provide a review of this debate in a South African context– focusing on three main aspects, namely:

- the fundamental philosophical debate: the legitimacy of restrictions on inheritances
- the tax objectives debate and
- the tax policy debate.

In conclusion, political considerations will also be referred to.



4.2 THE FUNDAMENTAL PHILOSOPHICAL DEBATE: THE LEGITIMACY OF RESTRICTIONS ON INHERITANCES

Inheritance is a concept that dates back to the ancient societies. One of the oldest codes of law, dating from the rule of Hammurabi during the golden age of Babylonia (1792–1750 BCE), described the early treatment of inheritances.¹ The Twelve Tables, which codified the Roman law in 451 and 452 BCE, included provisions in respect of both the testate and intestate law of succession.² The institution of inheritance was adopted throughout the world and, although it has been abolished at times and in various places throughout history,³ it has a place in every Western legal system today, including South Africa.⁴

For centuries, philosophers have debated whether or not people have an entitlement to own and transfer property upon their death.⁵ Although it is beyond the scope of this study

¹ Hauser (1999) *Real Prop Prob & Tr J* 394 n 201 refers to CHW Johns *The Oldest Code of Law in the World* (1903).

² Coetzee LLD Thesis (2006) 18; Hauser (1999) *Real Prop Prob & Tr J* 395 refers to B Nicholas *An Introduction to Roman Law* (1977). See also Hirsch and Wang (1992) *Indiana Law J* 5 n 15.

³ E.g. by the Puritans in England in 1624 and the Soviet Bolcheviks in 1918. See Hauser (1999) *Real Prop Prob & Tr J* 396 and Dukeminier *et al* (2005) 17.

⁴ Although the South African property law is essentially Roman-Dutch in character, the law of succession, and especially principles regarding the freedom of testation and the execution and interpretation of wills, was greatly influenced by the English law, thereby ousting the Roman-Dutch rule of “legitimate portion”. The South African Wills Act 7 of 1953, which regulates the formalities of wills, is based on the former provincial ordinances, which were strongly influenced by the English Wills Act of 1837. In respect of the law of intestate succession, there has always been an order of succession in South Africa, dealing with the situation where a person dies and has failed to execute a valid will. The first order of intestate succession can be traced back to the *Octrooi* of 10 January 1661, which was formulated with reference to a number of statutory codifications in Holland (nowadays the Netherlands) based on the principles of *Aasdomsrecht* and *Schependomsrecht*. The order of intestate succession so established was replaced by the Succession Act 13 of 1934, which added the surviving spouse and adopted children to the order of succession. This Act was repealed and replaced by the Intestate Succession Act 81 of 1987, which is currently in force. For further reading, see Corbett *et al* (2001) and De Waal and Schoeman-Malan (2008).

⁵ Youdan in Atherton *ed* (2003) 130 refers to a statement of RM Bird in “The Case for Taxing Personal Wealth” in the *Report of the Proceedings of the Twenty-Third Tax Conference, Canadian Tax Foundation* (1972) 6 14. See also Adriani and Van Hoorn Vol 3 (1954) 188–190; Chester (1976) *Rutgers Law Rev* 78–100; Hirsch and Wang (1992) *Indiana Law J* 1; Thistle (2007) *Ga J Int & Comp L* 707.



to provide an extensive analysis of the philosophical justification of inheritance,⁶ it is important to understand that one's orientation towards this institution would influence one's viewpoint on the legitimacy of the taxation of wealth transfers, which is something governments have traditionally used to inhibit inherited wealth. The extreme differences in thought can be traced to the fixed ideological ideas of the various schools of thought.⁷

In the seventeenth century, the philosopher John Locke argued that people have a fundamental and natural right to bequeath property to their children, which the state should not restrict.⁸ This point of view was also supported by classical scholars such as Hugo Grotius, Gottfried Leibniz and Immanuel Kant.⁹ Conversely, theorists such as Samuel von Pufendorf, William Blackstone and William Godwin have taken the position that control over property is for the living and that this control is lost at the moment of death.¹⁰ Others preferred some sort of middle ground. The utilitarians Jeremy Bentham and John Stuart Mill, the Italian economist Eugenio Rignano, and several other scholars have supplied various proposals to regulate inheritances by, for example, limiting the amount that a person should be entitled to inherit from others or by levying a tax on inheritances (or deceased estates).¹¹

⁶ For further reading on the debate, see Haslett (1986) *Philos Publ Aff* 122 *et seq*; Ascher (1990) *Michigan Law Rev* 69 *et seq*; the collection of essays in Erreygers and Vandeveld (eds) *Is Inheritance Legitimate* (1997); Trout and Buttar (2000) *J Law Polit* 765 *et seq*; Auerbach (2008) *WFR* 1080–1083.

⁷ Vandeveld in Erreygers and Vandeveld *eds* (1997) 1 *et seq* describes the legitimacy of inheritance according to communitarianism (focusing on the social nature of human beings in preference to individual needs), liberalism (focusing on equality of opportunity) and libertarianism (focusing on individual liberty).

⁸ Thistle (2007) *Ga J Int & Comp L* 708 n 13 refers to Locke's *Two Treaties of Government* (1690). See also Hirsch and Wang (1992) *Indiana Law J* 6 n 18.

⁹ Hirsch and Wang (1992) *Indiana Law J* 6 n 18. These scholars have classified this entitlement as a "natural right". Others have categorised this freedom rather as a "civil right". See in general discussion by Ascher (1990) *Michigan Law Rev* 76–80 and Hirsch and Wang (1992) *Indiana Law J* 1.

¹⁰ Hirsch and Wang (1992) *Indiana Law J* 7 n 23.

¹¹ Bentham, in his book *Supply Without Burthen* (1795), proposed that all intestate inheritances should be abolished, except in the case of immediate relatives. See Buehler (1948) 387; Seligman (1969) 127–130 and West (2004) 110. Mills, in his book *Principles of Political Economy* (1871) suggested the total abolition of all collateral inheritances, as well as a limitation on the amount which every person should be allowed to inherit. See Seligman (1969) 130; Musgrave (2000) 141 and West (2004) 110. Rignano, in his Footnote continues on the next page



However, in modern jurisprudence, it is widely accepted that a person does not have a fundamental right to transfer property unrestricted to his or her heirs upon his or her death, irrespective of the fact that the institution of inheritance has become a well-rooted feature in most countries' legal systems all over the world.¹² Restrictions on inherited wealth, by virtue of, for example, rules of forced heirship or taxation, are commonly encountered.

However, a government's power to tax inherited wealth (as a form of property), and for that matter, *inter vivos* transfers, should be exercised fairly and requires justification in a constitutional democracy.¹³ It was already pointed out in Chapter 2 that, in a South African context, a taxpayer would generally be unable to challenge fiscal legislation merely because it constituted a violation of the right to property, unless the tax is confiscatory.¹⁴ Also, where the tax applies to the public in general, it cannot be said that the tax is violating the right of equality set out in section 9 of the Constitution.¹⁵ In South Africa, dutiable estates and taxable donations are currently taxed at a flat rate of 20 percent,¹⁶ which seems reasonable and fair and certainly not confiscatory and thus open to

book *Di Un Socialismo in Accordo Colla Dottrina Economica Liberale* (1901) differentiated among property which constituted a person's own savings, property which the person has inherited from other persons and which came from their own savings, property which a person has inherited from other persons who in their turn has inherited it from others, etc. The Rignano principle states that, the higher the number of transfers a piece of property has been subject to, the smaller the power of the owner to dispose of it by will. He proposed that the rate of inheritance taxation levied at each transfer of property should increase with the number of transfers. See Erreygers in Erreygers and Vandavelde *eds* (1997) 37. For some modern proposals on inheritance quotas by US scholars, see e.g. Haslett (1986) *Philos Publ Aff* 126; Haslett in Erreygers and Vandavelde *eds* (1997) 133–155; Ascher (1990) *Michigan Law Rev* (who suggested an inheritance quota of \$250 000 per person); Trout and Buttar (2000) *J Law Polit* 765 n 2 and Dukeminier *et al* (2005) 14–17 (who discuss the proposals of Ascher (*supra*)) and Irving Kristol, who suggested a limitation of \$1 000 000 in his book *Taxes, Poverty and Equality* (1974)).

¹² Even the libertarian Robert Nozick backed off from his original claim that the power to bequeath property upon death is an unconditional right of the wealth-holder. See McCaffery (1994) *Philos Publ Aff* 282 n 4 and accompanying text.

¹³ Youdan in Atherton *ed* (2003) 130; Seligman (1969) 127.

¹⁴ See Ch 2 par 2.4.3.3.2.

¹⁵ See Ch 2 par 2.4.3.3.3.

¹⁶ See Ch 5 par 5.1 and Ch 6 par 6.1.



possible constitutional attack. In addition, estate duty and donations tax have general application.

4.3 THE OBJECTIVES DEBATE

It has often been observed that the objectives of the taxation of wealth transfers are (a) to raise revenue and (b) to assist in the redistribution of resources.

4.3.1 Revenue

It was pointed out in Chapter 2 that the principal purpose of taxation is to raise revenue.¹⁷ Although wealth transfer taxes raised significant amounts of revenue during the first part of the twentieth century,¹⁸ none of the major OECD economies has raised more than two percent of national revenue from these taxes in any year over the last forty years.¹⁹ Apparently, this is also true for the developing countries.²⁰ In South Africa, the revenue collectively raised from estate duty and donations tax has contributed a mere 0,14 to 0,16 percent of the national tax revenue over the last seven tax years.²¹ This “is nothing more

¹⁷ See Ch 2 par 2.3.1.

¹⁸ In the UK, estate duty provided approximately 16–19% of the total tax revenue receipts in the early nineteen hundreds. See Sandford (1971) 68 Table 2.5 and Bracewell-Milnes (2002) 22. In the US, the estate tax provided up to half the amount of federal revenue until the outbreak of the World War II, when a considerable increase in reliance on the income tax occurred. By the 1980s the contribution of the estate tax to progressivity had declined radically and by 1974 it only rarely represented more than 2% of total revenue. See Eisenstein (1956) *Tax Law Rev* 227; Donaldson (1993) *W&L Law Rev* 544; McCaffery (1999) *Tax Notes* 1433; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 19. In the Netherlands, the revenue yield from the *successierecht* was approximately 10% in 1913, and this decreased to about 1,5% in 1960 and has remained at that level ever since. See Zwemmer (2001) *Mededelingen* 11. See also discussion by Duff (1993) *Can J Law Jur* 6–7.

¹⁹ See Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 7 Figure 1.1 for a graphical proposal of the OECD Revenue Statistics data across G7 countries (US, UK, Japan, Germany, Italy, France and Canada).

²⁰ Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp *eds* (2008) 195.

²¹ See statistics under “Estimate of National Revenue” of the various tax years at <http://treasury.gov/za/documents/national%20budget/default.aspx> (accessed on 24 September 2008). The Footnote continues on the next page

than a drop in the ocean” for the South African fiscus.²²

As a result, a common justification for the repeal of wealth transfer taxes is their insignificant revenue yield.²³ This was apparently one of the factors that contributed to the demise of these taxes in Canada.²⁴ Some scholars, however, point out that even small amounts of revenue can be significant.²⁵ Opponents, on the other hand, suggest that it may be far less costly, administratively, to raise the same amount of revenue by increasing other taxes.²⁶ This may, however, distort the distribution of the tax pressure, which may lead to undesirable results.²⁷ An increase in indirect taxes would, for example, increase the regressivity of the system.²⁸

A second argument advanced by opponents is that governments may even lose more than their nominal yield from the reductions they effect in the yields of other taxes, especially

Fourth Interim Katz Report (1997) par 1.11 advanced the following reasons for the insignificant revenue yield of these taxes, namely (1) the lack of record-keeping by non-business entities, (2) the fact that ownership of family assets is seldom clearly demarcated, (3) the lack of distinction between an outright donation and a mere “duty to support” and (4) the decline in the actual transfer of assets by the implementation of generation-skipping devices.

²² Mazansky (2002) *Executive Business Brief* 17.

²³ See e.g. Morgan (1981) *Tax Notes* 341; Dobris (1984) *Syracuse Law Rev* 1217–1218; McCaffery (1994) *Yale Law J* 300; Wampler (2001) *Seton Hall Legis J* 534; Youdan in Atherton *ed* (2003) 132; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 3, 9–10, 77.

²⁴ Bird (1978) *Osgoode Hall Law J* 137; Bird (1991) *Can Publ Pol* 326; Duff (2005) *Pittsburgh Tax Rev* 109.

²⁵ Graetz (1983) *Yale Law J* 271; Dobris (1984) *Syracuse Law Rev* 1227; Ascher (1990) *Michigan Law Rev* 91–93, 117–119; Third Interim Katz Report (1995) pars 7.2.2 (a yield of “1 to 1,5 percent of total tax revenues might be an appropriate target”) and 7.3.4; Rudnick and Gordon in Thuronyi *ed* Vol 1 (1996) 299; Schmalbeck (2000) *Cleve State Law Rev* 763; Wampler (2001) *Seton Hall Legis J* 538; Ventry (2000) *Tax Notes* 1164; Repetti (2000) *Tax Notes* 1497; Graetz (2002) *Yale Law J* 264; Klooster (2003) *Drake Law Rev* 644; Darnell (2004) *Seton Hall Law Rev* 684–685, 688; Lee (2007) *Legal Studies* 698.

²⁶ Dobris (1984) *Syracuse Law Rev* 1218; Galvin (1991) *Tax Notes* 1414; Youdan in Atherton *ed* (2003) 132; Lee (2007) *Legal Studies* 700; Oliemans and Stevens (2008) *WFR* 578.

²⁷ Davey (1986) *Ins & Tax* 13; Oliemans and Stevens (2008) *WFR* 578.

²⁸ Oliemans and Stevens (2008) *WFR* 578–579.



if the system is prone to tax avoidance measures.²⁹ The argument is that, if the yield of wealth transfer taxation had remained in the hands of the taxpayers, it would have been spent or reinvested, resulting in revenue being collected by governments in the form of value-added tax, excise duties and income tax. Therefore it seems that it is a case of rather “killing the goose than taxing the eggs”.³⁰ This line of argument is, however, usually criticised for lack of empirical evidence.³¹

Although it has been claimed that transferor-based taxation is a better source of revenue than recipient-based taxation,³² it is submitted that this viewpoint rests on a misconception, because the rate scale does not need to be the same. It would be relatively easy to adjust the rate structures of a recipient-based tax to eliminate any difference in the revenue yield.³³

4.3.2 Redistribution of Resources

It was pointed out in Chapter 2 that taxation can be used as an instrument to redistribute resources in an economy.³⁴ John Rawls, a liberal theorist, observed that the primary purpose of the taxation of wealth transfers is indeed “to correct the distribution of wealth and to prevent concentrations of power detrimental to the fair value of political liberty

²⁹ McCaffery (1994) *Yale Law J* 300–301; Hauser (1999) *Real Prop Prob & Tr J* 385; Feldstein “Kill the Death Tax Now...” *Wall Street Journal* (14/07/2000) A14; Schmalbeck (2000) *Cleve State Law Rev* 763; Bracewell-Milnes (2002) 28–29; Lee (2007) *Legal Studies* 700, 703; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 11.

³⁰ Bracewell-Milnes (2002) 30.

³¹ See e.g. Repetti (2000) *Tax Notes* 1497; Schmalbeck (2000) *Cleve State Law Rev* 763; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 42.

³² O’Brien Report (1982) 444; Margo Report (1986) par 20.44; Maloney (1991) *Can Publ Admin* 245.

³³ The Third Interim Katz Report (1995) par 7.3.2 refers to Sandford *More Key Issues in Tax Reform* (1955). See also Wagner (1973) 33 and O’Brien Report (1982) 445.

³⁴ See Ch 2 par 2.3.2.1.



and fair equality of opportunity”.³⁵ The inequality of unencumbered inheritance and gifts lies in the fact that people receive money or goods for which they have not worked or saved.³⁶ The Franzsen Commission commented that inherited wealth has traditionally been considered the most important and also the most unfair cause of inequality, which has so often given rise to social unrest.³⁷ Apparently, this statement is also true for most of the OECD countries.³⁸ As a consequence, the reduction of inequalities has transpired to be a significant justification for the existence of taxes on wealth transfers, in spite of their meagre revenue-raising capabilities.³⁹ In this regard, tax reform commissions and commentators have observed that recipient-based taxation has an advantage over transferor-based taxation, because a recipient-based approach acts as an incentive to transferors to distribute assets amongst a number of persons (entitled to their own tax-free threshold).⁴⁰ Where a recipient-based tax is levied at progressive rates, transferors would

³⁵ Rawls (1971) 277. See also Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp eds (2008) 195 and Oliemans and Stevens (2008) *WFR* 580.

³⁶ Rakowski (1996) *Tax Law Rev* 429; Schmalbeck (2000) *Cleve State Law Rev* 752; Kaplov in Gale, Hines and Slemrod eds (2001) 184; Bernstein (2004) *Cardozo J Int & Comp L* 194–195; Waldeck (2005) *Virginia Tax Rev* 680–682.

³⁷ Second Franzsen Report (1970) par 362.

³⁸ Sandford (2000) 112.

³⁹ Buehler (1948) 408; Eisenstein (1956) *Tax Law Rev* 252–253; Rawls (1971) 277; Sandford, Willis and Ironside (1973) Ch 1–2; Chester (1976) *Rutgers Law Rev* 62; Meade Report (1978) 318; Green and McKay (1980) *Victoria Univ Wellington Law Rev* 239; Morgan (1981) *Tax Notes* 340; O’Brien Report (1982) 442–445; Graetz (1983) *Yale Law J* 270–273; Gutman (1983) *Virginia Law Rev* 1188, 1193–1196; Chelliah Report (1986) 211; Maloney (1988) *Ottawa Law Rev* 602, 607, 611 635; Ascher (1990) *Michigan Law Rev* 87–91; Maloney (1991) *Can Publ Admin* 245; Duff (1993) *Can J Law Jur* 46–62; Gammie Report (1994) 52; Rakowski (1996) *Tax Law Rev* 438; Davenport and Soled (1999) *Tax Notes* 598; Schmalbeck (2000) *Cleve State Law Rev* 752, 754; Schlachter (2000) *Virginia Tax Rev* 790–792; Gale and Slemrod (2000) *Tax Notes* 931; Sandford (2000) 96; Kaplov in Gale, Hines and Slemrod eds (2001) 181–182; Wampler (2001) *Seton Hall Legis J* 539; Repetti (2001) *NY Univ Law Rev* 827, 851–852 856–858; Klooster (2003) *Drake Law Rev* 637–639; Dodge (2003) *SMU Law Rev* 556–557; Bernstein (2004) *Cardozo J Int & Comp L* 194; Waldeck (2005) *Virginia Tax Rev* 674–680; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 15, 22; Lee (2007) *Legal Studies* 695–696; Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 11–14; Juch (2008) *WFR* 655; Oliemans and Stevens (2008) *WFR* 580; Sonneveldt and De Kroon (2008) *WFR* 593; Dodge (2009) *Hastings Law J* 1002.

⁴⁰ See Wagner (1973) 33; Cretney (1973) *Modern Law Rev* 284; O’Brien Report (1982) 442–445; Chelliah Report (1986) 211; Repetti (2001) *NY Univ Law Rev* 858; Lee (2007) *Legal Studies* 682; Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 2–3; Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp eds (2008) 194.



especially be tempted to break up their estates by making smaller transfers to more people to make use of the favourable tax rates.

A popular, but controversial, counter-argument is that transfer taxes are inefficient in reducing concentrations of wealth.⁴¹ The revenues collected from these taxes are so small in relation to the wealth possessed by the very wealthy, that it does not have a significant effect on the redistribution thereof, especially if the tax is easily avoidable.⁴²

4.4 THE TAX POLICY DEBATE

Basic tax policy calls for adherence to the “canons of taxation”, which were discussed extensively in Chapter 2 above.⁴³ The following discussion will review the arguments against and in favour of the taxation of wealth transfers by reference to the canons of equity, certainty and simplicity, convenience and cost efficiency (including neutrality).

4.4.1 The First Canon: Equity

4.4.1.1 Ability-to-Pay

A powerful argument for the justification of the taxation of wealth transfers is that inheritances and gifts constitute ability-to-pay by providing additional status, convenience, satisfaction and capital appreciation.⁴⁴ If wealth in the form of inheritances

⁴¹ Adams (1915) *Am Econ Rev* 241; Dobris (1984) *Syracuse Law Rev* 1218–1220, 1227–1228; Donaldson (1993) *W&L Law Rev* 540; Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 5–10; Davenport and Soled (1999) *Tax Notes* 598; Schlachter (2000) *Virginia Tax Rev* 792; Wampler (2001) *Seton Hall Legis J* 540; Darnell (2004) *Seton Hall Law Rev* 687; Lee (2007) *Legal Studies* 695, 696, 708; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 77.

⁴² Dobris (1984) *Syracuse Law Rev* 1219.

⁴³ See Ch 2 par 2.4.2.

⁴⁴ Smith (1776) book v ch ii, available at <http://www.adamsmith.org> (accessed on 20 June 2008); Adriani (1925) 36; Rudnick (1945) *Tax Law Rev* 25; Buehler (1948) 324, 386; Eisenstein (1956) *Tax Law Rev* 256; Andrews (1967) *Tax Law Rev* 589; Van Nispen and Schuttevaer (1969) 45–49; Sandford (1970) 29; Ford
Footnote continues on the next page



and gifts were excluded from the tax base, especially if one takes into account that wealthy taxpayers are generally more inclined to be holders of wealth than poorer taxpayers, it would create inequality and a violation of the criterion of (horizontal and vertical) equity. This has also been acknowledged in a South African context.⁴⁵

The following question may be posed: how can the increase in ability-to-pay afforded by wealth transfers be absorbed in the tax system? First of all, it should be evaluated whether or not the levying of capital gains tax on the death of a wealth holder (or on making the donation) may act as a substitute measure to tax wealth transfers in a tax system.

4.4.1.2 Capital Gains Tax

It was pointed out that South Africa has applied (in a way similar to Canada) a deemed-realisation approach on death since the introduction of capital gains tax in the South

(1971) 3; Sandford (1971) 23; Cretney (1973) *Modern Law Rev* 284; Meade Report (1978) 40, 317–318; O’Brien Report (1982) 40, 423, 444; Gutman (1983) *Virginia Law Rev* 1188; Graetz (1983) *Yale Law J* 259; Dobris (1984) *Syracuse Law Rev* 1228–1229; Davies (1984) *Rutgers Law J* 865–869; Stephan (1986) *Virginia Law Rev* 1472, 1481; Davey (1986) *Ins & Tax* 13; Report of the OECD *The Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals* (1988) 15; Halbach (1988) *Real Prop Prob & Tr J* 211; Bird (1991) *Can Publ Pol* 323; Maloney (1991) *Can Publ Admin* 245; Mintz (1991) *Can Publ Pol* 253; Brown (1991) *Can Publ Pol* 344; Riley (1991) 7; Bird (1992) 132, 138; Rudnick and Gordon in Thuronyi *ed* Vol 1 (1996) 295; Editorial (1997) *Taxpayer* 67; Chason and Danworth (1997) *Real Prop Prob & Tr J* 121; Davenport and Soled (1999) *Tax Notes* 598; Schlachter (2000) *Virginia Tax Rev* 807–810; Schmalbeck (2000) *Cleve State Law Rev* 753; Gravelle and Maguire (2000) *Tax Notes* 556; Zwemmer (2001) *Mededelingen* 25–26; Graetz (2002) *Yale Law J* 267; Van Vijfeijken (2004) *WPNR* 322; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 18, 21; Van Vijfeijken (2006) *Int Tax Rev* 151–152; Duff in Tiley *ed* (2007) 334; Lee (2007) *Legal Studies* 682, 695; Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 2, 11–12; Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp *eds* (2008) 195; Oliemans and Stevens (2008) *WFR* 579; Sonneveldt and De Kroon (2008) *WFR* 593; Juch (2008) *WFR* 655; Van Vijfeijken (2008) *WPNR* 425; Van Rijn (2008) *WPNR* 436; Tiley (2008) 1258.

⁴⁵ See Second Franzsen Report (1970) par 360 and the Margo Report (1986) pars 20.8–20.14. The Third Interim Katz Report (1995) concluded that “capital contributes to a person’s ability to pay taxes” (par 7.1.5) and “the contribution which a tax on wealth can make to the overall fairness of the tax system should not be underestimated” (par 7.1.4). Its fourth interim report conceded that “it is appropriate to accord a place for a wealth tax” (par 1.3), in view of the fact that “it promotes vertical and horizontal equity” (par 1.4). More specifically, the report stated that the criterion of equity demanded the taxation of inheritances and gifts, even if income taxation were levied on saved income and capital gains (par 5.2).



African tax system in 2001.⁴⁶ Although the introduction of capital gains tax (and a deemed-realisation approach on death) did not supplant the existing estate duty and donations tax regimes, the question was posed whether the South African tax system has the perfect window of opportunity to get rid of these wealth transfer taxes.⁴⁷

In attempting to suggest alternatives for the inefficiencies of wealth transfers taxes internationally, some commentators have suggested the taxation of unrealised capital gains on death, either by way of deemed realisation or carry-over approach, as an acceptable alternative to a wealth transfer tax.⁴⁸ This argument, at first glance, seems to have some merit. For example, the abolition of wealth transfer taxation in Canada in 1972 was indeed justified by the introduction of a capital gains tax, which provided for a deemed realisation in respect of transfers on death.⁴⁹

It has, however, often been observed that there is a conceptual difference between a wealth transfer tax and a capital gains tax and that these taxes should not be viewed as substitutes for one another.⁵⁰ As discussed, a capital gains tax is levied on realised capital appreciation, the increase in value or “profit content” of transferred assets.⁵¹ When the tax is imposed on a deemed realisation at death, the untaxed unrealised capital gains are subject to taxation in the hands of the deceased. If property, deemed to be disposed of at

⁴⁶ See Ch 3 par 3.3.4.

⁴⁷ See Ch 3 par 3.4(j).

⁴⁸ Minority Report of Commissioner Beauvais, Carter Report Vol 1 (1966) 54; Chason and Danforth (1997) *Real Prop Prob & Tr J* 125; McCaffery (1999) *Tax Notes* 1441; Schlachter (2000) *Virginia Tax Rev* 824; Schmalbeck (2000) *Cleve State Law Rev* 753; Lee (2007) *Legal Studies* 700, 703; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 66 n 77 and accompanying text.

⁴⁹ Bird (1978) *Osgoode Hall Law J* 137; Bird (1991) *Can Publ Pol* 326; Duff (2005) *Pittsburgh Tax Rev* 109; Van Vijfeijken (2008) *WPNR* 427.

⁵⁰ First Franzsen Report (1968) par 281; Bucovetsky and Bird (1972) *Natl Tax J* 37–38; O’Brien Report (1982) 210; Maloney (1988) *Ottawa Law Rev* 606; Gammie Report (1994) 53; Sandford (2000) 115; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 2, 67; Dodge (2009) *Hastings Law J* 998 n 4.

⁵¹ See Ch 2 par 2.2.3.3.2.



death, has not appreciated in value, it will not be subject to capital gains tax, but wealth transfer taxation could still be payable. A wealth transfer tax, on the other hand, is imposed on all property and assets at death, including those purchased or saved out of income which has already been taxed, irrespective of any capital gains which may have accrued on the assets within the estate.⁵² A capital gains tax would therefore result in double taxation to the same extent that the levying of other taxes, such as income tax, does.⁵³ The taxpayer may be exempt from wealth transfer taxation, even though the main component of the estate's value is gains on the estate's assets.⁵⁴

Consider the following example. Mr A purchased a capital asset for R500 000 during his life. On Mr A's death, the value of the asset had increased to R1.5 million. The idea of a deemed-realisation capital gains tax is to tax Mr A (or his deceased estate) on his ability to have enjoyed the asset during his lifetime. Capital gains tax is payable on the "gain" of R1 million. If Mr A bequeaths the asset to his son B, then the idea of a tax on wealth transfers (in whichever form) is to tax the transfer itself. Strictly speaking, the target of a capital gains tax should be to capture Mr A's increase in taxable capacity (the gain) and the target of a wealth transfer tax should be to capture Mr B's increase in taxable capacity (the inheritance). Where the asset did not increase in value there should be no capital gains tax liability, but Mr B should still be liable for tax because of his increase in taxable capacity afforded by the inheritance. The absence of a wealth transfer tax levied on the inheritance would create inequities in a system where other income accruals are subjected to taxation. Suppose that Mrs C earns a salary of R1.5 million in the year that Mr B receives his inheritance. It should be clear that the absence of a wealth transfer tax on Mr B's inheritance would be unfair towards Mrs C, who would be liable for income tax on the salary. The fact that Mr A's unrealised capital gain is captured in the tax net on the date of his death (merely because the taxation of the gain in his hands cannot be further

⁵² First Franzsen Report (1968) par 281; Maloney (1988) *Ottawa Law Rev* 606; Gammie Report (1994) 53.

⁵³ Maloney (1988) *Ottawa Law Rev* 606.

⁵⁴ Gammie Report (1994) 53.



deferred), does not make any material difference to the positions of Mr B and Mrs C. One can therefore agree with Richard Bird's remark that "[a]n estate tax is no substitute for constructive realisation at death, and a constructive realisation at death is no substitute for an estate tax".⁵⁵

In Canada, however, arguments that capital gains tax is a supplement to the income tax rather than a substitute for death taxes "fell on deaf ears".⁵⁶ Imposing both taxes were perceived as double taxation,⁵⁷ which contributed to the abolition of the wealth transfer taxes in that country.⁵⁸ It is submitted that this perception can be explained by virtue of the fact that Canada imposed a transferor-based estate duty, which would, together with a transferor-based capital gains tax in respect of unrealised transfers at death, indeed have constituted double taxation.⁵⁹ The production of double taxation is indeed a significant objection against the taxation of wealth transfers through transferor-based taxation because it violates the basic principles of equity.⁶⁰

As observed in Chapter 3, the double taxation produced by capital gains tax and transferor-based wealth transfer taxation in the United States and United Kingdom resulted in both countries implementing a stepped-up approach for purposes of capital gains tax on the death of a wealth holder. Previous efforts to impose a carry-over or deemed-realisation approach on death were unsuccessful in these countries, because of

⁵⁵ Bale (1985) *Law and Contemporary Problems* 177.

⁵⁶ Bird (1991) *Can Publ Pol* 325.

⁵⁷ Bird (1978) *Osgoode Hall Law J* 138 n 32 refers to the minority report to the Carter Report, delivered by Beauvais. See also Bird (1991) *Can Publ Pol* 325; Van Vijfeijken (2008) *WPNR* 427.

⁵⁸ Bird (1978) *Osgoode Hall Law J* 137; Bird (1991) *Can Publ Pol* 326; Duff (2005) *Pittsburgh Tax Rev* 109.

⁵⁹ It is arguable that Canada might have been able to retain its wealth transfer taxes if the 1971 income tax reforms, instead of having provided for deemed realisation of capital gains at death, imposed a carry-over base-cost system at death. See Goodman (1999) *Tax Notes* 1472.

⁶⁰ Paper by Shev *The Combined Tax Effects of Capital Gains Tax and Estate Duty* (2003) 133; Van Rijn (2008) *WPNR* 436.



the double taxation produced.⁶¹ The stepped-up-approach has, however, often been identified as a lack in these tax systems, especially because such an approach encourages people to hold on to their assets until their death (reinforcing the so-called “locking-in effect”).⁶² As a consequence, the Capital Taxes Group of the Institute for Fiscal Studies (1988), the Gammie Report (1994) and the Mirrlees Review (2008) proposed that the United Kingdom should preferably replace the stepped-up CGT approach with a deemed-realisation approach.⁶³ This was also recommended for the Irish system by the O’Brien Commission (1982).⁶⁴ From a perspective of ability-to-pay, it is not surprising that these commissions, other international commissions (such as the Carter Commission)⁶⁵ and academic commentators⁶⁶ generally favour the taxation of unrealised gains on the death of a wealth holder. Although the levying of both capital gains taxation and wealth transfer taxation would be levied on the same event, a tax system could harmonise the interaction between the taxes in various ways.

The situation in South-Africa, where transferor-based estate duty is levied together with a deemed-realisation capital gains tax, reflects a scenario of double taxation on the deceased estate. It is submitted that this position is unjustifiable and should be improved. However, the deemed-realisation capital gains tax approach cannot justify the repeal of estate duty and donations tax from the South African tax system without considering

⁶¹ See Ch 3 par 3.2.3 n 37, n 38 (and accompanying text) and n 48, n 52 (and accompanying text) and par 3.4(g).

⁶² Meade Report (1978) 58; Graetz (1983) *Yale Law J* 262; Epstein (1986) *Soc Philos Pol* 68 n 35; Sweet & Maxwell (1992) *Br Tax Rev* 238; Gammie Report (1994) 53; Third Interim Katz Report (1995) par 6.3.7; Freedman in Essers and Rijkers *eds* (2005) 200. Dodge (2001) *Tax Law Rev* 430 n 37 has estimated that the stepped-up approach at death allows from 35%–50% of capital gains to escape CGT entirely in the US.

⁶³ See Ch 3 par 3.2.3 n 42, n 44 (and accompanying text) and par 3.2.4 n 104 (and accompanying text).

⁶⁴ See Ch 3 par 3.2.3 n 74 (and accompanying text).

⁶⁵ See Ch 3 par 3.2.3.

⁶⁶ See e.g. Kerridge (1990) *Br Tax Rev* 77; Arnold and Edgar (1995) *Can Publ Pol* 68; Zelenak (1993) *Vanderbilt Law Rev* 440; Dodge (2001) *Tax Law Rev* 434.



whether these taxes could be replaced by a more appropriate alternative.⁶⁷ Also, the existence of a tax (or taxes) on wealth transfers cannot justify the replacement of a deemed-realisation approach by a stepped-up base-cost approach, especially in the absence of a net wealth tax.⁶⁸ The taxation of capital gains (on the one hand) and the taxation of wealth transfers (on the other hand) have a unique function in the tax system and cannot operate as substitutes for one another.

4.4.1.3 Equity Requires Recipient-based Taxation (In the Form of A Recipient-based Wealth Transfer Tax or Inclusion in the Income Tax Base)

It should be evident that the double taxation produced by wealth transfer taxation and capital gains tax would best be avoided by taxing the wealth transfers in the hands of the recipient, and not the transferor (such as currently applied under the estate duty and donations tax regimes in South Africa).⁶⁹ It is therefore not surprising that the classic justification for recipient-based taxation is based on the the principle of ability-to-pay.⁷⁰ This explains why commentators⁷¹ from jurisdictions which impose recipient-based taxation find the double-taxation argument unconvincing.⁷²

It may be argued, however, that it is actually irrelevant whether the tax is levied on the transferor (in which case the beneficiaries would acquire the net result reduced by the

⁶⁷ See e.g. Kourie (1994) *Ins & Tax* 20 and Mazansky (2002) *Executive Business Brief* 17.

⁶⁸ South Africa has never imposed a net wealth tax. See Ch 2 par 2.2.3.3.1.

⁶⁹ Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 16; Dodge (2009) *Hastings Law J* 1007.

⁷⁰ Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 17; Van Vijfeijken (2006) *Int Tax Rev* 152, 154; Van Vijfeijken (2004) *WPNR* 322; Van Vijfeijken (2008) *WPNR* 425; Van Rijn (2008) *WPNR* 436; Van Bommel and Pagter (2008) *WFR* 501; Dodge (2009) *Hastings Law J* 1005.

⁷¹ E.g. Van Vijfeijken (2006) *Int Tax Rev* 153; Van Vijfeijken (2004) *WPNR* 320; Dijkstra (2008) *WPNR* 442; Sonneveldt and De Kroon (2008) *WFR* 593.

⁷² Thuronyi (1990) *Tax Law Rev* 74; Dodge (2003) *SMU Law J* 553.



tax) or on the beneficiaries themselves.⁷³ This viewpoint is, however, too narrow. In South Africa, estate duty is generally satisfied from the residue of the estate.⁷⁴ Where, for example, A bequeaths his house (worth R2 million) to his son B, shares (worth R2 million) to his daughter C and the balance of his estate (say, R2 million) to his son D, then the total liability for estate duty would fall on the residuary heir D. In a recipient-based tax, B would be liable for the tax attributable to the house, C would be liable for the tax attributable to the shares and D would be liable for the tax attributable to the balance of the estate. It is submitted that the last-mentioned result is much more equitable. Under a recipient-based tax, equally situated taxpayers are treated equally, whereas the recipients of wealth transfers are taxed unequally under a transferor-based tax.⁷⁵

Although the South African concept of income traditionally excludes capital receipts and accruals such as inheritances and gifts,⁷⁶ the question may be posed whether these accruals could not merely be taxed in the hands of the recipient under the South African income tax base, especially because these fortuitous gains form part of the economic concept of income.⁷⁷ In a comprehensive income tax, the receipt of a gift or inheritance is usually treated as taxable income of the recipient as it increases his or her ability-to-pay.⁷⁸

⁷³ The Meade Report (1978) 318–319 illustrated this with reference to a flat rate transferor-based tax. If the transferor does not change his or her savings behaviour and passes on gross of tax the same amount as before, then the tax falls on the recipient. If, however, the transferor saves the tax during his or her lifetime, thereby passing on the same amount free of tax to the recipient, then the tax burden will vest in the transferor, irrespective of whether it is collected from the transferor or the recipient. The position would, however, be different in the case of a progressive capital transfer tax, because the rate of the tax rises progressively according to the cumulative amount of gifts which the transferor has made to date. The rate of tax depends upon the circumstances of the transferor, not the recipient. By contrast, a recipient-based capital acquisition tax at progressive rates would take the circumstances of the recipient into account.

⁷⁴ See Ch 6 par 6.4.

⁷⁵ Dodge (2009) *Hastings Law J* 1005.

⁷⁶ See Ch 2 par 2.2.2.1 and Ch 3 par 3.3.1.

⁷⁷ See Ch 2 par 2.2.2.2.

⁷⁸ See Ch 2 par 2.2.2.2.



Notwithstanding the reluctance of countries to adopt a pure comprehensive income tax, a number of scholars (from different countries) have over the years proposed that wealth transfers may possibly be included in existing income tax bases.⁷⁹ Theoretically, the inclusion of wealth transfers in income would satisfy the need for horizontal equity in a tax system to a larger extent than a separate wealth transfer tax, because a comprehensive income tax would take all the circumstances (and other income) of the taxpayer into consideration.⁸⁰

Because income is predominantly taxed on a global basis in South Africa, one possibility would simply be to include inheritances and donations in the definition of gross income.⁸¹ The problem is that the general public and political roleplayers would probably be reluctant to view gratuitous receipts as income, especially because these receipts have historically been excluded from income.⁸² In addition, inheritances and donations are generally sporadic, in contrast to other income receipts that are usually recurrent and constant. Internationally, it has often been observed that the application of progressive income tax rates on these accruals may result in hardship.⁸³ In addition, the income tax is predominantly designed to tax “cash” receipts on a realisation basis and is not equipped to deal with the valuation problems typically encountered under wealth transfer taxes.

An inclusion in gross income would also create difficulties for the application of tax treaties, because it would certainly not reflect the international trend.⁸⁴ It is therefore not

⁷⁹ See Ch 3 par 3.2.4 n 91 and n 100. See also Van Vijfeijken (2004) *WPNR* 322 *et seq.*

⁸⁰ Wagner (1973) 47; Van Vijfeijken (2004) *WPNR* 322–325, 329; Report of the OECD *Fundamental Reform of Personal Income Tax* (2006) 73.

⁸¹ See Ch 2 par 2.2.2.1 for a discussion on the difference between a global and a schedular income tax.

⁸² Dodge (2009) *Hastings Law J* 1005 explains that this reluctance is partly the reason why he prefers the introduction of an accessions tax to an income-inclusion approach for the US.

⁸³ Bittker (1967) *Harv Law Rev* 945; Riley (1991) 22; O’Brien Report (1982) 41, 424.

⁸⁴ This was observed by Van Vijfeijken (2008) *WPNR* 427 when she considered an income-inclusion approach for the Dutch tax system.



surprising that a report published by the OECD in 2006 stated that the inclusion of inheritances and gifts in the concept of income would be very difficult and impractical and would imply high compliance and administration costs.⁸⁵ It is suggested that, although the inclusion of inheritances and donations in the definition of gross income under the current Income Tax Act⁸⁶ represents a theoretical possibility for the accommodation of wealth transfers in a South African context, it is probably realistic to assume that such a move would be politically and administratively unlikely.

However, for the South African context, a possible solution could be to follow a schedular approach to wealth transfers in much the same way as for capital gains, by providing for a separate schedule to the income tax and by including only a certain percentage of wealth transfers in the taxable income of a person. Such an approach would not only be able to minimise unnecessary hardship,⁸⁷ but would also provide a platform for the accommodation of unique provisions and valuation rules. Such an approach would, it is submitted, also be more acceptable in the political realm (than a mere inclusion in gross income). What is noteworthy is that a separate schedule providing for the taxation of wealth transfers (within the income tax system) would basically operate on the basis of a recipient-based wealth transfer tax.

In conclusion, wealth transfers contribute to the taxable capacity (“ability-to-pay”) of the recipients. From a theoretical perspective, it is evident that the principles of equity require that wealth transfers should be taxed in the hands of the recipient. In South Africa, this may be accomplished by way of a recipient-based wealth transfer tax or a separate schedule to the existing Income Tax Act.⁸⁸

⁸⁵ Report of the OECD *Fundamental Reform of Personal Income Tax* (2006) 73. See also Riley (1991) 24.

⁸⁶ Act 58 of 1962.

⁸⁷ Capital gains are, for example, taxed at lower rates than income. See Ch 2 par 2.2.3.3.2.

⁸⁸ Act 58 of 1962.



4.4.1.4 Progressivity (A Function of Vertical Equity)

It has often been claimed by international scholars and tax reform commissions that the taxation of wealth transfers enhances the progressivity of tax systems and that the abolition of taxes on these transfers would favour only the very wealthy.⁸⁹ It would seem that providing for a basic exemption, which is often provided for in a wealth transfer tax regime, plays a significant role in ensuring that the tax targets only the very rich.⁹⁰ It is therefore understandable that, where a government neglects to adjust the basic exemption for inflation, it may contribute to the overall unpopularity of the tax, which may increase the risk for its total repeal. This was apparently one of the factors that contributed to the abolition of the federal estate tax in Australia⁹¹ and has been advanced as one of the explanations for the current unpopularity of the inheritance tax in the United Kingdom.⁹² It is submitted, however, that the total abolition of a tax on wealth transfers would be detrimental to the overall progressivity of a tax system, even where the basic exemption is inadequate. The mere adjustment of the basic exemption would be a far better remedy.

⁸⁹ See e.g. Green and McKay (1980) *Victoria Univ Wellington Law Rev* 239; O'Brien Report (1982) 442; Graetz (1983) *Yale Law J* 270–273; Gutman (1983) *Virginia Law Rev* 1188, 1193–1196; Dobris (1984) *Syracuse Law Rev* 1230; Chelliah Report (1986) 211; Task Force on Transfer Tax Restructuring (1988) *Tax Law Rev* 396; Mintz (1991) *Can Publ Pol* 253–254; Gammie Report (1994) 52; Davenport and Soled (1999) *Tax Notes* 598; Sandford (2000) 96; Gravelle and Maguire (2000) *Tax Notes* 555; Gale and Slemrod (2000) *Tax Notes* 930–931; Schmalbeck (2000) *Cleve State Law Rev* 753; Repetti (2000) *Tax Notes* 1500; Gale and Slemrod in Gale, Hines and Slemrod eds (2001) 29–30, 58; Graetz (2002) *Yale Law J* 264–265; Mazansky (2002) *Executive Business Brief* 17; Klooster (2003) *Drake Law Rev* 639–640; Darnell (2004) *Seton Hall Law Rev* 685; Graetz and Shapiro (2005) 267; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 15, 22; Lee (2007) *Legal Studies* 695–696; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 11–14.

⁹⁰ Dodge (2009) *Hastings Law J* 1006.

⁹¹ Head and Bird in Cnossen ed (1983) 22. The federal estate duty in force at that time exempted only AU\$20 000 for an estate passing to a surviving spouse, child or grandchild, and AU\$10 000 for all other transfers. See Duff (2005) *Pittsburgh Tax Rev* 108–109.

⁹² Lee (2007) *Legal Studies* 707.



4.4.1.5 Inequity through Special Provisions

To increase fairness in the system, wealth transfer tax frameworks often provide special exemptions, for example, in respect of surviving spouses, business property relief, agricultural property, art, forests and charitable giving.⁹³ Opponents of these taxes often argue that these special provisions, exemptions and special valuation rules may result in substantial horizontal and vertical inequity.⁹⁴ However, an optimal tax system balances equity and efficiency. Most of these special provisions can be justified for reasons based on socio-economic considerations and efficiency. The argument is that the overall utility derived from these special provisions generally outweighs the inequity caused thereby. The inequity itself does not substantiate a claim for repeal of the system. However, substantial inequity should be addressed through tax reform measures.

4.4.1.6 Inequity through Increased Consumption

McCaffery, a lawyer from the United States, argues that the negative impact of wealth transfer taxation on saving would increase large-scale consumption by the rich, which could be used to buy influence in the present generation, thereby creating inequality of spending, which may increase inequality overall. He argues that “possession” of wealth should not be more heavily taxed than the “use” of wealth and that the taxation of inherited wealth could actually undermine the concepts of fairness and equality that liberals ought to support.⁹⁵

⁹³ See Ch 5 and Ch 6 for a discussion of the South African position. Special rules apply for example to surviving spouses, public benefit organisations, agricultural property etc (for purposes of estate duty and donations tax).

⁹⁴ Donaldson (1993) *W&L Law Rev* 542; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 31.

⁹⁵ See in general McCaffery (1992) *Texas Law Rev* 1216; McCaffery (1994) *Philos Pub Aff* 281; McCaffery (1994) *Yale Law J* 304–312, 319–320; McCaffery (1999) *Tax Notes* 1440 and McCaffery (2005) *Can J Law Juris* 863. McCaffery (1994) *Yale Law J* 296, 345 *et seq* proposes that a progressive consumption-without-wealth tax would best support liberal egalitarian values, although he indicated that the tax base could be supplemented by separate and higher rate structures on spending out of gifts and inheritances. See McCaffery (1994) *Yale Law J* 350.



McCaffery's controversial viewpoint has provoked a debate amongst scholars.⁹⁶ Some find his argument persuasive,⁹⁷ or at least plausible.⁹⁸ Others have suggested that his viewpoint is untenable, mainly by arguing that saving is not morally superior to spending and that the taxation of wealth transfers can reinforce the philosophical foundations of a liberal democratic state supportive of the value of equality.⁹⁹ It is submitted that McCaffery's argument is not persuasive. The taxation of inherited wealth should not be perceived as punishment for thrift, but a mere function of equity in a fair tax system.

4.4.1.7 Estate Planning: Cause for Inequity

A common point of criticism against the taxation of wealth transfers is that it encourages expensive estate planning advice. In jurisdictions where trusts are acknowledged, such as the United Kingdom, the United States and South Africa, these taxes also encourage the use of "by-pass" trust arrangements. The argument is that the taxation operates unfairly because the tax is easy to avoid by wealthy individuals, who can afford estate planning advice.¹⁰⁰ However, most people are resistant to part with their assets during their lifetime. Wealth confers pleasure, status and security.¹⁰¹ Some commentators are therefore

⁹⁶ See e.g. the collection of articles and commentaries ("Colloquium on Wealth Transfer Taxation") published in the (1996) *Tax Law Review*.

⁹⁷ See e.g. Weiss (1996) *Tax Law Rev* 403.

⁹⁸ Kaplov in Gale, Hines and Slemrod *eds* (2001) 193.

⁹⁹ See e.g. Alstott (1996) *Tax Law Rev* 363; Rakowski (1996) *Tax Law Rev* 419; Davenport and Soled (1999) *Tax Notes* 603; Schmalbeck (2000) *Tax Notes* 1060; Schmalbeck (2000) *Cleve State Law Review* 756; Ventry (2000) *Tax Notes* 1167–1168.

¹⁰⁰ Cretney (1973) *Modern Law Rev* 285; Dobris (1984) *Syracuse Law Rev* 1221; Galvin (1991) *Tax Notes* 1415–1417; Donaldson (1993) *W&L Law Rev* 545; McCaffery (1994) *Yale Law J* 302; Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 30; McCaffery (1999) *Tax Notes* 1436; Schlachter (2000) *Virginia Tax Rev* 793; Schmalbeck (2000) *Cleve State Law Rev* 757; Gale and Slemrod (2000) *Tax Notes* 930; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 40–41; Schmalbeck in Gale, Hines and Slemrod *eds* (2001) 113–149; Youdan in Atherton *ed* (2003) 133; Darnell (2004) *Seton Hall Law Rev* 691; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 21; Lee (2007) *Legal Studies* 690, 694, 708; Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 77; Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp *eds* (2008) 195.

¹⁰¹ Schmalbeck (2000) *Cleve State Law Rev* 758.



of the opinion that the tax-avoidance argument is exaggerated.¹⁰² It is submitted that the defects of an easily avoidable system should not in general substantiate abolition of these taxes, but should rather be addressed through tax reform to the existing legal structure and more effective administration. However, effective tax avoidance could contribute significantly to the unpopularity of the taxation of inherited wealth, which could increase the overall risk for repeal. Tax avoidance has indeed been considered as one of the main factors behind the abolition of these taxes by the States and the Commonwealth in Australia,¹⁰³ and has apparently contributed to the present unpopularity of the inheritance tax in the United Kingdom.¹⁰⁴ Tax policy makers and reformers should therefore guard against this occurrence. It is however, not always possible or desirable to design complicated anti-avoidance measures, as this could increase the overall complexity and efficiency of the tax. Once again, the desired approach would be a balancing act.

Tax avoidance is an important equity concern in South Africa's wealth transfer tax system. The Katz Commission examined some common avoidance issues in its fourth interim report, some of which will be referred to in chapter 7.¹⁰⁵ Although most of the recommendations have not been implemented yet, it is submitted that these defects in the system cannot, by themselves, justify the abolition of the current system without any suitable replacement.

¹⁰² Schmalbeck (2000) *Cleve State Law Rev* 760.

¹⁰³ Pedrick (1981) *Tax Lawyer* 119–122, 125; Head and Bird in Cnossen *ed* (1983) 22; Duff (2005) *Pittsburgh Tax Rev* 108–109.

¹⁰⁴ Lee mentions that wealthy taxpayers are best placed to make gifts during their lifetime (outside the period of seven years before death). See Lee (2007) *Legal Studies* 687 n 74 and accompanying text, 694, 707.

¹⁰⁵ See Ch 7 pars 7.4.5 and 7.4.6.



4.4.2 The Second Canon: Certainty and Simplicity

Complex legislation violates the canon of simplicity.¹⁰⁶ A common point of criticism against wealth transfer taxes is that they are overly complicated.¹⁰⁷ On the other hand, complexity can achieve a fairer and more efficient system.¹⁰⁸ The problem is that the further the system deviates from simplicity in the pursuit of equity, the more taxpayers will exploit complicated avoidance techniques to escape their liability.¹⁰⁹

However, it is submitted that mere complexity cannot justify the total abolition of wealth transfer taxation. Legislatures should rather balance the principles of simplicity and equity to arrive at an optimal and workable system.

An established principle in tax policy is that an old tax is more virtuous than a new tax.¹¹⁰ Estate duty and donations tax are well-established in the South African tax system. This factor will have to be considered in establishing whether these regimes should be replaced by a recipient-based system.

4.4.3 The Third Canon: Convenience

Taxation at an inopportune time violates the third canon of taxation. There is a belief that taxation upon the transfer of property at death is imposed at an inopportune time, and it seems immoral and heartless.¹¹¹ A counter-argument is that taxation upon the transfer of

¹⁰⁶ Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 31–32.

¹⁰⁷ Fourth Interim Katz Report (1997) par 1.7; Darnell (2004) *Seton Hall Law Rev* 691; Lee (2007) *Legal Studies* 700, 708; Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 6, 21.

¹⁰⁸ Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 21.

¹⁰⁹ Youdan in Atherton *ed* (2003) 134.

¹¹⁰ Davenport and Soled (1999) *Tax Notes* 600.

¹¹¹ McCaffery (1999) *Tax Notes* 1436; Gale and Slemrod (2000) *Tax Notes* 929; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 1; Paper by Shev *The Combined Tax Effects of Capital Gains Tax and Estate Duty* (2003) 16; Bernstein (2004) *Cardozo J Int & Comp L* 192 n 32.



property at death is levied at a convenient time, when the former owner can no longer use or enjoy his or her wealth, when property is bound to change ownership anyway and when assets are required to be valued for estate administration purposes.¹¹²

It is submitted that it is not the death itself which is taxed, but the property that is transferred gratuitously. It is therefore proposed that any inconveniences should rather be addressed by virtue of specific legislative measures, such as the deferment of payment and provision for payment in instalments. What is noteworthy is that transferor-based taxation is apparently more susceptible to being characterised as a tax on death itself than recipient-based taxation, which is perceived instead as a tax on the transfer itself.¹¹³

4.4.4 The Fourth Canon: Cost Effectiveness and Efficiency (The Economic Arguments)

4.4.4.1 Collection Costs¹¹⁴

If the legislative framework is complicated, as in the United States and the United Kingdom (where transferor-based taxation is levied), the high administrative costs of the system is a common point of criticism against its fundamental existence.¹¹⁵ The problem is that special provisions are generally required to counter hardship, which increases the

¹¹² Buehler (1948) 387; Second Franzsen Report (1970) par 365; O'Brien Report (1982) 444–445; Dobris (1984) *Syracuse Law Rev* 1228; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 32; Tiley (2008) 1258.

¹¹³ Dodge (2009) *Hastings Law J* 1003.

¹¹⁴ Collection costs comprises of administrative costs (for the government) as well as compliance costs (for the taxpayers). See Ch 2 par 2.4.2.4.1.

¹¹⁵ See e.g. Morgan (1981) *Tax Notes* 341, 343; Dobris (1984) *Syracuse Law Rev* 1220, 1222; Donaldson (1993) *W&L Law Rev* 544; McCaffery (1994) *Yale Law J* 302; Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 18; Davenport and Soled (1999) *Tax Notes* 618; Repetti (2000) *Tax Notes* 1507; Schmalbeck (2000) *Cleve State Law Rev* 765; Bracewell-Milnes (2002) 28; Youdan in Atherton *ed* (2003) 133; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 35; Lee (2007) *Legal Studies* 700.



administrative complexity of the legislation.¹¹⁶ However, some commentators are of the opinion that this argument is exaggerated.¹¹⁷ Although complicated legislation is inefficient and undesirable, it is submitted that the argument of high collection costs is not strong enough to nullify the existence of wealth transfer taxation. Unnecessary complexities should rather be avoided or removed from the system. Equity, in some cases, has to yield to simplicity. Furthermore, it has been maintained that wealth transfer taxes are in general relatively easy for revenue authorities to collect, and tax returns could assist in the capturing of data, which could serve as a cross-check with other information and could therefore add to an effective comprehensive tax administration system.¹¹⁸

In a South African context, it has been maintained that the existing collection structure through the Master's offices (involving executors) affords very little additional administration requirements on the collection of estate duty and that the tax is therefore cost efficient.¹¹⁹ However, the question may be posed how a possible replacement of the existing regimes with recipient-based taxation would impact on the tax collection system, especially because recipient-based taxation (involving a larger number of taxpayers) has traditionally been perceived as administratively more complex than transferor-based taxation, where the deceased estate acts as a centralised reporting and collection agency (in the case of transfers on death).¹²⁰ It is therefore submitted that a caveat should be noted on the administrative feasibility of a recipient-based tax.

¹¹⁶ Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp eds (2008) 195.

¹¹⁷ Maloney (1988) *Ottawa Law Rev* 633, 635; Davenport and Soled (1999) *Tax Notes* 625; Schmalbeck (2000) *Cleve State Law Rev* 769; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 35.

¹¹⁸ Report of the OECD *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals* (1988) 20.

¹¹⁹ Editorial (1986) *Taxpayer* 62; Davey (1986) *Ins & Tax* 13.

¹²⁰ See comments by the South African tax reform commissions referred to in Ch 3 par 3.3.2.3. See also Wagner (1973) 34; O'Brien Report (1982) 444; Chelliah Report (1986) 210–211; Brown (1991) *Can Publ Pol* 344; Lee (2007) *Legal Studies* 702; Van Rijn (2008) *WPNR* 436; Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp eds (2008) 195; Boadway, Chamberlain and Emmerson: *Mirrlees Review* (2008) 3; Tiley (2008) 1259; Dodge (2009) *Hastings Law J* 1009.



Opponents sometimes argue that the valuation costs are too high for the taxpayer or his or her executor.¹²¹ It is submitted, however, that in view of the fact that assets have to be valued for purposes of the administration of deceased estates or for capital gains tax purposes, the compliance costs for taxpayers would actually be minimal.¹²²

4.4.4.2 Deadweight Costs: Market Distortions on Micro-economic and Macro-economic Level

One consequence of taxation is its distortionary effect on economic behaviour. The criterion of efficiency requires that a tax should be imposed with minimum market distortions.¹²³ It has often been argued that the taxation of wealth transfers may have a negative impact on economic behaviour on the micro-economic level, which could ultimately be an impediment to economic growth on the macro-economic level.

On the micro-economic level, the taxation of wealth transfers may influence the decisions of taxpayers in respect of saving, investment, work effort and the preservation of small businesses.¹²⁴

Numerous international commentators have expressed the concern that wealth transfer taxation penalises saving.¹²⁵ The argument is that a taxpayer may instead choose

¹²¹ Bracewell-Milnes (2002) 28; Lee (2007) *Legal Studies* 700–701.

¹²² Maloney (1988) *Ottawa Law Rev* 633; Davenport and Soled (1999) *Tax Notes* 621.

¹²³ See Ch 2 par 2.4.2.4.2.

¹²⁴ See in general Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 43–50 (for a discussion on the possible distortions that the federal estate tax may have on saving, labour and entrepreneurship in the US) and Lee (2007) *Legal Studies* 701 *et seq* (for a discussion on the possible distortions that inheritance tax may have in the UK).

¹²⁵ See e.g. Dobris (1984) *Syracuse Law Rev* 1222–1223 (although he acknowledges the argument, he is unconvinced that it truly interferes with saving and consumption); Davey (1986) *Ins & Tax* 12; Donaldson (1993) *W&L Law Rev* 545; Vandeveld in Erreygers and Vandeveld *eds* (1997) 5 refers to the economists Bracewell-Milnes, Becker and Kotlikoff; Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 17, 19; Holz-Eakin (1999) *Tax Notes* 784; Davenport and Soled (1999) *Tax Notes* 602–606; Ventry (2000) *Tax Notes* 1163; Gravelle and Maguire (2000) *Tax Notes* 556; Gale and Slemrod (2000) Footnote continues on the next page



consumption over saving in view of the fact that the taxation of accumulated wealth increases its opportunity costs (the so-called “substitution effect”).¹²⁶ The burden placed by these taxes on savings would generally depend on why people give transfers.¹²⁷ Apparently the empirical studies conducted in the United States are inconclusive,¹²⁸ and, consequently, proponents of wealth transfer taxes suggest that people have various incentives to save.¹²⁹ The other possibility is that a taxpayer may give up more consumption and save more to maintain the size of his or her estate, which in economic terms is referred to as the “income-effect”.¹³⁰ Some commentators have therefore argued that wealth transfer taxation may even fuel savings to counteract the taxation.¹³¹ Taxpayers could also be encouraged to utilise capital assets productively by choosing productive investment assets which yield income.¹³²

Tax Notes 929–930; Schmalbeck (2000) *Cleve State Law Rev* 754; Youdan in Atherton *ed* (2003) 133 (thereby “encouraging profligacy and punishing thrift”); Bernstein (2004) *Cardozo J Int & Comp L* 192; Lee (2007) *Legal Studies* 702–703.

¹²⁶ Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp *eds* (2008) 195.

¹²⁷ See in general Masson and Pestieau in Erreygers and Vandeveldel *eds* (1997) 54 *et seq*; Gravelle and Maguire (2000) *Tax Notes* 557; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 21–22, 34–37; Kaplov in Gale, Hines and Slemrod *eds* (2001) 175–181.

¹²⁸ Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 21–23.

¹²⁹ Graetz (1983) *Yale Law J* 279–283; Maloney (1988) *Ottawa Law Rev* 628; Ascher (1990) *Michigan Law Rev* 102–106; Duff (1993) *Can J Law Jur* 11 n 44 (quoting RM Bird), 12 n 52 and accompanying text, 33–34; Third Interim Katz Report (1995) par 17.1.2; Alstott (1996) *Tax Law Rev* 363; Rakowski (1996) *Tax Law Rev* 419; Davenport and Soled (1999) *Tax Notes* 606, 609; Joulfaian (2000) *Nat Tax J* 743–763; Gravelle and Maguire (2000) *Tax Notes* 556; Schmalbeck (2000) *Cleve State Law Rev* 755, 756; Kartiganer and Sedlaczek in Atherton *ed* (2003) 123; Lee (2007) *Legal Studies* 703.

¹³⁰ Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp *eds* (2008) 195.

¹³¹ Second Franzsen Report (1970) pars 366–368; Dobris (1984) *Syracuse Law Rev* 1230; Maloney (1988) *Ottawa Law Rev* 627–628. However, the Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 24 pointed out that saving to counter estate taxation reduces the resources available for investment and employment.

¹³² Sandford, Willis and Ironside (1973) 8; Meade Report (1978) 318; Graetz (1983) *Yale Law J* 283; Dobris (1984) *Syracuse Law Rev* 1230; Report of the OECD *The Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals* (1988) 18.



Opponents of wealth transfer taxes claim that these taxes are detrimental to entrepreneurial activity and work incentive.¹³³ Conversely, proponents argue that people work for many other reasons, for example the achievement of power and prestige, to be able to purchase food, housing, clothes and luxuries, or simply because they like it.¹³⁴ Some scholars claim that these taxes could even encourage work effort among the beneficiary generation.¹³⁵ Although some studies in the United States and the United Kingdom have indicated that large inheritances have indeed motivated the beneficiaries thereof to withdraw from productive work,¹³⁶ others have concluded that the labour disincentive of inheritance is negligible or fairly small.¹³⁷

Perhaps the most powerful economic argument against any type of tax on wealth transfers is the potential harmful effects on small and medium enterprises and family-owned businesses. The argument is that these taxes could force inheritors to sell small businesses and farms, in order to pay the taxes when the original owner dies, or hold on to cash and liquid assets rather than invest in profitable investment projects.¹³⁸ The potential threat

¹³³ Ascher (1990) *Michigan Law Rev* 100; McCaffery (1994) *Yale Law J* 318–321; Davenport and Soled (1999) *Tax Notes* 599–600.

¹³⁴ Ascher (1990) *Michigan Law Rev* 100.

¹³⁵ Mintz (1991) *Can Publ Pol* 254; Duff (1993) *Can J Law Jur* 11 n 48 and accompanying text (he refers to earlier empirical studies of Brannon, Thurow and Jantscher); Joulfaian and Wilhelm (1994) *J Hum Resources* 1206; Rudnick and Gordon in Thuronyi *ed* Vol 1 (1996) 298; Chason and Danforth (1997) *Real Prop Prob & Tr J* 128–131, 134; Gale and Slemrod (2000) *Tax Notes* 929; Repetti (2000) *Tax Notes* 1509; Schmalbeck (2000) *Cleve State Law Rev* 755; Kartiganer and Sedlaczek in Atherton *ed* (2003) 124.

¹³⁶ The economists Holtz-Eakin, Joulfaian and Rosen concluded in a US study that 18,2% of beneficiaries who received inheritances of more than \$150 000 (out of deceased estates that fell open in 1982) left the labour force. See Holtz-Eakin, Joulfaian and Rosen (1993) *QJE* 413 *et seq.* See also Chason and Danforth (1997) *Real Prop Prob & Tr J* 132–133 for a discussion of the research findings. For criticism on the findings, see Hauser (1999) *Real Prop Prob & Tr J* 378. Henley concluded in a UK study (in 2004) that the receipt of real housing wealth gains in particular resulted in significant reductions in hours of work for both men and woman. See Henley (2004) *Oxford Bulletin Econ Stat* 439.

¹³⁷ Joulfaian and Wilhelm (1994) *J Hum Resources* 1207 (as quoted by Chason and Danforth (1997) *Real Prop Prob & Tr J* 134); Holz-Eakin (1999) *Tax Notes* 782.

¹³⁸ Adriani and Van Hoorn Vol 3 (1954) 190; Cretney (1973) *Modern Law Rev* 285; Dobris (1984) *Syracuse Law Rev* 1225–1226; Davey (1986) *Ins & Tax* 12; Maloney (1988) *Ottawa Law Rev* 630; Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 22–29; Holtz-Eakin (1999) *Tax Notes* 784; Gravelle and Maguire (2000) *Tax Notes* 558; Repetti (2000) *Tax Notes* 1503; Schmalbeck

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that wealth transfer taxation holds for family enterprises has evoked concerns and outcries all over the world. It has even been considered one of the main driving forces of the repeal movements in Australia¹³⁹ and Canada.¹⁴⁰ In The United States, the owner of the newspaper *The Seattle Times* has started a website,¹⁴¹ where people have been invited to post horror estate tax stories of family businesses that have been killed by the tax, referred to as the “death tax”.¹⁴²

Although some international studies have indicated that wealth transfer taxation exerts a strongly negative influence on entrepreneurial activity,¹⁴³ other studies have provided evidence that only a small number of dutiable estates comprise small business assets and agricultural property, and of these only a small number of estates are detrimentally affected by these taxes.¹⁴⁴ These findings support the conclusion that the alleged effect of wealth transfer taxes on family businesses seems overstated.¹⁴⁵ Proponents also argue that the owner of a business can keep assets sufficiently liquid or secure life insurance policies so that readily available cash on hand would be available in the event of an

(2000) *Cleve State Law Rev* 767; Wampler (2001) *Seton Hall Legis J* 536; Bracewell-Milnes (2002) 29; Youdan in Atherton *ed* (2003) 131; Darnell (2004) *Seton Hall Law Rev* 692; Paper by Zodrow and Diamond *The US Experience with the Estate Tax* (2006) 39.

¹³⁹ Pedrick (1981) *Tax Lawyer* 119–122, 125; Head and Bird in Atherton *ed* (2003) 22; Duff (2005) *Pittsburgh Tax Rev* 108–109.

¹⁴⁰ Bird (1978) *Osgoode Hall Law J* 137; Bird (1991) *Can Publ Pol* 326; Duff (2005) *Pittsburgh Tax Rev* 109.

¹⁴¹ www.deathtax.com (accessed on 15 July 2008).

¹⁴² Graetz and Shapiro (2005) 59.

¹⁴³ See e.g. Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 22–29.

¹⁴⁴ See Maloney (1988) *Ottawa Law Rev* 631 n 96 for reference to UK and Canadian studies. See also McCaffery (1999) *Tax Notes* 1441 n 34; Ventry (2000) *Tax Notes* 1162; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 45–50 and Paper by Gale and Slemrod *Estate Tax Debate* (2001) 10–14.

¹⁴⁵ See e.g. Pedrick (1981) *Tax Lawyer* 125; Maloney (1988) *Ottawa Law Rev* 633; Bird (1992) 137; Duff (1993) *Can J Law Jur* 32–33; Repetti (1999) *Tax Notes* 1544; Davenport and Soled (1999) *Tax Notes* 612; Gale and Slemrod (2000) *Tax Notes* 929; Schmalbeck (2000) *Cleve State Law Rev* 768–769; Ventry (2000) *Tax Notes* 1162; Wampler (2001) *Seton Hall Legis J* 537; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 45; Van Vijfeijken (2006) *Int Tax Rev* 153.



untimely death.¹⁴⁶ Assets or a share in the business could also be realised to meet the tax liability.¹⁴⁷ In addition, liquidity concerns could be addressed by legislative measures providing for the deferral of payment or payment in instalments, or special valuation rules.¹⁴⁸ A final observation is that property acquired by purchase tends to drift into the hands of people who can use it most productively, whereas inherited property does not always fall into the hands of owners best qualified to use it.¹⁴⁹

On the macro-economic level, wealth transfer taxes fall on capital and are paid out of savings, which ultimately reduces capital stock and economic growth.¹⁵⁰ Also, lower capital accumulation decreases the productivity of labour, resulting in a reduction of wages, labour supply and job growth.¹⁵¹ The forced liquidation of small and medium

¹⁴⁶ Davey (1986) *Ins & Tax* 12; Wampler (2001) *Seton Hall Legis J* 537; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 46; Youdan in Atherton *ed* (2003) 131.

¹⁴⁷ Youdan in Atherton *ed* (2003) 131.

¹⁴⁸ Adriani and Van Hoorn Vol 3 (1954) 191. The creation of flexible non-voting preference shares was one of the remedies suggested as a solution for helping firms to obtain the finance needed to pay the taxes. See Meade Report (1978) 358–360; Maloney (1988) *Ottawa Law Rev* 631; Duff (1993) *Can J Law Jur* 33; Weber (2001) *Elder Law J* 138–139; Duff in Tiley *ed* (2007) 332; Schmalbeck (2000) *Cleve State Law Rev* 768; Van Vijfeijken (2006) *Int Tax Rev* 153.

¹⁴⁹ Adams (1915) *Am Econ Rev* 240; Sandford, Willis and Ironside (1973) 150; Report of the OECD *The Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals* (1988) 19; Bird (1992) 137; Davenport and Soled (1999) *Tax Notes* 600, 607; Schmalbeck (2000) *Cleve State Law Rev* 767. The UK Committee of Inquiry on Small Firms (the “Bolton Committee”) (1971) 3 confirmed that the growth rate in respect of companies with founder managements was higher than the growth rate (61%) experienced by companies managed by individuals who purchased or inherited a controlling interest (56%). See Maloney (1988) *Ottawa Law Rev* 632–633.

¹⁵⁰ Smith (1776) book 5 ch 2 appendix to articles 1 and 2, available at <http://www.adamsmith.org> (accessed on 20 June 2008); Adams (1915) *Am Econ Rev* 240; Cretney (1973) *Modern Law Rev* 284; Graetz (1983) *Yale Law J* 278; Dobris (1984) *Syracuse Law Rev* 1222 (although he acknowledges the potential effect on capital formation, he is not convinced that it is indeed the case); McCaffery (1994) *Philos Pub Aff* 293; McCaffery (1994) *Yale Law J* 304–312; Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 18; Davenport and Soled (1999) *Tax Notes* 606–607.

¹⁵¹ McCaffery (1994) *Yale Law J* 306; Holz-Eakin (1999) *Tax Notes* 784. The Special Report ACCF *New International Survey* (2007) 2 refers to US studies conducted by Mankiw, Beren and Holz-Eakin & Maples (on wages and labour supply), Poterba and Holz-Eakin (on job growth) and Sinai (on macro-economic impact).



enterprises could furthermore impede economic growth,¹⁵² encouraging capital flight from the economy.¹⁵³

Another objection is that the taxation of wealth transfers could shift major investments from dynamic private investors into the hands of bureaucratic government authorities, which could ultimately inhibit economic growth.¹⁵⁴ The counter-argument is that any decrease in private capacity to save could be counter-balanced by an increase in that of the public sector.¹⁵⁵ If the proceeds of these taxes were to be utilised to pay off public debts, as John Stuart Mill suggested, or to create public investments funds, the negative impact on private savings would to some extent be neutralised.¹⁵⁶ The resulting effect on the macro-economic level would arguably be small and could easily be neutralised.¹⁵⁷

Nevertheless, the empirical evidence is not conclusive. Only a few international studies have attempted to establish the relation between wealth transfer taxes, savings and capital stock, and the results they report vary considerably.¹⁵⁸ Proponents furthermore claim that

¹⁵² Cretney (1973) *Modern Law Rev* 284–285; Chason and Danforth (1997) *Real Prop Prob & Tr J* 143; Youdan in Atherton *ed* (2003) 131; Holz-Eakin (1999) *Tax Notes* 782, 784. However, Repetti (1999) *Tax Notes* 1541 *et seq* criticises Holz-Eakin’s findings by arguing that income tax elasticities cannot be applied for the purpose of evaluating distortions in respect of the estate tax. He also argues that the findings do not take external factors into account.

¹⁵³ Wagner (1973) 23–25; Editorial (1985) *Taxpayer* 172; Report of the Joint Committee on Taxation *The Economics of the Estate Tax* (1988) 19; Youdan in Atherton *ed* (2003) 131.

¹⁵⁴ Smith (1776) book 5 ch 2 appendix to articles 1 and 2, available at <http://www.adamsmith.org> (accessed on 20 June 2008); Von Hayek (1960) 90–91; Duff (1993) *Can J Law Jur* 34 n 186; Davenport and Soled (1999) *Tax Notes* 601; Bracewell-Milnes (2002) 30.

¹⁵⁵ Sandford, Willis and Ironside (1973) 150.

¹⁵⁶ Adams (1915) *Am Econ Rev* 241; Graetz (1983) *Yale Law J* 282; Maloney (1988) *Ottawa Law Rev* 629; Ascher (1990) *Michigan Law Rev* 110–111; Davenport and Soled (1999) *Tax Notes* 609.

¹⁵⁷ Sandford, Willis and Ironside (1973) 150.

¹⁵⁸ One of the first US studies on the subject estimated that the federal estate tax has only a small negative effect on capital stock. Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 43 refer to LJ Kotlikoff and LH Summers “The Role of Intergenerational Transfers in Capital Accumulation” (1981) *Journal of Political Economy* 706. In 1998, an American Department of Treasury economist, Joulfaian, found no evidence of any distortion in the savings behaviour of people in response to the federal estate tax. In another study, Kopczuk and Slemrod in Gale, Hines and Slemrod *eds* (2001) 338–339 concluded that

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the negative effects on economic growth are no doubt dwarfed by the overall impact of other taxes.¹⁵⁹

Although numerous United States commentators argue that the supposedly negative effects of the federal estate tax lack definitive supporting evidence and seems grossly overstated,¹⁶⁰ it seems that the economic arguments are gaining force in that country. A recently published special report of the American Council for Capital Formation concluded in a report in 2007 that

“[m]ore of the rest of the world realises the futility of taxing saving, investment and capital income. The US needs more saving and investment for job creation, higher standards of living and a strong economy in a very competitive global economy. The US estate tax is an unnecessary impediment to economic growth.”¹⁶¹

One can, however, agree with Richard Bird’s statement that “it is safe to say that there is as good (or bad) an economic case for, as there is against, wealth [transfer] taxes”.¹⁶²

“[s]ummary measures of the estate [and gift] tax rate structure are generally negatively related to the reported aggregate net worth of the top estates as a fraction of national wealth”. Apparently this finding suggests that the federal estate and gift tax discourages savings, or, alternatively, wealthy people are aggressive and successful in their estate planning. Due to data and study design problems, the authors cautioned that their findings are suggestive rather than definite (at 339). By contrast, the economists Gale and Perozek found that higher estate tax rates could even raise saving under various different circumstances. See Gale and Perozek in Gale, Hines and Slemrod *eds* (2001) 236. In yet another US study published in 2001, Laitner suggested that the elimination of estate taxes would slightly increase savings. See Laitner in Gale, Hines and Slemrod *eds* (2001) 258 *et seq.* A recent study conducted by Holz-Eakin and Maples conceded that eliminating the estate tax would correspond to increased household saving of between \$800 and \$3000 annually. See in general Paper by Holz-Eakin and Maples *Estate Taxes, Labor Supply and Economic Efficiency* (2008).

¹⁵⁹ O’Brien Report (1982) 446; Graetz (1983) *Yale Law J* 279; Gutman (1983) *Virginia Law Rev* 1188 n 7 refers to the economists Brannon, Jantscher and Fiekowski; Maloney (1988) *Ottawa Law Rev* 627; Duff (1993) *Can J Law Jur* 11; Alstott (1996) *Tax Law Rev* 388; Repetti (2000) *Tax Notes* 1509.

¹⁶⁰ Ventry (2000) *Tax Notes* 1166; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 58. Dodge (2001) *Tax Law Rev* 426 n 20 suggests that the capital formation concern appears to be political, since there was ample capital in the US in the 1990s.

¹⁶¹ See in general the Special Report ACCF *New International Survey* (2007).

¹⁶² Bird (1992) 136.



Internationally, the economic studies vary considerably and there appears to be no conclusive evidence that wealth transfer taxation exerts a strong negative effect on economic decision-making (on the micro-economic level) and economic growth (on the macro-economic level). What is noteworthy, however, is that recipient-based taxation is apparently less subject to economic distortions than transferor-based taxation, because recipients are less likely to arrange their economic activities based on the wealth of others not under their control. Transferors, on the other hand, would be tempted to manipulate asset arrangements and dispositive schemes.¹⁶³

Although concern has been expressed about the possible discouragement of wealth creation and preservation under wealth taxation in South Africa,¹⁶⁴ no empirical study has been conducted to measure the effect of estate duty and donations tax on savings, labour supply, job growth, small businesses and capital stock in a South African context.¹⁶⁵ It is submitted that these aspects require future attention and research, especially if one considers the importance of small businesses for the South African economy.¹⁶⁶ It is, however, dangerous to rely on, for example, the numerous international studies that have been published in this regard, due to the fact that the economic impact of taxes in a developing country, such as South Africa, differs significantly from the position of a developed economy. A final observation is that, historically, economic considerations

¹⁶³ Donaldson (1993) *W&L Law Rev* 548–549.

¹⁶⁴ Third Interim Katz Report (1995) par 7.2.5.

¹⁶⁵ The South African studies focus in general on the distortionary effects caused by the overall tax burden on savings and economic growth. See e.g. Koch, Schoeman and Van Tonder (2005) *SA J Econ* 190 *et seq.* These authors have indeed acknowledged that “future research to uncover the underlying effects of taxation is needed” (at 209).

¹⁶⁶ The Margo Report (1986) par 4.78 underlined the importance of small and medium enterprises in the South African economy. These entities enjoy favourable treatment under various fiscal statutes. E.g, under the Income Tax Act 58 of 1962 small business corporations (as defined in s 12E) pay no tax on a certain part of their taxable income. They are also taxed at lower rates. For the 2008/2009 year of assessment, these corporations pay no tax on the first R46 000 of their taxable income and a lower rate of 10% on their taxable income from R46 001 to R300 000. The taxable income that exceeds R300 000 is taxed at the corporate rate of 28%. In terms of the Value Added Tax Act 89 of 1991 s 23, vendors are only liable under the Act if their taxable supplies exceed a certain threshold amount over a consecutive period of 12 months. From 1 March 2009, the threshold has been increased from R300 000 to R1 000 000.



have not played a significant role in the tax reform proposals provided by the South African tax reform commissions.¹⁶⁷

4.4.4.3 Unproductive Costs

There are several costs associated with wealth transfer tax avoidance. Firstly, estate planning techniques, such as the use of generation-skipping devices and interest-free loans, influence the choices and actions of wealth holders. This carries an efficiency cost for the economy.¹⁶⁸ Secondly, these taxes give rise to an unproductive estate planning industry, consisting of fees paid to lawyers and accountants.¹⁶⁹ Thirdly there are public costs in respect of policing avoidance efforts.¹⁷⁰ However, any negative influence, it is submitted, does not justify the abolition of wealth transfer taxation, but should rather be addressed by virtue of special measures or the simplification of the legislation. The Katz Commission remarked that an overzealous effort to design wealth transfer tax legislation to be beyond avoidance or evasion should, in the absence of an effective revenue department, be avoided.¹⁷¹

¹⁶⁷ See Ch 2 par 2.3.2.2.

¹⁶⁸ Schmalbeck in Gale, Hines and Slemrod *eds* (2001) 149–151; Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp *eds* (2008) 195.

¹⁶⁹ Dobris (1984) *Syracuse Law Rev* 1221; Donaldson (1993) *W&L Law Rev* 544; Fourth Interim Katz Report (1997) par 1.7; Davenport and Soled (1999) *Tax Notes* 621; Holz-Eakin (1999) *Tax Notes* 784; Gale and Slemrod in Gale, Hines and Slemrod *eds* (2001) 41–42; Schmalbeck in Gale, Hines and Slemrod *eds* (2001) 151–54; Steenekamp *Taxation of Wealth* in Black, Calitz and Steenekamp *eds* (2008) 195.

¹⁷⁰ Schmalbeck in Gale, Hines and Slemrod *eds* (2001) 154–155.

¹⁷¹ Fourth Interim Katz Report (1997) par 1.9.



4.5 POLITICAL CONSIDERATIONS

It is evident from the discussion in Chapter 3 above that political victories have in general contributed to the decline of wealth transfer taxes. Bird concludes that “[t]he fate of wealth taxation is primarily determined by political forces”.¹⁷²

The political vulnerability of wealth transfer taxes has puzzled numerous commentators,¹⁷³ especially in light of the fact that these taxes generally apply only to a small percentage of substantial estates.¹⁷⁴ Duff explains that public choice theory predicts that most voters are ignorant of tax policies, except for affluent individuals and corporations, who are better advised and informed about tax policy proposals.¹⁷⁵ Political costs will therefore be higher in respect of wealthy voters.¹⁷⁶ Also, small numbers of persons with common interests are more likely to be represented by organised interest groups than large numbers of persons with common interests.¹⁷⁷ This is certainly true of the repeal initiatives in the United States, Australia and Canada. Interest groups were at the head of the fight for abolition in these countries. Duff furthermore explains that the limited revenue potential of these taxes rendered such taxes particularly vulnerable to political calculation.¹⁷⁸

¹⁷² Bird (1991) *Can Publ Pol* 330.

¹⁷³ See e.g. Graetz (1983) *Yale Law J* 284.

¹⁷⁴ In the UK, it is estimated that about 2,3% of estates paid inheritance tax in 1986/1987 and 5,9% in 2005/2006. Apparently 37% households now have an estate with the value above the threshold. See Piketty: Mirrlees Review (2008) 3. In the US, an estimated 1–2% of all estates are affected by the federal estate tax. See McCaffery (1999) *Tax Notes* 1430. Repeal occurred in Canada, although less than 5% of Canadian taxpayers were affected by the tax. See Bird (2002) *Can Tax J* 678.

¹⁷⁵ Duff in Tiley *ed* (2007) 313.

¹⁷⁶ Duff in Tiley *ed* (2007) 314. See also Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 7.

¹⁷⁷ Duff in Tiley *ed* (2007) 314.

¹⁷⁸ Duff (1993) *Can J Law Jur* 8 refers to a study by DG Hartle *Political Economy of Tax Reform: Six Case Studies*, Discussion Paper no 290 (Ottawa: Economic Council of Canada, 1985) 56–84.



In conclusion, it is important to acknowledge that any debate for or against wealth transfer taxation will hardly ever be influenced by theoretical and socio-economic considerations only. The chances are that politics may even play the dominant role.¹⁷⁹ Tax reform can fail because of a lack of political willpower, which appeared to be a factor in the public's reaction to the Canadian Carter Report in 1966.¹⁸⁰ Although some commentators warn against political influence, others submit that it is inevitable that tax legislation will have a political character.¹⁸¹

4.6 CONCLUSIONS

- (a) This chapter reviewed the arguments for and against the taxation of wealth transfers in a South African context, which are currently accommodated under the transferor-based estate duty and donations tax regimes.
- (b) A powerful argument for the taxation of inheritances and gifts (donations) in a tax system is the fact that these transfers contribute to the taxable capacity (“ability-to-pay”) of the recipients thereof.¹⁸²
- (c) The question was posed whether the deemed-realisation approach currently applied for capital gains tax purposes on the death of a wealth holder could act as a substitute for wealth transfer taxation in the South African tax system (to absorb the increase in taxable capacity afforded by wealth transfers). It was, however, explained that there is a conceptual difference between a wealth transfer tax and a capital gains tax and that each of them has a unique role and function in a tax system. It was

¹⁷⁹ Ventry (2000) *Tax Notes* 1169 suggests that the uncertain future of the federal estate tax in the US will ultimately “be decided in the political arena”.

¹⁸⁰ Sandford (1987) *Br Tax Review* 161–162.

¹⁸¹ Gassner in Essers and Rijkers *eds* (2005) 39–40.

¹⁸² See par 4.4.1.1.



consequently concluded that the deemed-realisation capital gains tax approach could not serve as an alternative measure to tax wealth transfers in the South African tax system and that these transfers should rather be accommodated in a separate tax.¹⁸³

- (d) In addition, it was pointed out that transferor-based wealth transfer taxation produces double taxation in a system where the unrealised capital gains are captured in the tax base on the death of a wealth holder. This phenomenon has motivated some countries (that levy transferor-based wealth transfer taxation) to implement a stepped-up approach for capital gains tax purposes, an approach that has often been criticised as leaving a gap in the capital gains tax base. As regards the South African position, the application of a deemed-realisation approach for the purposes of capital gains tax together with the levying of transferor-based estate duty and donations tax produces double taxation, which is unjustifiable. This does not, however, warrant the abolition of estate duty and donations tax from the South African tax system without considering whether these taxes could be replaced by a more appropriate alternative.¹⁸⁴
- (e) It was shown that the equity criterion ideally supports the taxation of wealth transfers in the hands of the recipient and that recipient-based taxation deflects the double taxation argument levelled against transferor-based taxation (referred to in paragraph (d) above). Furthermore, it was pointed out that equally situated taxpayers are treated equally under a recipient-based tax, in contrast to the position of transferor-based taxation, where the recipients of wealth transfers are taxed unequally.¹⁸⁵ The

¹⁸³ See par 4.4.1.2.

¹⁸⁴ See par 4.4.1.2.

¹⁸⁵ See par 4.4.1.3.



theoretical appeal of recipient-based taxation is also bolstered by the fact that it encourages the redistribution of resources¹⁸⁶ and is more likely to be experienced as a “transfer tax” (in contrast to a “death tax”).¹⁸⁷ Also, from an economic perspective, deferred recipient-based taxation is apparently less likely to distort economic decision-making than taxing the person who accumulated (or saved) the wealth.¹⁸⁸ A caveat was, however, noted on the administrative efficiency of recipient-based taxation.¹⁸⁹

- (f) The possibility of merely including wealth transfers in the “gross income” of the recipient (for the purposes of the South African Income Tax Act of 1962) was explored. It was, however, concluded that such a move would be politically and administratively unlikely. It was explained that, in a South African context, the taxation of wealth transfers in the hands of the recipients may rather be accomplished by a recipient-based wealth transfer tax, which may even be accommodated as a separate schedule to the existing Income Tax Act¹⁹⁰ in much the same way as capital gains tax.¹⁹¹
- (g) Apart from the ability-to-pay argument, a number of other arguments and policy considerations were reviewed in the debate for or against the taxation of wealth transfers in the South African tax system. It was submitted that:

¹⁸⁶ See par 4.3.2.

¹⁸⁷ See par 4.4.3.

¹⁸⁸ See par 4.4.4.2.

¹⁸⁹ See par 4.4.4.1.

¹⁹⁰ Act 58 of 1962.

¹⁹¹ See par 4.4.1.3.



- the taxation of wealth transfers enhances the progressivity of the tax system;¹⁹²
- special provisions and valuation rules do not substantiate a claim for repeal from the system (and that substantial inequity should rather be addressed through tax reform measures);¹⁹³
- McCaffery's argument that taxation would increase large-scale consumption by the rich, thereby increasing inequality overall, is not persuasive;¹⁹⁴
- the existence of tax avoidance opportunities (which is detrimental to equity and which carries an efficiency cost for the economy) cannot justify the abolition of the current system without any suitable replacement;¹⁹⁵
- mere complexity cannot justify the total abolition of wealth transfer taxation;¹⁹⁶
- the tax on wealth transfers is not levied at an inopportune time;¹⁹⁷
- the compliance costs for taxpayers are minimal, because assets have to be valued for purposes of estate administration and for purposes of capital gains tax;¹⁹⁸ and
- there is no empirical proof that the taxation of wealth transfers has a negative effect on the South African economy.¹⁹⁹

¹⁹² See par 4.4.1.4.

¹⁹³ See par 4.4.1.5.

¹⁹⁴ See par 4.4.1.6.

¹⁹⁵ See pars 4.4.1.7 and 4.4.4.3.

¹⁹⁶ See par 4.4.2.

¹⁹⁷ See par 4.4.3.

¹⁹⁸ See par 4.4.4.1.

¹⁹⁹ See par 4.4.4.2.



- (h) In conclusion, it is submitted that the arguments against the fundamental existence of wealth transfer taxation are not compelling enough to justify its abolition from the South African tax system, even though this type of taxation is a poor revenue raiser²⁰⁰ and even if empirical evidence could prove that it is not effectively breaking down large concentrations of wealth in South Africa.²⁰¹ Its abolition would simply cause an unjustifiable leak in the tax system. It should nonetheless be kept in mind that politics have played and can still play a significant role in its future existence.²⁰²
- (i) It was, however, shown that transferor-based taxation (together with a deemed-realisation capital gains tax approach) is unjustifiable (see paragraph (d) above) and that recipient-based taxation has substantive theoretical appeal (as discussed in paragraph (e) above). The question whether or not South Africa should replace its well-established transferor-based estate duty and donations tax regimes with recipient-based taxation (in the form of a recipient-based wealth transfer tax or a schedule to the Income Tax Act)²⁰³ requires some further investigation.

The following chapters will provide an overview of the contemporary framework for wealth transfer taxation in South Africa. Chapter 5 will provide an overview of donations tax and Chapter 6 will elaborate on estate duty.

²⁰⁰ See par 4.3.2.

²⁰¹ See par 4.3.3.

²⁰² See par 4.5.

²⁰³ See par 4.6(f).

CHAPTER 5

A CONTEMPORARY OVERVIEW OF DONATIONS TAX IN SOUTH AFRICA

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5.1 INTRODUCTION

As was pointed out in Chapter 3,¹ donations tax is currently provided for in Part V of the Income Tax Act (hereafter “the Act”).² Although the tax was initially made payable at progressive rates, it has been levied at a flat rate since 1988.³ The initial flat rate of 15 percent was increased to 25 percent in 1996, but decreased to 20 percent in 2001 as a concession granted as a result of the introduction of capital gains tax.⁴

5.2. TAX BASE

5.2.1 Donations and Deemed Donations

Donations tax is levied on the value of any property “disposed of, whether directly or indirectly and whether in trust or not, under any donation by any resident [of the Republic of South Africa]”.⁵ Donations tax is primarily levied on the donor and the divestment by

¹ See Ch 3 par 3.3.2.2.2.

² Act 58 of 1962.

³ The amendment in respect of the rate structure was effected subsequent to a recommendation by the Margo Commission. See Ch 3 par 3.3.2.3.

⁴ See Explanatory Memorandum to the Taxation Laws Amendment Bill (2001) 15. See also King and Victor (2008/2009) par 12.2.

⁵ S 54.



the donor is therefore the focal point, not the accrual to the donee.^{6 7} The term “donation” is defined in the Act as “any gratuitous disposal of property including any gratuitous waiver or renunciation of a right”.⁸ As a consequence, the gratuitous waiver of a usufructuary or fiduciary interest or the gratuitous release of debt is included in the tax base.⁹ Where a person repudiates an inheritance, it seems as if SARS accepts that the repudiation does not constitute a waiver of a “right”, as long as the beneficiary repudiates unconditionally.¹⁰ It is submitted that this viewpoint is correct.¹¹

⁶ The term “donee” means any beneficiary under a donation (s 55(1) “donee”). The term includes a trustee under a trust. See par 5.6.3.

⁷ De Koker and Williams Vol 3 (2009). See also *ITC 1387* (1984) 46 SATC 121 124.

⁸ S 55(1).

⁹ See in general Meyerowitz on Income Tax (2007/2008) par 31.4; De Koker and Williams Vol 3 (2009) par 23.3.

¹⁰ De Koker and Williams Vol 3 (2009) par 23.3. See also Meyerowitz on Income Tax (2007/2008) par 31.4; Editorial (2002) *Taxpayer* 184 and Davis, Beneke and Jooste (2009) par 9.5A.

¹¹ In the law of succession, the long-standing viewpoint is that an heir acquires on the death of the testator a *right* to claim from the executors of the deceased estate, unless the heir repudiates the inheritance. This event is referred to as *dies cedit*. See *Greenberg v Estate Greenberg* (1955) 3 SA 361 (A) 364; *CIR v Estate Crewe* 1943 AD 656 669 and 692. See also Corbett *et al* (2001) 121, 147–148 and Sonnekus (2000) *TSAR* 793–794. In *Crookes NO v Watson* 1956 (1) SA 227 (A) Van der Heever JA said (at 298) that “[t]he oft-repeated saying that a legatee does not acquire a legacy unless he accepts it, misplaces the stress; it would be more correct to say that he acquires a right to the subject-matter of the bequest unless he repudiates it”. However, the Supreme Court of Appeal has recently held in *Wessels NO v De Jager* 2000 (4) SA 924 (SCA) (at par 6) that an heir merely acquires a *power* at the death of the testator and that he only acquires a *right* once he has accepted the benefits. This case dealt with *inter alia* the question whether the repudiation of the heir constitutes a disposition of a *right* in property for purposes of insolvency law. The failure of the court to substantiate its cursory judgment, which seems to fly in the face of the traditional viewpoint, gave rise to some severe academic criticism. See e.g. Sonnekus (2000) *TSAR* 808, where the author concludes that “[d]ie Hoogste Hof van Appèl het in dié woordknep uitspraak die wissels met betrekking tot *delatio* en die insolvensiereg verlê in ’n voorbeeld van regsinding wat met die grootste respek nie op sterkte van oortuigende argument as knap bestempel kan word nie”. However, Stevens (2001) *SALJ* 235 explains (it is submitted, correctly) that the heir’s *right* to claim from the executor of the deceased estate is terminated with retrospective effect where the heir repudiates, as a consequence of which the right cannot be regarded as having vested in the heir in such instance. He therefore argues (at 231) that the *Wessels* case was correctly decided, but that the court could have arrived at its decision in “a better fashion”. The *Wessels* case does therefore not contradict the well-embedded principle that an heir’s right vests at the date of the testator (provided that the heir does not repudiate). However, it provides authority that, upon repudiation by an heir, one cannot conclude that a right has been disposed of. By parity of reasoning, any repudiation by an heir would probably not constitute a waiver of a *right* for purposes of donations tax.



Although a donation is effected by a contract in terms of the common law, the statutory definition's reference to a "disposition" implies a wider meaning and includes "all acts in the law which affect property".¹² However, in *Welch's Estate v CIR*,¹³ Marais JA contended that the concept "... contemplates the existence of another person in whom the property disposed of is intended to vest".¹⁴

To prevent the avoidance of donations tax by giving some sort of *quid pro quo* in exchange for property, section 58(1) provides that property disposed of for consideration which, in the opinion of the Commissioner,¹⁵ constitutes inadequate consideration shall be deemed to have been disposed of under a donation, provided that, in the determination of the value of such property, a reduction shall be made of an amount equal to the value of the consideration.¹⁶

Furthermore, since 2004 with the introduction of section 58(2), it is provided that, where a person disposes of a restricted equity instrument to a connected person (as contemplated in s 8C(5)), that restricted equity instrument shall be deemed to have been donated by that

¹² *CIR v Estate Kohler* 1953 (2) SA 584 (A) 600. See also *Estate Furman & Others v CIR* 1962 (3) SA 517 (A) 526 and *ITC 1387* (1984) 46 SATC 121 123–124.

¹³ 2004 (2) SA 586 (SCA), 66 SATC 303. See Sonnekus (2005) *THRHR* 149 *et seq*; Burt (2004) September *De Rebus* 36; Silke (2004) *Tax Planning* 156 *et seq* and Davis, Beneke and Jooste (2009) par 2.9.2 for a discussion of the case.

¹⁴ *Welch* case 315 (par 36).

¹⁵ The section confers a discretionary power on the Commissioner to invoke the deeming provision on a transaction. See *ITC 1448* (1988) 51 SATC 58 62. See discussion in De Koker and Williams Vol 3 (2009) par 23.5.

¹⁶ S 58(1). For the application of s 58(1) to the massing of estates, see Derksen (1980) *Moderne Besigheidsreg* 1 *et seq*.



person at the time that it is deemed to vest for the purpose of section 8C.^{17 18} The value for donations tax is the fair market value of the instrument at the time of the deemed vesting, provided that a reduction shall be made of the value of any consideration given in respect of that donation.¹⁹

The characteristics of a donation in terms of the primary charging provision as well as a section 58(1) disposition will more fully be discussed in chapter 7 below.²⁰

The Act states that a donation shall be deemed to take effect on the date upon which all the legal formalities for a valid donation have been complied with.²¹ However, the question arises when a section 58(1) disposition shall be considered to take effect. The natural interpretation would be that, where a deemed donation is applicable, the donation takes effect on the date on which the legal formalities for the affected disposition have been complied with, for example if the disposition was made by virtue of a sales

¹⁷ Section 8C provides for the taxation of a restricted equity instrument in the hands of an employee or director, if the instrument was acquired by virtue of such person's employment or office. Any gain or loss realised by the employee or director must be included in his or her gross income in the tax year in which the instrument had vested in him or her. The liability for tax only arises once the instrument has "vested", not when it was "obtained". A tax avoidance scheme developed whereby an employee or director would dispose of a restricted equity instrument to a connected person at an earlier date, thereby effecting "vesting" of the instrument at an earlier date. Section 8C(5) accordingly introduced a specific anti-avoidance rule providing for the deferral of the "vesting" on the disposition of such an instrument to the connected person and thereby treating such a disposal as a non-event.

¹⁸ S 58(2). See De Koker and Williams Vol 3 (2009) par 23.5 for further reading.

¹⁹ S 58(2).

²⁰ Ch 7 par 7.4.2.

²¹ S 55(3). The General Law Amendment Act 50 of 1956 deals with the formalities of a donation. S 5 provides that no donation concluded (after the commencement of the Act on 22 June 1956) is invalid merely by reason of the fact that it has not been registered or notarially executed. However, in the instance of an executory donation, namely a donation which has not been carried into effect, the terms of the donation must be embodied in a written document signed by the donor or by a person acting on his written authority granted by him or her in the presence of two witnesses. See in general Owens in *LAWSA* (2005) par 309; Meyerowitz on Income Tax (2007/2008) par 31.8 and De Koker and Williams Vol 3 (2009) par 23.4. Prior to the enactment of Act 50 of 1956, a donation, whether executed or not, was revocable in regard to the amount exceeding £500, unless it was registered in the Deeds Office or embodied in a notarial deed. See Owens in *LAWSA* (2005) par 300. See also *Coronel's Curator v Estate Coronel* 1941 AD 323 330–343 for a concise overview of the formality requirements of a donation in the Roman law, Roman Dutch law (as accepted in Holland) and the Roman-Dutch law (as applied in South Africa).



agreement, the date on which the requirements for a valid sales agreement have been completed. This minor issue may easily be rectified with an amendment to the legislation and will not be explored further in this thesis.

5.2.2. Jurisdictional Basis

In levying taxation in general, countries use a variety of connecting factors. For purposes of income taxation, the main connections are residency, domicile or nationality (establishing a “worldwide” jurisdictional basis) and source.²² It is also common practice to adopt a combination of residency and source.²³ For purposes of wealth transfer taxation, the main connecting factors are residency, domicile or nationality, where the worldwide assets of a resident taxpayer fall within the jurisdictional basis of the tax. For purposes of non-resident taxpayers, the basis often extends to assets situated or registered in the relevant country. This will be referred to as *situs*-based taxation.

5.2.2.1 Residency

When donations tax was first introduced into the income tax structure in 1955, the jurisdictional basis was established with reference to a donor “ordinarily resident” in the republic.²⁴ In view of the fact that the income tax legislation did not contain a definition for an ordinary resident, interpretation of the meaning of this concept was left to the courts.²⁵

²² Resident-based taxation can be justified on the basis that a resident (domiciliary or citizen) enjoys the protection of the state and should therefore contribute towards the cost of the government. Source-based taxation, on the other hand, ignores a person’s place of residence, domicile or nationality, and levies a tax on the country’s national resources or income derived from the national resources. See Olivier (2001) *TSAR* 21 n 5.

²³ Olivier (2001) *TSAR* 21.

²⁴ S 54 (as it then read).

²⁵ The “ordinary residence” of a taxpayer was described in *Cohen v CIR* 1946 AD 174, 13 SATC 362 as “... the country to which he [the taxpayer] would naturally and as a matter of course return from his wanderings: as contrasted with other lands it might be called his usual or principal residence and it would be described more aptly than other countries as his real home.” See also *CIR v Kuttel* 1992 (3) SA 242 A. Footnote continues on the next page



When a worldwide basis was adopted for purposes of income tax in respect of years of assessment ending on or after 1 January 2001,²⁶ the Income Tax Act introduced a specific definition for a “resident”, referring to natural persons as well as juristic persons (“person[s] other than natural person[s]”).²⁷ In terms of the definition, a natural person is regarded as a resident of the republic if that person has either been “ordinarily resident” in the republic, or complies with the physical presence test, which extends over a period of six years.²⁸ A person, other than a natural person (such as a company or close corporation), is defined as a resident if such person has been incorporated, established or formed in the republic, or if that person has its place of effective management in the republic.²⁹

When the Income Tax Act adopted a definition for a resident, the donations tax reference to “ordinarily resident” was replaced with the term “resident”. As a consequence, donations tax has subsequently been levied on property disposed of under a donation by a “resident” (as defined for purposes of income taxation), which includes a legal person as

For further reading, see Stein (2004) 16; Williams (2005) 7–11; Morphet (2008) *Tax Planning* 123 *et seq*; De Koker and Williams Vol 1 (2009) par 1.8; Meyerowitz on Income Tax (2007/2008) pars 5.16–5.18; and Davis, Beneke and Jooste (2009) par 2.3.4.

²⁶ See Olivier (2001) *TSAR 20 et seq* for a comprehensive discussion on the change in the basis of charge.

²⁷ S 1.

²⁸ See s 1 “resident”. The test can only operate with reference to a year of assessment. In order for a person to comply with this test, he or she must have been physically present for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as each of the five years of assessment preceding such year of assessment. In addition, the person must have been present for a period or periods exceeding 915 days in aggregate during those 5 preceding years of assessment. Where the person complies with these requirements, he or she will be regarded as a resident from the first day of the relevant year of assessment. The definition is subject to the proviso that where a person who is a resident in terms of this subparagraph is physically outside the republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the republic, such person shall be deemed not to have been a resident from the day on which such person ceased to be physically present in the republic. The definition furthermore excludes a person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic of South Africa and that other country for the avoidance of double taxation. See in general Davis, Beneke and Jooste (2009) par 2.9.1A.

²⁹ See s 1 “resident”. See in general Meyerowitz on Income Tax (2007/2008) par 5.19; Davis, Beneke and Jooste (2009) par 2.9.1A.



well as a natural person who is either ordinarily resident in the republic or who complies with the physical presence test.³⁰

No donations tax is, however, payable in respect of property, disposed of under a donation by a resident, that consists of any right in property situated outside the republic that was acquired by the donor –

- before he or she became a “resident of the republic” for the first time;³¹ or
- by inheritance from a person who at the date of his death was not “ordinarily resident”³² in the republic or by a donation if, at the date of the donation, such person (donor) was a person other than a company not “ordinarily resident” in the republic;³³ or
- out of the funds derived by him for the disposal of any property referred to in (a) or (b) or, if the donor disposed of such last-mentioned property and replaced it successively with other properties (all situated outside the republic and acquired by the donor out of funds derived by him from the disposal of any of the said properties referred to in (a) or (b)), out of funds derived by him from the disposal of, or from revenue from any of those properties.³⁴

5.2.2.2 Location of Assets

A non-resident is not subject to donations tax, even if the donated property is situated within the republic.³⁵

³⁰ S 54 (as amended).

³¹ S 56(1)(g)(i). Apparently, the accepted view is that this exemption can apply only in the case of an immigrant and not in the case of a person who was born in the republic. See Stein (2004) *Tax Planning* 95.

³² The Act has not yet been amended to refer to a “resident”. See Stein (2004) *Tax Planning* 95.

³³ S 56(1)(g)(ii).

³⁴ S 56(1)(g)(iii).

³⁵ Meyerowitz on Income Tax (2007/2008) par 31.9; De Koker and Williams Vol 3 (2009) par 23.2.



Donations tax is therefore primarily levied on a worldwide basis, because the worldwide property of residents (with the exclusion of certain foreign assets listed above) falls within the jurisdictional basis of the tax. For purposes of non-residents, the tax base is not extended to a *situs* basis.³⁶

5.2.3 Double Taxation

In view of the fact that different countries apply different jurisdictional bases and apply different rules for the determination of residence (or domicile) and the location of assets in the realm of wealth transfer taxation, (international) double taxation may arise. The incidence of double taxation under donations tax is relatively restricted in view of the fact the donations of South African assets by non-residents fall outside the tax net. However, where a resident donates a foreign asset which is not exempt from the tax, double taxation may occur in the instance where the country in which the property is situated levy taxation on the event.

Relief for double taxation is usually granted by way of unilateral relief in the form of a tax credit, or by virtue of double taxation agreements. Although the Income Tax Act contains a provision for the granting of a tax credit,³⁷ the provision does not extend to donations tax. However, the Act empowers the National Executive to enter into double taxation agreements for the prevention of double taxation in respect of donations.³⁸ The only double taxation agreement entered into by the government which applies to donations tax is the agreement concluded with the United Kingdom in 1978.³⁹

³⁶ For criticism on the Katz Commission's analysis of the jurisdictional basis of donations tax, see Ch 7 par 7.4.1.

³⁷ S 6quat.

³⁸ S 108.

³⁹ See in general De Koker and Williams Vol 3 (2009) par 23.31 for further reading.



5.2.4 Object of Taxation: Property

“Property” is defined as “any right in and to property movable or immovable, corporeal or incorporeal, wheresoever situated”.⁴⁰ To establish whether or not an asset complies with a “right in and to property”, the general property law principles are of importance. The definition is wide and includes personal as well as real rights in property.⁴¹ Personal servitudes, such as a usufruct,⁴² use⁴³ and habitation,⁴⁴ being real rights, would therefore be included, as well as fiduciary interest in property (under a *fideicommissum*⁴⁵).

⁴⁰ S 55(1) “property”. Corporeal property is considered to be an object which occupies space and is capable of sensory perception. Rights, such as personal rights and immaterial property rights, are therefore examples of incorporeals. Immovable corporeal property is land and everything that is attached thereto by natural or artificial means. A corporeal is, on the other hand, movable if it can be moved without being damaged and without losing its identity. Incorporeal (personal) rights are movable (even if the performance concerned consists of, for example, the right to claim transfer of immovable property). Real rights having immovable things as objects would be classified as immovable, whereas real rights having movable things as objects would be movable. A usufruct over land is therefore immovable, whereas a usufruct over a herd of cattle is movable. See Badenhorst, Pienaar and Mostert (2006) 33–36.

⁴¹ Meyerowitz on Income Tax (2007/2008) par 31.3.

⁴² A usufruct is a personal servitude providing the usufructuary with a limited real right to use another person’s property and to enjoy the fruits thereof, subject to the obligation to return the property eventually to the owner, having preserved its substantial quality. See in general Badenhorst, Pienaar and Mostert (2006) 339–342; De Waal and Schoeman-Malan (2008) 166 and Davis, Beneke and Jooste (2009) par 2.3.2.2.

⁴³ A *use* is a personal servitude similar to the usufruct, but the holder’s rights are far more restricted. He or she may, for example, only take fruits of the property for his or her household’s daily needs, but nothing in excess of that. The fruits may furthermore not be sold. See in general Badenhorst, Pienaar and Mostert (2006) 341 and Davis, Beneke and Jooste (2009) par 2.3.2.2.

⁴⁴ A *habitatio* is a personal servitude which confers on its holder the right to live in another person’s house. The holder may lease or sublease the property. See in general Badenhorst, Pienaar and Mostert (2006) 341 and Davis, Beneke and Jooste (2009) par 2.3.2.2.

⁴⁵ A *fideicommissum* is a legal institution in terms of which a person (*fideicomittens*) transfers property to another person (*fiduciarius*) subject to a provision that, after a certain time has lapsed or a certain condition has been fulfilled, the property passes to another person (*fiducommissarius*). See in general Meyerowitz (1992) *Taxpayer* 65–66; Corbett *et al* (2001); De Waal and Schoeman-Malan (2008) 150–154, Ch xvi and Davis, Beneke and Jooste (2009) par 2.3.2.2 for further reading. Under the South African law, the duration of a *fideicommissum* is limited to two successive fideicommissaries (Immovable Property (Removal or Modification of Restrictions) Act 94 of 1965 ss 6, 7). See De Waal and Schoeman-Malan (2008) 155. Some scholars hold the viewpoint that the fideicommissary does not have a vested right during the existence of the *fideicommissum*, but only a *spes fideicommissi*. See Corbett *et al* (2001) 295 and n 315 and authority cited there. Others submit that the interest should be categorised as a personal right. There are, however, two divergent views on the nature of such a right. One view is that the fideicommissary has a vested personal right against the fiduciary that is subject to a resolutive condition (for example, if the fideicommissary dies before the condition has been fulfilled). According to the other view, the

Footnote continues on the next page

Although these rights are usually not transferable,⁴⁶ the renunciation of any such right would in principle be taxable, constituting a waiver of a right.

De Koker and Williams submit that the definition embraces only vested rights, and would therefore exclude a *spes* and a conditional right.⁴⁷ The rendering of services would apparently not constitute property.⁴⁸ This must, however, be distinguished from the case where a person waives a right to receive compensation for services rendered.

5.3 VALUATION

Accept for a general valuation rule, the Act contains special provisions for the valuation of usufructuary, fiduciary or other like interests, annuities, bare *dominium* property and agricultural property. The discussion below deals with all these rules, except for the valuation rule in respect of agricultural property, which will be more fully addressed under paragraph 5.5.2 below.

5.3.1 General Rule

In the absence of a special valuation rule, the value of property forming a donation is determined as the fair market value as at the date upon which the donation takes effect.⁴⁹ This provision is subject to the proviso that, in a case in which the value of the property is

fideicommissary's right is subject to a suspensive condition and therefore contingent until the condition has been fulfilled. Both views explain why the personal right of the fideicommissary who dies before the fulfilment of the condition cannot be transferred to his or her heirs. See De Waal and Schoeman-Malan (2008) 160–163 and authority cited there.

⁴⁶ See Badenhorst, Pienaar and Mostert (2006) 339, 340 n 170 and authority cited there. The *fideicommissarius* or a court (in some limited instances) may, however, grant the fiduciary the right to alienate the property. See De Waal and Schoeman-Malan (2008) 157–159 and Corbett *et al* (2001) 298–315. See also De Waal and Schoeman-Malan (2008) 195–160 and authority cited there for further reading on the fiduciary's legal position (rights and obligations).

⁴⁷ De Koker and Williams Vol 3 (2009) par 23.3.

⁴⁸ Meyerowitz on Income Tax (2007/2008) par 31.3; De Koker and Williams Vol 3 (2009) par 23.3.

⁴⁹ S 62(1)(d).



reduced in consequence of conditions, in the opinion of the Commissioner imposed by or at the instance of the donor, the value of such property shall be determined as though those conditions had not been imposed.⁵⁰ The “fair market value” is defined as the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm’s length in an open market.⁵¹

5.3.2 Usufructuary, Fiduciary or Other Like Interests

Where the donation consists of a usufructuary, fiduciary or other like interest in property, its value is an amount determined by capitalising at twelve percent the annual value⁵² of the right of enjoyment of the property over which such interest was or is held, to the extent⁵³ to which the donee becomes entitled to such right of enjoyment with reference to the expectation of the life of the *donor*, or if such right of enjoyment is to be held for a lesser period, over such lesser period.⁵⁴ Where the interest is to be enjoyed for an uncertain period, the annual value must be capitalised over the expectation of life of the donor.⁵⁵ If a calculation is required in respect of the expectation of life of a person other than a natural person, the annual value should be capitalised over a period of fifty years.⁵⁶

⁵⁰ S 62(1)(d) proviso. See also *Ogus v CIR* 1978 (3) SA 67 (T).

⁵¹ S 55(1) “fair market value” paragraph (a). In practice the Commissioner, as a general rule, requires an appraisal in the case of immovable property, a broker’s certificate in the case of quoted shares, an auditor’s valuation in the case of unquoted shares and a valuation by a competent person in the case of any other property such as copyrights and patents. See Meyerowitz on Income Tax (2007/2008) par 31.66.

⁵² The annual value should be determined by reference to the value of the full ownership of the underlying property. See s 62(2). The underlying property should be valued in terms of the general rule. See Meyerowitz on Income Tax (2007/2008) par 31.44.

⁵³ Meyerowitz on Income Tax (2007/2008) par 31.45 submits, in the light of the provision that the annual value should be capitalised to the *extent* to which the donee becomes entitled to such right, that the annual value of a lesser right such as a *usus*, *habitatio*, or grazing rights, should be valued by apportioning the annual value between such rights and the remainder of the right of enjoyment.

⁵⁴ S 62(1)(a). Where the life expectancy of the donee is less than that of the donor, then the donee’s life expectancy should be used instead. See Meyerowitz on Income Tax (2007/2008) pars 31.41 and 31.46–31.51 and De Koker and Williams Vol 3 (2009) pars 23.23–23.24.

⁵⁵ Meyerowitz on Income Tax (2007/2008) par 31.41.

⁵⁶ S 62(3).



The Act provides that the State President may make regulations as to the valuation of annuities or fiduciary, usufructuary or other like interests in property.⁵⁷ No regulations have been promulgated, but in practice the Commissioner applies the life expectancy tables published under the Estate Duty Act⁵⁸ for donations tax purposes.⁵⁹

Where the Commissioner is satisfied that the property could not reasonably be expected to produce an annual yield equal to twelve percent, the Commissioner may fix such sum as representing the annual yield as may seem to him to be reasonable, and the sum so fixed by him shall be deemed to be the annual value of the limited interest.⁶⁰

5.3.3 Annuities

In the case where the donation consists of a right to an annuity, the value thereof is an amount equal to the annual value of the annuity capitalised at twelve percent over the expectation of life of the donor, or if such right is to be held by the donee for a lesser period, over such lesser period.⁶¹ If a calculation is required in respect of the expectation of life of a person other than a natural person, the annual value will be capitalised over a period of fifty years.⁶²

⁵⁷ S 107(1)(d).

⁵⁸ Act 45 of 1955.

⁵⁹ De Koker and Williams Vol 3 (2009) pars 23.20 and 23.21. See Ch 6 par 6.3.3.2.

⁶⁰ S 62(2) proviso (a). The section also provides that, should the property subject to the right of enjoyment consist of books, pictures, statutory or other objects of art, the annual value of the right of enjoyment shall be deemed to be the average net receipts (if any) derived by the person entitled to such right of enjoyment of such property during the three years immediately preceding the date on which the donation took effect (proviso (b)). See also comment in Ch 6 par 6.3.3.2 n 133.

⁶¹ S 62(1)(b). See Meyerowitz on Income Tax (2007/2008) pars 31.53–31.55 and De Koker and Williams Vol 3 (2009) par 23.26 for example calculations.

⁶² S 62(3).



5.3.4 Bare *Dominium*

Where the ownership in property is donated, and this property is subject to a usufructuary or other like interest in that property, the Act provides that the value of that property (referred to as the “bare *dominium*”), shall be the amount by which the fair market value of the full ownership of the property exceeds the value of such interest.⁶³ Although the Act contains special valuation rules for these interests (as has been described above), the section on the valuation of the bare *dominium* contains its own rules for the valuation of these interests, depending on their nature.

In the case of a usufructuary interest, the interest is valued by capitalising at twelve percent the annual value of the right of enjoyment of the property subject to the usufructuary interest over the expectation of life of the person entitled to such interest, or, if such interest is to be enjoyed for a lesser period, over such lesser period.⁶⁴ In the case where the property is subject to an annuity charged upon property, the value of the annuity is determined by capitalising at twelve percent the amount of the annuity over the expectation of life of the person entitled to such annuity, or, if it is to be held for a lesser period, over such lesser period.⁶⁵ In the case where the property is subject to any interest (other than a usufructuary interest or an annuity charged on property), such as a *usus*, *habitatio* or grazing rights, the value of the interest is determined by capitalising at twelve percent such amount as the Commissioner may consider reasonable as representing the annual yield of such interest, over the expectation of life of the person entitled to such interest, or, if it is to be held for a lesser period, over such lesser period.⁶⁶ If a calculation

⁶³ S 62(1)(c).

⁶⁴ S 62(1)(c)(i). See Meyerowitz on Income Tax (2007/2008) par 31.58 and De Koker and Williams Vol 3 (2009) par 23.28 for example calculations.

⁶⁵ S 62(1)(c)(ii). See Meyerowitz on Income Tax (2007/2008) par 31.60 and De Koker and Williams Vol 3 (2009) par 23.29 for example calculations.

⁶⁶ S 62(1)(c)(iii). See Meyerowitz on Income Tax (2007/2008) par 31.62 for an example calculation.



is required with reference to the expectation of life of a person other than a natural person, the annual value must be capitalised over a period of fifty years.⁶⁷

5.4 TAXPAYER AND PAYMENT OF THE TAX

Donations tax is levied on the donor,⁶⁸ unless the donor fails to pay the tax within the prescribed period, in which case both the donee and the donor become jointly and severally liable for the tax.⁶⁹ In the case of a trust, the trustee (being regarded as the “donee” would be responsible (in his representative capacity) for the payment of the tax.⁷⁰

In view of the fact that a “resident” includes juristic persons, companies are in principle also liable for donations tax. The representative taxpayer would be the public officer of such company.⁷¹ However, where any property has been donated by any “body corporate” at the instance of any person,⁷² that property shall be deemed to have been disposed of by that person.⁷³ The tax payable may nonetheless be recovered from the assets of the body corporate.⁷⁴

⁶⁷ S 62(3).

⁶⁸ S 57 provides that, where spouses are married in community of property and property is donated by one of the spouses, the donation is deemed to have been made by each of the spouses in equal shares if the property forms part of the joint estate. If the property is excluded from the joint estate, the donation will be deemed to have been made solely by the spouse making the donation.

⁶⁹ S 59.

⁷⁰ S 55(1) “donee”.

⁷¹ S 61(1)(a).

⁷² The question arises whether this section can be invoked if a donation was made at the instance of more than one person. See Meyerowitz on Income Tax (2007/2008) par 31.12 and De Koker and Williams Vol 3 (2009) par 23.17) for further reading.

⁷³ S 57(1).

⁷⁴ S 57(1) proviso.



Donations tax is payable within three months from the time the donation takes effect or such longer period that the Commissioner may allow.⁷⁵ Certain prescribed forms must accompany the tax payment. In addition, the normal income tax return calls for the particulars of donations made during the year of assessment.

5.5 RELIEF MECHANISMS

5.5.1 Consideration: Deemed Donations

In respect of a donation, the donee would not pay any consideration for the donated property. However, in respect of deemed donations (both disposals for inadequate consideration and restricted equity instruments), the Act provides that any consideration paid may be deducted from the value of the property transferred.⁷⁶

5.5.2 Preferential Valuation: Agricultural Property

A favourable basis for the valuation of agricultural property was initially provided for by granting the taxpayer the right to determine the fair market value as the value equal to the aggregate value of the fair agricultural value of the land and the fair market value of any mineral rights attaching to the land (commonly referred to as the “land bank value”).⁷⁷ However, in view of the fact that farms adjoining towns and cities would have a much higher value than farming properties situated in rural areas,⁷⁸ the Income Tax Act was amended in 2005 to provide that the fair market value of property (on which a *bona fide* farming undertaking is being carried on in the republic) may be fixed at the fair market

⁷⁵ S 60(1).

⁷⁶ See par 5.2.1.

⁷⁷ See Stein (2004) 60 for further reading.

⁷⁸ This concern was already raised by the Margo Commission. See Margo Report (1986) par 20.61.



value of such property⁷⁹ reduced by 30 percent.⁸⁰ Also, where any company, not quoted on any stock exchange,⁸¹ owns immovable property on which *bona fide* farming operations are being carried on in the republic, the value of such immovable property may, in so far as it is relevant for the purposes of determining the value of any shares in such company, be determined by reducing the fair market value of such immovable property with 30 percent.⁸²

5.5.3 Exemptions

In addition to certain foreign property (belonging to a resident) which is exempt from donations tax (as has been pointed out above),⁸³ the Act provides for the exemption of the following:

- any donation to or by or for the benefit of the following persons or institutions:
 - any traditional council, traditional community or any tribe as defined in section 1 of the Traditional Leadership and Governance Framework Act 41 of 2003;⁸⁴
 - the Government of South Africa or any provincial administration;⁸⁵
 - a municipality;⁸⁶
 - certain institutions or bodies exempt from income tax in terms of section 10(1)(cA) of the Income Tax Act, that (i) conduct scientific, technical or industrial research, (ii) provide necessary or useful commodities,

⁷⁹ As determined in terms of s 55(1) “fair market value” paragraph (a). See par 5.3.1.

⁸⁰ S 55(1) “fair market value” paragraph (b).

⁸¹ The modern term used for purposes of the law of securities is a “securities exchange”. See Securities Services Act 36 of 2004.

⁸² S 62(1A).

⁸³ See par 5.2.2.1.

⁸⁴ S 56(1)(f).

⁸⁵ As referred to in s 10(1)(a). See s 56(1)(h).

⁸⁶ As referred to in s 10(1)(b). See s 56(1)(h).



amenities or services to the government or the general public or (iii) carry on activities, including the rendering of financial assistance by way of loans or otherwise, designed to promote commerce, industry or agriculture or any branch thereof (or any association, corporation or company, all the shares of which are held by any such institution, board or body, if the operation of such association, corporation or company are ancillary or complementary to the object of such institution, board or body);⁸⁷

- a political party registered under section 36 of the Electoral Act 45 of 1979;⁸⁸
- a public benefit organisation approved by the Commissioner;⁸⁹
- a recreational club approved by the Commissioner;⁹⁰
- a pension fund, provident fund, retirement annuity fund, benefit fund, mutual loan association, fidelity or indemnity fund, trade union, chamber of commerce or industries (or association of such chamber), local publicity association approved by the Commissioner and a company, society or association established to promote the common interests of its members, carrying on any particular kind of business, profession or occupation;⁹¹ and
- a body corporate, share block company and association of persons whose receipts and accruals are derived by way of levies from its members or shareholders;⁹²

⁸⁷ See s 56(1)(h).

⁸⁸ As referred to in s 10(1)(cE). See s 56(1)(h).

⁸⁹ As referred to in s 10(1)(cN). See s 56(1)(h).

⁹⁰ As referred to in s 10(1)(cO). See s 56(1)(h).

⁹¹ As referred to in s 10(1)(d). See s 56(1)(h).

⁹² As referred to in s 10(1)(e). See s 56(1)(h).



- a donation to and for the benefit of a spouse⁹³ of the donor under a duly registered⁹⁴ ante-nuptial or post-nuptial contract or under a notarial contract in terms of which the matrimonial property regime has been changed;⁹⁵
- any donation to or for the benefit of the spouse of the donor, who is not separated from him under a judicial order or notarial deed of separation;^{96 97}
- property disposed of under a *donatio mortis causa*⁹⁸ (because such a donation would be included in the estate duty tax base);^{99 100}
- a donation, in terms of which the donee will not obtain any “benefit” there under until the death of the donor (because such a donation would be included in the estate duty tax base);^{101 102}

⁹³ For purposes of donations tax, a spouse in relation to any person, means a person who is the partner of such person (a) in a marriage or customary union recognised in terms of the laws of the Republic; (b) in a union recognised as a marriage in accordance with the tenets of any religion; or (c) in a same-sex or heterosexual union which the Commissioner is satisfied is intended to be permanent. A marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union without community of property. See Income Tax Act s 1 “spouse”.

⁹⁴ It is considered that “duly registered” means registered in terms of the Deeds Registries Act 47 of 1937. See Meyerowitz on Income Tax (2007/2008) par 31.17.

⁹⁵ S 56(1)(a). This exemption has actually become redundant in that the exemption referred to directly below (which was introduced at a later stage) is broad enough to cover all donations between spouses. See Stein (1987) *Tax Planning* 130.

⁹⁶ Note that the procedure of notarial deed of separation has in the meantime been abolished.

⁹⁷ S 56(1)(b). This provision was introduced as a consequence of the legalisation of inter-spousal donations in 1984. At common law donations between spouses were void or voidable, except for certain exceptions, for example a donations made in terms of registered ante-nuptial or post-nuptial contract. However, the legal position was changed when donations between spouses were legalised in 1984 in terms of s 22 of the Matrimonial Property Act. See Owens in *LAWSA* (2005) par 300.

⁹⁸ See Ch 3 par 3.3.2.2.1 n 123.

⁹⁹ See Ch 6 par 6.2.4.2.3.

¹⁰⁰ S 56(1)(c).

¹⁰¹ See Ch 6 par 6.2.4.2.3.

¹⁰² S 56(1)(d). An example of such a donation is where a donor irrevocably donates property of which the delivery is to be made to the donee only on the death of the donor. See Meyerowitz on Income Tax (2007/2008) par 31.22 and De Koker and Williams Vol 3 (2009) par 23.6. The donee’s right under the donation should not be conditional upon him surviving the donor, in which instance the agreement would generally constitute an invalid *pactum successorium*. See Jooste (2004) *SALJ* 743 and Davis, Beneke and Footnote continues on the next page



- a donation which is cancelled within six months from the date upon which it took effect;¹⁰³
- the following voluntary awards that are required to be included in the gross income of the recipient in terms of the Income Tax Act:
 - an “amount”,¹⁰⁴ received or accrued in respect of services rendered or to be rendered or in respect of or by virtue of any employment or the holding of any office, as provided for in paragraph (c) to the definition of gross income in section 1 of the Income Tax Act;¹⁰⁵
 - an amount, received or accrued in respect of the relinquishment, termination, loss, repudiation, cancellation or variation of any office or employment (but excluding any lump sum award received from a pension fund, provident fund or retirement

Jooste (2009) pars 2.4.4.2 and 9.3.1A. In *ITC 1192* (1965) 35 SATC 213 the court held (at 220) that even the bare *dominium* transferred to trustees (even where the ultimate enjoyment of the property is postponed until the death of the donor) constitutes a “benefit” as envisaged in the section. An important observation made by the court (at 217) is that the contractual right of the donee would not merely qualify as a “benefit”, provided that the right cannot be attached, ceded, transferred or taken by creditors in the case of insolvency. For a general discussion of this case, see Meyerowitz on Income Tax (2007/2008) pars 31.22 and 31.23 and De Koker and Williams Vol 3 (2009) par 23.6. However, in *ITC 1786* (2004) 67 SATC 138, which was upheld in *CSARS v Marx* 2006 (4) SA 195 (CPD), 68 SATC 219, the court held that the donation was exempt from donations tax, without evaluating whether or not the donees’ rights were capable of being ceded or transferred, creating uncertainty as to the precise application of the exemption. Scholars generally criticised the court’s failure to analyse the nature of the underlying right and submitted that it is arguable that the exemption should not apply where the donee’s right is capable of being ceded or attached by creditors, in which case the right would have some commercial value. See Olivier (2007) *TSAR* 592–593 and Davis, Beneke and Jooste (2009) par 2.4.4.2.

¹⁰³ S 56(1)(e). See in general Meyerowitz on Income Tax (2007/2008) par 31.24.

¹⁰⁴ The meaning of “amount” has been a subject of controversy in the courts. In *Stander v CIR* 1997 (3) SA 617 (C), 59 SATC 212, for example, the Commissioner attempted to include a prize (an overseas trip), awarded to a car sales person by a car manufacturer, in the gross income of the sales person by relying on the provisions of paragraph (c) of the definition of gross income. In view of the fact that the sales person could not convert the prize into cash, the court held that the prize did not constitute an “amount” as envisaged (at 623). See Williams (1998) *SALJ* 430 *et seq* for a discussion of this case. The *Stander* case was, however, recently overturned by the Supreme Court of Appeal in *CSARS v Brummeria Renaissance v CIR* (2007) 99 (SCA), 69 SATC 205, in which case the court rejected the view that only receipts which could be converted into money had a monetary value (at 212–215 pars 13–16). It has therefore become clear that remuneratory donations would in general, where a monetary value could be placed on the value of the benefit, be included in the gross income of the recipient.

¹⁰⁵ See De Koker and Williams Vol 1 (2009) par 4.68 for further reading.



- annuity fund), as provided for in paragraph (d) to the definition of gross income in section 1 of the Income Tax Act;
- any cash equivalent of a taxable fringe benefit, as provided for in paragraph (i) to the definition of gross income in section 1 of the Income Tax Act; and
 - any share incentive gain as provided for in section 8A,¹⁰⁶ 8B¹⁰⁷ or 8C¹⁰⁸ of the Income Tax Act;¹⁰⁹
 - property disposed of under a donation under and in pursuance of any trust;¹¹⁰
 - a disposition of a right (other than a fiduciary, usufructuary or other like interest) to the use or occupation of property used for farming purposes, for no or inadequate consideration, where the donee is the child of the donor;¹¹¹

¹⁰⁶ S 8A includes in a taxpayer's income the amount of any gain made by the taxpayer by the exercise, cession or release of any right to acquire any marketable security, if such right was obtained by the taxpayer (before 26 October 2004) as a director or former director of any company or in respect of services rendered or to be rendered by him. See Meyerowitz on Income Tax (2007/2008) pars 9.42– 9.50 and De Koker and Williams Vol 1 (2009) par 4.72 for further discussion.

¹⁰⁷ S 8B includes in a taxpayer's income the amount of any gain made by the taxpayer from the disposal of any qualifying equity share (or any right thereto or interest therein), which is disposed of within five years from the date of grant of that qualifying equity share, otherwise than in exchange for another qualifying equity share or disposed of on the death or insolvency of the taxpayer. See Meyerowitz on Income Tax (2007/2008) par 9.50H and De Koker and Williams Vol 1 (2009) par 4.73 for further discussion.

¹⁰⁸ S 8C includes in a taxpayer's income the amount of any gain in respect of the vesting of a restricted equity instrument, if that equity instrument was acquired by the taxpayer by virtue of his or her employment or office of director or by virtue of any other restricted equity instrument held by the taxpayer. See Meyerowitz on Income Tax (2007/2008) pars 9.50A–9.50G and De Koker and Williams Vol 1 (2009) par 4.73C for further discussion.

¹⁰⁹ S 56(1)(k). See De Koker and Williams Vol 1 (2009) par 4.68 for further reading.

¹¹⁰ S 56(1)(l). Because a donation to a trust constitutes a donation to the trustees (see par 5.2.1), then the question arises whether this exemption is redundant. When Trollip J was faced with this question in *ITC 1192* (1965) 35 SATC 213, he answered that it “was probably inserted *ex abundante cautela* to make it crystal clear that property disposed of under and in pursuance of a trust was not a *gratuitous* disposal of property” (at 216). Marais AJ in the *Welch* case pointed out that this deduction cannot be correct, because where a disposal is not a donation as defined there cannot be talk of it being exempted from liability for donations tax (pars 66 and 67). If one considers, however, that a court could interpret a distribution by a trustee as a donation (analogous to the proposition expressed in the *Crookes v Watson* case (see par 5.6.2)), then the exemption would avoid the levying of donations tax once again and would therefore not be redundant.

¹¹¹ S 56(1)(m). An example of such a right would be under a lease agreement or where the occupation may be terminated by the donor at any time. See Meyerowitz on Income Tax (2007/2008) par 31.36.



- a disposal of property by a company which is recognised as a public company in terms of the provisions of section 38 of the Income Tax Act;¹¹²
- a disposal of the full ownership in immovable property, if it was acquired in terms of the Land Reform Programme (as contemplated in the White Paper on South African Land Policy, 1997) and the Minister of Land Affairs has approved the particular project in terms of which the immovable property has been acquired;¹¹³
- a donation made by a company to any other company, that is a resident of the republic,¹¹⁴ and that is a member of the same “group of companies”¹¹⁵ as the donor-company;¹¹⁶ and
- so much of any *bona fide* contribution made by the donor towards the maintenance of any person as the Commissioner considers reasonable.¹¹⁷

In addition, provision is made for the following basic exemptions:

- in respect of a natural person, no donations tax is payable in respect of so much of the sum of the values of all property disposed of under donations as does not exceed

¹¹² S 56(1)(n).

¹¹³ S 56(1)(o).

¹¹⁴ See par 5.2.2.1.

¹¹⁵ In terms of s 1 a “[g]roup of companies means two or more companies in which one company (hereafter referred to as the ‘controlling group company’) directly or indirectly holds shares in at least one other company (hereafter referred to as the ‘controlled group company’), to the extent that at least 70% of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and the controlling group company directly holds at least 70% of the equity shares in at least one controlled group company.”

¹¹⁶ S 56(1)(r).

¹¹⁷ S 56(2)(c). Apparently this provision exempts only maintenance payments made directly by the taxpayer to the person legally entitled to such maintenance, such as a minor child, a parent or a former spouse (in terms of a court order). See Meyerowitz on Income Tax (2007/2008) par 31.35. Williams (2004) *SALJ* 45 points out (correctly, it is submitted) that the exemption would also apply in respect of maintenance payments to the trustees of a *bewind* trust, where the beneficiary entitled to the trust fund is legally dependent on the person making the payments.



R100 000¹¹⁸ for the year of assessment;¹¹⁹ and

- in respect of a person other than a natural person, donations tax is not payable in respect of so much of the sum of the values of all casual gifts made during the year of assessment that does not exceed R10 000.¹²⁰

5.6 TREATMENT OF TRUSTS

In general terms, a trust (in the narrow sense of the word)¹²¹ is created by a settlor, who entrusts property to trustees to manage for the benefit of another person or persons or for the furtherance of a charitable purpose.¹²² For reasons that will appear from the discussion in paragraphs 5.6.2 and 5.6.3 below as well as in the discussions in Chapters 6 and 7 on the area of trusts, these institutions pose some challenges for wealth transfer taxation.¹²³ As a point of departure, a brief historic overview of trusts and their broad classification in the South African law will be provided.

¹¹⁸ The R100 000 exemption applies to years of assessment commencing on or after 1 March 2007. The previous exemptions were: R50 000 in respect of the year of assessment 1 March 2006 – 28 February 2007; R30 000 in respect of the years of assessment for the period 1 March 2002 – 28 February 2006; R25 000 in respect of years of assessment for the period 28 February 1997 – 28 February 2002.

¹¹⁹ S 56(2)(b).

¹²⁰ S 56(2)(a) (where the year of assessment exceeds or is less than twelve months, the exemption is increased or reduced in the ratio that the year of assessment bears to twelve months).

¹²¹ In the wide sense of the word, a trust exists whenever a person is entrusted with the fiduciary duty to administer the property of another, for example an executor of a deceased estate, an agent on behalf of a principal and a curator on behalf of a patient. See Cameron (2002) par 1; Olivier (2002) *TSAR* 220 and Lyons in Lyons and Jeffery *eds* (2003) 11–13.

¹²² Cameron (2002) par 1.

¹²³ See Ch 6 par 6.6 and Ch 7 par 7.4.6.



5.6.1 A Brief Historic Overview and Classification of Trusts

5.6.1.1 *The Origin and Development of Trusts*

The trust figure has principally developed in England. In terms of English property law the legal and beneficial ownership in property can be split. As a consequence, the law distinguishes between a “legal estate” (developed in terms of common law) and an “equitable estate” (developed in terms of equity law). This phenomenon is referred to as the principle of “dual ownership”. The trust figure developed as a mechanism whereby a person (the settlor) can pass the legal interest in property to one person and the beneficial interest therein to another. Apparently, the trust developed from the feudal “use” figure where “feoffees” (the equivalent of modern trustees) held the land of a monastery for the benefit (the “use”) of the monks, a practice that goes back to the eleventh century. However, the use was later broadly employed to avoid the payment of feudal dues and taxes. In 1535, King Henry VIII endeavoured to counter this loophole by enacting the *Statute of Uses*, which converted all English equitable estates that were created through uses to legal estates. Thus, the granting of property “to A for the use of B” would have resulted in A losing title and B acquiring the full title to the property. However, the *Statute* was circumvented by granting “a use to A in trust for B” and a trust was invented.¹²⁴

The English trust was transposed into common-law systems such as the United States, as a consequence of which the institution is commonly referred to as the “Anglo-American trust”. However, in view of the fact that civilian law (based on Roman law) does not recognise the separation of legal and beneficial ownership, the trust idea has traditionally been foreign to civil-law systems.¹²⁵ These systems have employed institutions such as

¹²⁴ Lyons in Lyons and Jeffery *eds* (2003) 17–19. For further reading on the English trust, see Sonneveldt in Sonneveldt and Van Mens *eds* (1992) 1–4; Lupoi (2000) 95–200; Sonneveldt Doctoral Thesis (2000) Ch 2, 3 and 4; Cameron (2002) pars 9–14 and Coetzee LLD Thesis (2006) Ch 3.

¹²⁵ Lyons in Lyons and Jeffery *eds* (2003) 14–15.



the usufruct or the *fideicommissum* to create successive interests in property.¹²⁶ Nonetheless, numerous civilian systems have introduced trust-like institutions into their law.¹²⁷

When the British settlers began to make use of a trust in the nineteenth century, the South African courts were confronted with this common-law institution.¹²⁸ However, because of the legal system's Roman-Dutch heritage, the English trust law could not serve as a basis for trusts in South Africa,¹²⁹ the legal system of which can predominantly be classified as a civilian system (with strong English influence). The question whether a trust could be accepted under the South African law was settled by the Supreme Court of Appeal in *Crookes NO v Watson*,¹³⁰ where the court decided that an *inter vivos* trust (a trust created during the lifetime of the settlor) is a form of a *stipulatio alteri* (benefit on behalf of a third party).¹³¹ In respect of a *mortis causa* trust (a trust created in the will of the testator), the court held that it is a *sui generis* institution.¹³² As a consequence, the country

¹²⁶ Lyons in Lyons and Jeffery *eds* (2003) 7 n 4 refers to A Dyer and H van Loon "Trusts and Analogous Institutions" Preliminary Document 1 (May 1982) in *The Hague Conference on Private International Law, Acts and Documents II, Proceedings of 15th Session: Trusts – Applicable Law and Recognition* (1985). See also Lyons (2009) *Private Client Business* 33 n 3 and accompanying text.

¹²⁷ For further reading on the reception of trust-like figures in civilian systems, see Hayton, Kortmann and Verhagen (1999); Hayton (1999) Ch 2–4; Lupoi (2000) Ch 5; Lyons in Lyons and Jeffery *eds* (2003) 22.

¹²⁸ See Cameron (2002) par 8 for a historic overview.

¹²⁹ *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 859; *Crookes v Watson* case 285.

¹³⁰ 1956 (1) SA 277 (A).

¹³¹ *Crookes v Watson* case 285. This was followed and confirmed in *Hofer v Kewitt NO* 1998 (1) SA 382 (SCA) 386–387. This viewpoint has not escaped academic criticism. See Olivier LLD Thesis (1982) 319–331 for a summary of some viewpoints. See also the criticism expressed by Cameron (2002) par 16, where the writer acknowledges the fact that an *inter vivos* trust is usually created by way of a *stipulatio alteri*, but where he warns that "this does not establish that trusts *inter vivos* are contracts or a species of contract, and the suggestion that 'in our law a consensual trust is nothing but a contract' suggests an unfortunate reductionism that ignores the subtlety of 200 years of historical development, while threatening to impoverish our law of obligations. A contract is not a public-law institution and the courts have no general protective supervisory jurisdiction over contracting parties, [as in the case of trusts]." See also Davis, Beneke and Jooste (2009) par 5.3.

¹³² See *Braun v Blann and Botha* case 859. In this case the court rejected the view that a testamentary trust could be construed as *fideicommissum purum*. See Cameron (2002) pars 29–34 for a discussion on the differences between a trust and a *fideicommissum*.



developed its own system of trust law, which is basically a mixture of English, Roman-Dutch and distinctively South African rules.¹³³ In 1988 the Trust Property Control Act¹³⁴ came into force, which is largely focused on administrative matters and establishing control over trustees by the Master of the High Court. The Act is therefore by no means an attempt to codify the South African trust law.¹³⁵

5.6.1.2 No Rule against Perpetuities

What is of particular importance in the context of wealth transfer taxation is that there is no “rule against perpetuities” in the South African trust law, which means that a trust can remain in operation indefinitely.¹³⁶

¹³³ Cameron (2002) par 8. For further reading on South African trust law, see in general Olivier LLD Thesis (1982); Strydom LLD Thesis (2000); De Waal (2000) *SALJ* 548 *et seq*; Olivier (2001) *SALJ* 224 *et seq*; Cameron (2002); Coetzee LLD Thesis (2006); Du Toit (2007); De Waal and Schoeman-Malan (2008) 168–186 and Davis, Beneke and Jooste (2009) section B Ch 5.

¹³⁴ Act 57 of 1988.

¹³⁵ Davis, Beneke and Jooste (2009) par 5.2.

¹³⁶ Du Toit (2007) par 7.6; Olivier and Honiball (2008) 266. It may seem as if the Immovable Property (Removal or Modification of Restrictions) Act 94 of 1965 imposes some form of a restriction on the perpetual operation of trusts. In terms of section 8(1) of this Act no restriction against the alienation of immovable property imposed by any will or other instrument (otherwise than by way of *fideicommissum*), which provides for benefits for successive beneficiaries named therein, is effectual to prohibit or restrict the alienation of the immovable property after a right to enjoy any benefit in connection with or derived from immovable property or any fund of which it forms part has in terms of the will or other instrument vested in the third successive beneficiary. However, Du Toit (2007) par 7.6 points out that this rule does not establish a rule against perpetuities, but merely imposes a limitation on the operational effectiveness of any restrictions other than a *fideicommissum*. What is most important to observe, however, is that s 8(2) provides that the proceeds of the property would remain subject to the trust, as a consequence of which the trust can still remain operative in perpetuity.



5.6.1.3 *The Personification of Trusts for Purposes of Income Tax and Capital Gains Tax*

The judiciary has, on several occasions, confirmed that a trust is not a separate legal person.¹³⁷ Because the Income Tax Act levies income tax on a “person”, and in the absence of any special provision deeming a trust to be a “person” at that stage, the court confirmed in *CIR v Friedman NNO and Others*¹³⁸ that a trust cannot be regarded as a person capable of being taxed under the Income Tax Act.¹³⁹ However, the definition of “person” was subsequently amended to expressly include a trust.¹⁴⁰ Section 25B was also introduced, in terms of which it is arranged that trust income will (subject to certain specific exceptions)¹⁴¹ be deemed to accrue in the hands of a beneficiary to the extent that he or she has obtained a vested right to such income in the fiscal year in which the income is received by or accrued to the trust. On the other hand, where no beneficiary has obtained a vested right to such income, then it will accrue to the trust itself.¹⁴² Although a trust has basically been personified for the purposes of the income tax, it is evident that the legislature embraced in its approach the idea that a trust is merely a *conduit pipe*¹⁴³ to the eventual beneficiaries. This trend was also adopted for the purposes of capital gains tax. The vesting of an interest in an asset of a trust in a beneficiary, either by virtue of the provisions of a trust deed or by virtue of the exercise of the trustees’ discretion in the

¹³⁷ *CIR v MacNeillie’s Estate* 1961 (3) SA 833 (A). See also *Braun v Blann and Botha* case 860 and authority cited by Olivier (2002) TSAR 221 n 8.

¹³⁸ 1993 (1) SA 353 (A), 55 SATC 39.

¹³⁹ De Koker and Williams Vol 2 (2009) par 12.14.

¹⁴⁰ See s 1 “person”.

¹⁴¹ See s 7.

¹⁴² S 25 (1) and (2). For further reading on trusts and income tax, see De Koker and Williams Vol 2 (2009) pars 12.14–12.30.

¹⁴³ In *Armstrong v CIR* 1938 AD 343, 10 SATC 1 the court held that a trust is a mere *conduit pipe* to the beneficiaries and that the income retains its identity until it reaches them. See also *SIR v Rosen* 1971 (1) SA 173 (AD), 32 SATC 249. See De Koker and Williams Vol 2 (2009) par 12.16 for a discussion of these cases.



event of a discretionary trust, constitutes a disposal by the trustees on the date that the interest vests.¹⁴⁴ However, the capital gains tax regime attributes any gain that accrues as a result of such appointment (over the duration of the period that the assets were kept on trust) to a resident beneficiary.¹⁴⁵ The actual distribution of any trust asset to a beneficiary does not constitute a further disposal for purposes of capital gains tax.¹⁴⁶ Where the trustees dispose of property to a third party, the trustees will be liable for capital gains tax on any taxable capital gain in accordance with the normal rules, unless such a gain is attributed by them to a resident beneficiary, in which case the gain will be taxed in the hands of the beneficiary.¹⁴⁷

5.6.1.4 Ownership Trusts and Bewind Trusts

Where property is transferred into a trust, the nature of the beneficiaries' interests *vis-à-vis* the trust property becomes extremely relevant. Although trusts can be classified according to various criteria, this thesis will identify two main types of trusts, namely a "bewind trust" and an "ownership trust".¹⁴⁸

A "bewind trust" is a trust where a settlor transfers the ownership of assets to beneficiaries to be administered on their behalf by trustees.¹⁴⁹ The capital beneficiaries have vested *real* rights in the trust property.¹⁵⁰

¹⁴⁴ Par 11(1)(d) read with par 13(1)(d) Eighth Schedule to the Income Tax Act.

¹⁴⁵ Par 80(1) Eighth Schedule to the Income Tax Act.

¹⁴⁶ Par 11(2)(e) read with par 13(1)(d) Eighth Schedule to the Income Tax Act.

¹⁴⁷ Par 80(2) Eighth Schedule to the Income Tax Act.

¹⁴⁸ It is to be noted that the definition of a "trust" in the Trust Property Control Act s 1 envisages both trusts, namely where ownership of the assets vests in the trustees (the so-called "ownership trust", par a) and where ownership of the assets vests in the beneficiaries (the so-called "bewind trust", par b).

¹⁴⁹ Cameron (2002) par 357; Olivier (2002) *TSAR* 220.

¹⁵⁰ Strydom LLD Thesis (2000) 250 n 99, n 100 and accompanying text; Coetzee LLD Thesis (2006) 311 n 170.



However, the most common type of trust is an “ownership trust” where a settlor transfers assets to trustees to be held and administered for the benefit of certain determinable beneficiaries. The important aspect is that ownership of the assets vests in the trustees (in their capacity as such).¹⁵¹ It is, however, crucial to establish whether or not the beneficiaries have vested or contingent interests.¹⁵² In this regard it is necessary to distinguish between the trust income and the trust capital. The trustees may have the discretion to distribute the trust capital according to their sole discretion, or they may be bound by certain directions in the trust deed. In respect of the trust income, the trustees may similarly have the discretion to distribute the income among the beneficiaries, or they may be obliged to distribute or accumulate the income in accordance with the set provisions of the trust deed.¹⁵³ It may also happen that a beneficiary or beneficiaries have vested rights to the trust income of a trust, but the trustees have the discretion to allocate the trust capital among the beneficiaries. Where a beneficiary *may* benefit under a trust (depending on the discretion of the trustees), such a beneficiary has a contingent interest (*spes*) to the trust income or trust capital (whatever the case may be).¹⁵⁴ Where a beneficiary has a vested (and certain) right, such an interest is classified as a right *in personam*, and not a real right. This will be the position even where the beneficiary has a vested right in the trust capital, unless such beneficiary possesses a personal right to the transfer of ownership of a specific property (*ius in personam ad rem acquirendam*).¹⁵⁵ By contrast, the beneficiary under English law has a form of ownership in the trust property, namely “equitable ownership”.¹⁵⁶

¹⁵¹ Olivier (2002) TSAR 220.

¹⁵² See Cameron (2002) par 347 for a discussion on the difference between vested and contingent rights.

¹⁵³ Olivier (2002) TSAR 222–223.

¹⁵⁴ *CIR v Sive's Estate* 1955 (1) SA 249 (A). See also authority cited by Cameron (2002) par 348 n 41.

¹⁵⁵ Cameron (2002) pars 8, 14 and 349 (and authority cited there). These rights would vest upon acceptance by the beneficiaries. See *Crookes NO v Watson* case 286.

¹⁵⁶ Cameron (2002) par 8.



In practice, trusts under which the beneficiaries have vested rights are often referred to as vested (or vesting) trusts, whereas trusts where the beneficiaries have discretionary rights are commonly referred to as discretionary trusts.

Where the identities of the income beneficiaries differ from the capital beneficiaries, the courts usually classify the vested right of an income beneficiary as either a usufructuary interest or a fideicommissary interest. In the case of a usufructuary interest, the capital beneficiary will be regarded as having a vested right in the trust property (which is valued according to the same principles as *bare dominium* property). On the other hand, where the income beneficiary's right is classified as a fideicommissary interest, the capital beneficiary will not be regarded as having a vested right to the trust capital.¹⁵⁷

5.6.2 A Donation to a Trust: The Common-Law Position

Although one can accept that a donation to a bewind trust would be construed as a donation to the beneficiary or beneficiaries under the trust, it seems as if the common-law position is unclear on whether a donation to an ownership trust constitutes a donation to the trustees or to the beneficiaries. In *CIR v Smollan's Estate*¹⁵⁸ Van der Heever AJ expressed the view that such a transfer does not constitute a true donation to the trustees, in view of the fact that the trustees are not enriched,¹⁵⁹ although the judge acknowledged the possibility that the transfer could be a donation to the beneficiaries by using the construction of a donation through an intermediary (*etiam per interpositam personam donation consummari fideicommissum inter vivos*), where the trustees are mere conduits to confer an offer of donation.¹⁶⁰ On the other hand, *Oost v Reek and Snyderman*¹⁶¹

¹⁵⁷ See *Hilda Holt Will Trust v CIR* 1992 (4) SA 661 (A); Olivier and Honiball (2008) 266.

¹⁵⁸ 1955 (3) SA 266 (A).

¹⁵⁹ *Smollan* case 272.

¹⁶⁰ *Smollan* case 272. See Cameron (2002) par 20 and 21.

¹⁶¹ 1967 (1) SA 472 (T).



provides authority for the view that a gratuitous transfer to an ownership trust constitutes a donation to the trustees. Cameron mentions that this approach is analogical to the direction taken in *Kohlberg v Burnett*,¹⁶² where the Appellate Division (as it then was) decided that a bequest to an *inter vivos* property trust is legal and effective.¹⁶³ Although the trust is not a legal person, the trustees are entitled to act on behalf of the trust and to hold, in their capacities as trustees, property for the purposes of the trust.¹⁶⁴ The court held that the bequest was valid, notwithstanding the fact that the trustees were not beneficially entitled to the property.¹⁶⁵ In *Crookes NO v Watson*,¹⁶⁶ Van der Heever AJ (the same judge who expressed the opinion in the *Smollan Estate* case) was prepared to say that two donations occur: a donation to the trustee and a donation to the beneficiaries.¹⁶⁷

5.6.3 Trusts and Donations Tax

The uncertainty of the legal position in respect of a donation to a trust was also mirrored in the realm of estate duty and donations tax. In *CIR v Estate Merensky*,¹⁶⁸ which was decided under the former Death Duties Act,¹⁶⁹ the court decided that the trustees (of an ownership trust) can receive a donation on behalf of beneficiaries. The approach of the court was substantiated by the fact that the tax levied under the Death Duties Act is a transferor-based tax where the focus is on the divestment of the transferor.¹⁷⁰

¹⁶² 1986 (3) SA 12 (A).

¹⁶³ The trust receiving the bequest is referred to as a “pour-over” trust. See Davis, Beneke and Jooste (2009) par 5.10.

¹⁶⁴ *Kohlberg v Burnett* case 25.

¹⁶⁵ *Kohlberg v Burnett* case 26. See Cameron (2002) par 20.

¹⁶⁶ 1956 (1) SA 277 (A).

¹⁶⁷ *Crooks v Watson* case 298–299.

¹⁶⁸ 1959 (2) SA 600 (A), 22 SATC 343.

¹⁶⁹ Act 29 of 1922.

¹⁷⁰ *Estate Merensky* case 361.



However, when donations tax was enacted, it seems as if the legislature intended to eliminate any confusion by referring in the principal levying provision to property disposed of under a donation, “whether in trust or not”.¹⁷¹ Furthermore, the definition of “donee” includes a trustee in a case where property has been disposed of to such a trustee to be administered by him or her for the benefit of any trust beneficiary, provided that any donations tax payable by any trustee in his capacity as such may, notwithstanding the provisions of the trust deed, be recovered by him from the assets of the trust.¹⁷² It is clear from the wording of these provisions that the trustee(s) should be regarded as the donee(s) under a donation, and not the beneficiaries, even in the case of a bewind trust.¹⁷³

5.7 GENERAL ANTI-AVOIDANCE RULE

Apart from the fact that the Commissioner would, in terms of established common-law principles,¹⁷⁴ in principle be entitled to levy donations tax on a simulated transaction or transactions (the substance and nature of which can be equated with a donation or a disposal for inadequate consideration), the Commissioner may also rely on the provisions

¹⁷¹ See par 5.2.1.

¹⁷² S 55(1).

¹⁷³ Cameron (2002) 22. See *ITC 891* (1959) 23 SATC 354.

¹⁷⁴ The so-called “substance over form” principle has been acknowledged in the realm of tax avoidance by the Supreme Court of Appeal in *Erf 3183/I Ladysmith (Pty) Ltd & Another v CIR* 1996 (3) SA 942 (A), 58 SATC 229 and *Relier (Pty) Ltd v CIR* (1998) 60 SATC 1. See Olivier (1996) *TSAR* 378 *et seq* and Olivier (1998) *SALJ* 646 *et seq* for a discussion on these cases. It is submitted that the principle was also tacitly applied in earlier cases, such as *SIR v Hartzenberg* 1966 (1) SA 405 (A) (that dealt with a transfer duty issue). See Burt (2004) *SALJ* 751–752, where the writer submits that the recent trend developed in the English law as a consequence of the decisions in *Furniss (Inspector of Taxes) v Dawson* [1984] AC 474 (HL) and *WT Ramsey Ltd v IRC* [1982] AC 300 (HL) (namely to construct and give effect to legal acts and agreements according to their true nature and character and to levy taxation accordingly (see Ch 8 par 8.8), is “faintly echoed in our jurisprudence” in the *Hartzenberg* case. But *cf* Derksen (1990) *SALJ* 416 *et seq*. However, Olivier (1996) *TSAR* 383 explains that all tax avoidance schemes cannot merely be struck down as a consequence of the “substance over form” doctrine. The well-known principle corroborated in *Duke of Westminster* [1936] AC 1 (HL) at 19–20, namely that a taxpayer has a right to arrange his affairs to his best advantage and that a taxing statute seeking to recover tax should do so within the letter of the law, is still applicable. The qualifying requirement is that the supporting documents should be given effect to. For further reading on the common law principles in the realm of tax avoidance, see in general Derksen LLD Thesis (1989); Williams in *LAWSA* (2009) pars 702–703 and Olivier and Honiball (2008) 385–390.



of the statutory general-anti avoidance rule as contained in Part IIA (sections 80A-L) of the Income Tax Act.¹⁷⁵

Part IIA deals with an impermissible tax avoidance arrangement, the definition of which requires several elements. Most importantly, it is required that the sole or main purpose of the arrangement must be to obtain a tax benefit.¹⁷⁶ In the context of a business, it is furthermore required that the arrangement must have been entered into or carried out by means or manner which would not normally be employed for *bona fide* business purposes (other than obtaining a tax benefit); or which lacked commercial substance.¹⁷⁷ In a context other than a business (which would normally be the position in the case of a disguised donation), it is required that the arrangement must have been entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose (other than obtaining a tax benefit). An alternative test (for any context), which would bring an arrangement within the ambit of the anti-avoidance rules, is where the arrangement has created rights or obligations that would not normally be created between person's dealing at arm's length; or would result directly or indirectly in the misuse or abuse of the provisions of the Act.¹⁷⁸

If the Commissioner is satisfied that an arrangement meets the requirements as set out above, he or she is empowered to determine the tax consequences by disregarding, combining or re-characterising any steps in the arrangement, or by disregarding any

¹⁷⁵ Part IIA replaced the previous general anti-avoidance rule, which was contained in s 103 of the Act with effect from 2 November 2006. See Williams in *LAWSA* pars 704–713 for a discussion on the old s 103 and pars 714–724 for a discussion on the new regime.

¹⁷⁶ S 80G provides that an arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining such benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the arrangement.

¹⁷⁷ An arrangement would lack commercial substance if it would result in a significant tax benefit for a party, but does not have a significant effect on either the business risks or the net cash flows of that party (apart from any effect attributable to the intended tax benefit). See s 80BC.

¹⁷⁸ S 80A. For further reading, see De Koker and Williams Vol 3 (2009) Ch 19; Meyerowitz on Income Tax (2007/2008) Ch 29.



accommodating or tax-indifferent party or treating any such party and any other party as one and the same person. The Commissioner may furthermore deem persons who are connected persons in relation to each other to be one and the same person and reallocate or re-characterise any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties. In addition, he or she may treat the arrangement as if it had not been entered into or carried out, or in such other manner as he or she deems appropriate.¹⁷⁹

5.8 CAPITAL GAINS TAX

5.8.1 Capital Gains Tax Consequences

A donation of an asset constitutes a disposal for capital gains tax purposes.¹⁸⁰ The donor is treated as having disposed of the assets for a consideration equal to the market value of that asset at the date of the disposal.¹⁸¹ The person who acquires the asset is treated as having acquired it at a cost equal to the market value.¹⁸² Roll-over relief is available for disposals between spouses.¹⁸³

5.8.2 Interaction with Donations Tax

In determining a capital gain or loss on the disposal of an asset by virtue of a donation a portion of the donations tax paid is added to the base cost of the asset.¹⁸⁴

¹⁷⁹ S 80B.

¹⁸⁰ Par 11(1)(a) Eighth Schedule to the Income Tax Act. See in general De Koker and Williams Vol 3 (2009) par 24.23.

¹⁸¹ Par 38(1)(a) Eighth Schedule to the Income Tax Act.

¹⁸² Par 38(1)(b) Eighth Schedule to the Income Tax Act.

¹⁸³ Par 67(1) Eighth Schedule to the Income Tax Act.

¹⁸⁴ Par 20(1)(vii) and (viii) Eighth Schedule to the Income Tax Act. For further reading and example calculations, see Davis, Beneke and Jooste (2009) par 9.3.4.



5.9 CONCLUSIONS

This chapter provided an overview of the main characteristics of donations tax. The following chapter will provide an overview of the main principles of estate duty.



CHAPTER 6

A CONTEMPORARY OVERVIEW OF ESTATE DUTY IN SOUTH AFRICA

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6.1 INTRODUCTION AND BROAD OVERVIEW OF ESTATE DUTY

As has been pointed out above,¹ estate duty is currently levied in terms of the Estate Duty Act of 1955 (hereafter “the Act”).² The duty is levied on the dutiable amount of a

¹ Ch 1 par 1.1.

² Act 45 of 1955.



deceased estate,³ which is calculated by determining the gross value of all the deceased's property and deemed property at the date of his or her death⁴ less any allowable deductions and less the primary abatement.⁵ The tax is levied at the rates set out in the first schedule to the Act.⁶ The tax was initially levied at progressive rates, but since 1988 it has been levied at a flat rate.⁷ Similar to the position under donations tax,⁸ the initial flat rate of 15 percent was increased to 25 percent in 1996, but decreased to 20 percent in 2001.⁹ From the duty so calculated, certain deductions are granted for transfer duty¹⁰ or foreign death duties paid¹¹ and a rebate in respect of successive deaths.¹²

³ S 2(2).

⁴ As provided for in s 3. See par 6.2.4.

⁵ As provided for in s 4 and s 4A. See par 6.5.2. See Stein (2004) Ch 1; Meyerowitz (2007) pars 27.1–27.3 and King and Victor (2008/2009) par 13.1 for a brief discussion of the basic calculation principles.

⁶ S 2(2).

⁷ The amendment in respect of the rate structure was effected subsequent to a recommendation by the Margo Commission. See Ch 3 par 3.3.2.3.

⁸ See Ch 5 par 5.1.

⁹ See King and Victor (2008/2009) par 13.1. The 20% rate applies in respect of persons dying on or after 1 October 2001.

¹⁰ S 16(a). See in general Stein (2004) 90; Meyerowitz (2007) par 30.8 and King and Victor (2008/2009) par 13.6.1. A deduction is granted for any transfer duty paid in respect of the acquisition from the deceased or his estate of any property included in the estate, by any person liable for the duty attributable to that property. In view of the fact that no transfer duty is payable on inherited property (Transfer Duty Act 40 of 1949 s 9(e)), this provision is currently ineffective.

¹¹ S 16(c).

¹² First Schedule to the Estate Duty Act. A rebate is allowed in respect of property included in the estate which formed part of the estate of a person who died within ten years of the deceased (see the first schedule of the Estate Duty Act): If the deceased died within 2 years of the death of the first-dying: 100%, between 2 and 4 years: 80%, between 4 and 6 years: 60%; between 6 and 8 years: 40%, between 8 and 10 years: 20%. See Stein (2004) 90–92 and Meyerowitz (2007) par 30.9 for examples of the relevant calculations.



6.2 TAX BASE

6.2.1 The Estate of Every Person

Unlike the Death Duties Act,¹³ which levied a duty on the “passing of property” on death,¹⁴ the Estate Duty Act levies a tax on the “estate” of “every person” who has died on or after 1 April 1955.¹⁵ The focal point is therefore not the acquisition of an inheritance or a right by a beneficiary, but the ownership of property or rights vested in the deceased (his “estate”) immediately prior to his or her death.

6.2.2 Jurisdictional Basis

Although there seems to be no domiciliary, residential or geographical limitations in respect of the deceased persons liable under the primary charging provision in the Act, a distinction is drawn on the basis of residency – i.e. in respect of property of a person who died whilst ordinarily resident in the Republic of South Africa (“the republic”) and the property of a person who was not so resident at the date of his or her death.

6.2.2.1 Residency

Except for a few exceptions (that will be discussed below), all the property of a person who died ordinarily resident in the republic is in principle chargeable under the Act. Although “ordinarily resident” is not specifically defined, its meaning is regarded to be similar to the meaning that the judiciary has attached to the same concept under income tax legislation, where this term has also been used but not defined.¹⁶

¹³ Act 29 of 1922.

¹⁴ In *CIR v Estate Kohler & Others* 1953 (2) SA 584 (A) 601 Schreiner JA remarked that the expression “passing under a donation” means no more than “covered by or involved in a donation”. At 602 he added that “the word ‘pass’ in this kind of legislation is borrowed from the English provisions, where it is more at home than with us”.

¹⁵ S 2(1).

¹⁶ See Ch 5 par 5.2.2.1.



All of an ordinary resident's worldwide property is, however, not necessarily dutiable under the Act. Provision is made for the deduction of property included in the deceased estate, situated "outside the Republic",¹⁷ and acquired by the deceased:

- before he or she became ordinarily resident in the republic for the first time,¹⁸ or,
- in respect of property acquired by him or her after he or she became ordinarily resident for the first time,
 - if such property was donated to him or her by a person (other than a company) not ordinarily resident in the republic (at the date of donation),
or
 - inherited by him or her from a person, who at the date of his or her death was not ordinarily resident in the republic,¹⁹ or

acquired by him or her out of profits or proceeds of any such property, proved to the satisfaction of the Commissioner to have been acquired out of such profits or proceeds.²⁰

6.2.2.2 Location of Assets

Where the deceased was not ordinarily resident in the republic on his or her death, certain "foreign" properties would basically be excluded from the tax. The Act provides for the exclusion of the following six categories of property:

¹⁷ The Act requires that the property is "situate outside the Republic" at the date of death. The value of foreign property that was acquired by the deceased before he became ordinarily resident in the republic, but that was brought or transferred into the republic prior to the date of death, would therefore not constitute an exclusion. See Meyerowitz (2007) par 28.13.

¹⁸ S 4(e)(i). See in general Meyerowitz (2007) par 28.13.

¹⁹ S 4(e)(ii). See in general Meyerowitz (2007) par 28.13.

²⁰ S 4(e)(iii). See in general Meyerowitz (2007) par 28.13. See also discussion by Stein (2004) *Tax Planning* 95–96. According to Stein (at 96) there are two possible interpretations for the requirement that the exemption applies only to a person "after he [or she] became ordinarily resident for the first time". On the one hand, in the case where a person was born in the republic, left the republic for some time and then returned to it, it may be argued that the deduction should be available in respect of all donations and inheritances from foreigners at any time. On the other hand, it may be argued that that the provision applies only to a person who became ordinarily resident in the republic after first having been ordinarily resident elsewhere.



- (a) any right in immovable property situated outside the republic;²¹
- (b) any right in movable property physically situated outside the republic;²²
- (c) any debt not recoverable or right of action not enforceable in the courts of the republic, as well as any income derived from such debt or right of action;²³
- (d) any goodwill, licence, patent, design, trade mark, copyright or other similar right not registered or enforceable in the republic or attaching to any trade, business or profession in the republic, as well as any income derived from such goodwill, licence, patent, design, trade mark, copyright or other similar right;²⁴
- (e) any stocks or shares²⁵ held by him in a body corporate which is not a company,²⁶ and any stocks or shares held by him in a company in respect of which any change in ownership is not required to be recorded in the republic, as well as any income derived from such stocks or shares.²⁷

²¹ S 3(2)(c). See in general Stein (2004) 13 and Meyerowitz (2007) par 27.11. The concept “immovable property” includes limited interests in such property. See Davis, Beneke and Jooste (2009) par 2.3.3.1.

²² S 3(2)(d). See in general Stein (2004) 13 and Meyerowitz (2007) par 27.12. The concept “movable property” includes limited interests in such property. See Davis, Beneke and Jooste (2009) par 2.3.3.2.

²³ S 3(2)(e) and (h). Stein (2004) 12 refers to a life insurance policy issued by a foreign insurer and stocks and bonds issued by foreign governments. Meyerowitz (2007) par 27.10 refers to an annuity which is not enforceable in the courts of the republic. See also Meyerowitz (2007) pars 27.13 and 27.19.

²⁴ S 3(2)(f) and (h). See in general Stein (2004) 13 and Meyerowitz (2007) pars 27.14 and 27.19.

²⁵ “Stocks or shares” are defined in s1 as: “in relation to any company means any part of the share capital or member’s interest of that company and includes any debenture, debenture stock or any other like form of marketable security”. The definition is wide enough to include a member’s interest in a close corporation. See in general Stein (2004) 14.

²⁶ “Company” is defined in s 1 as: “any association incorporated or registered under any law in force in the Republic and any association which, although not so incorporated and registered, carries on business or has an office or place of business or maintains a share transfer register in the Republic”. The definition is wide enough to include a close corporation established under the Close Corporations Act of 1984. See in general Stein (2004) 14.

²⁷ S 3(2)(g) and (h). Stein (2004) 14 states that this exclusion would apply if the company law of the country of incorporation requires the shares to be registered in that country only, even if the company is trading in the republic. The exclusion would, however, not apply in the case where a company has its principal register in South Africa, even if the shares in foreign branches are registered in branch registers overseas. See also Meyerowitz (2007) pars 27.15–27.19 and Davis, Beneke and Jooste (2009) par 2.3.3.5.



Estate duty is therefore primarily levied on a worldwide basis, because the worldwide property of a person who died ordinarily resident in the country (with the exclusion of certain foreign assets listed above) falls within the jurisdictional basis of the tax. For the purposes of other persons (who were not ordinarily resident in the country at death), the tax base is extended to property or rights connected to the republic by location, registration or enforcement.

The Katz Commission concluded that donations tax and estate duty are effectively levied on a “source basis”, apparently in view of the fact that certain foreign assets belonging to resident donors fall outside the tax net.²⁸ It is submitted that this statement is technically incorrect.²⁹ Firstly, the term “source basis” is derived from income taxation where the “source” of income is used as a connecting factor to define the tax base.³⁰ Under wealth transfer taxation, the term “*situs* basis” would probably be a better term to describe the tendency to tax the transfer of property located in the jurisdiction where the taxpayer is not a resident (or domiciliary) of the jurisdiction. Secondly, donations tax and estate duty are primarily levied on the worldwide property of respectively “residents” and persons “ordinarily resident” in the republic.³¹ Foreign assets are only excluded to the extent that they meet the requirements. Furthermore, assets located in the republic belonging to non-residents fall outside the scope of donations tax, which is in contrast with a *situs*-based approach.

6.2.3 Double Taxation

Relief for double taxation can be provided through double taxation agreements or, in the absence thereof, the granting of a unilateral tax credit in terms of section 16(c) of the Act.

²⁸ Fourth Interim Katz Report (1997) par 13.1.

²⁹ This submission is supported by Davis, Beneke and Jooste (2009) par 18.3.6.

³⁰ See Ch 5 par 5.2.2.

³¹ For donations tax purposes, see Ch 5 par 5.2.2.



Certain double taxation agreements, concluded with Botswana, Lesotho and Swaziland, the United States of America and Zimbabwe, under the provisions of the Death Duties Act, are still in force in view of the fact that the agreements continue to apply in respect of any similar taxes subsequently enacted by the contracting states. The only agreements entered into under section 26 of the Estate Duty Act are the agreements with Sweden (terminated with effect from 1 January 2005) and the United Kingdom (still in force).³²

The general trend followed in all the agreements is that a contracting state is usually awarded the right to tax certain assets located in such state. The other state should either refrain from taxing those assets or provide a tax credit in respect of any tax payable in the first-mentioned state. The state in which the deceased was domiciled or ordinarily resident (in accordance with the rules of the agreement) usually has the right to levy taxation in respect of any other assets. What is of importance is that the fiscal domicile or residence is established with reference to the “deceased”.

Section 16(c) provides that, without modifying or adding to the rights of a person flowing from a double taxation agreement, where foreign death duty is levied on property situated outside the republic belonging to a person ordinarily resident at the date of his or her death, any such tax payable may be deducted from any estate duty payable in respect of such property (provided that the deduction may not exceed the amount of estate duty).³³

6.2.4 Object of Taxation: Property

The Act provides that the estate of any person shall consist of all “property of that person” as at the date of his or her death (as provided for in section 3(2)) together with all

³² The double taxation agreements are available at <http://www.sars.gov.za> (accessed on 28 August 2009).

³³ See in general Stein (2004) 89–90; Meyerowitz (2007) par 30.8 and King and Victor (2008/2009) par 13.6.2.



“property deemed to be the property of that person” (as provided for in section 3(3)).³⁴

6.2.4.1 Property

Section 3(2) provides a comprehensive description of property by declaring what it includes, as well as what it excludes. A deceased estate consists primarily of any right in or to property, whether “movable or immovable, corporeal or incorporeal”,³⁵ of the deceased at the date of his or her death.³⁶ The judiciary has confirmed that property as defined only embraces rights “vested” in the deceased at the date of his or her death, which means that a *spes* (such as a *spes* by a beneficiary to benefit from a trust) and a conditional right would be excluded.³⁷

Although the Act discarded the wording “passes on death”, as in the Death Duties Act, Meyerowitz submits that the meaning of “property passing”, as set out in *Estate Crewe v CIR*,³⁸ namely “all the proprietary rights of the deceased which continue in existence after his death and constitute assets in his estate, in contradiction, *inter alia*, to those which cease and determine on his death”, is equally applicable to “property of that person”. This conclusion implies that the property (or the rights thereto) must be transferable.³⁹ This would also explain why the legislature chose to deem certain rights (which cease at the

³⁴ S 3(1).

³⁵ See Ch 5 par 5.2.4 n 40 for meaning of “movable”, “immovable”, “corporeal” and “incorporeal”.

³⁶ S 3(1) read with s 3(2). See in general Stein (2004) 11–12 and Meyerowitz (2007) pars 27.21–27.27. If the deceased was married in community of property, only the share of the deceased constitutes his or her property. Property would also include all proprietary rights that continue to exist after the date of death of the deceased. See Stein (2004) 12; *CIR v Estate Crewe and Another* 1943 AD 656, 12 SATC 344 (decided under the Death Duties Act, but still instructive) and *CIR v Estate Hersov and Others* 1952 (4) SA 559 (A), 18 SATC 261 (decided under the Death Duties Act, but still instructive).

³⁷ See *CIR v Sive's Estate* 1955 (1) SA 249 (A), 20 SATC 66 (decided under the Death Duties Act, but still instructive) and *Burger v CIR* 1956 (1) SA 534 (W), 20 SATC 277 (decided under the Death Duties Act, but still instructive). See Stein (2004) 20 and Strydom LLD Thesis (2000) 253–267 for further reading.

³⁸ *Estate Crewe* case 666, 689.

³⁹ Meyerowitz (2007) par 27.21. Strydom LLD Thesis (2000) 229 concurs. See also discussion by Strydom LLD Thesis at 236–250.



death of the testator, to be property of the deceased. Although these ceasing rights are not “transferable” to another in the true sense of the word, their cessation results in the creation or expansion of someone else’s rights *ex lege*. The Act includes the following interests in property that were enjoyed by the deceased up to the time of his or her death:

- any fiduciary,⁴⁰ usufructuary⁴¹ or other like interest in property (including a right to an annuity⁴² charged upon property⁴³) held by the deceased immediately prior to his or her death;⁴⁴
- any right to an annuity (other than a right to an annuity charged upon any property) enjoyed by the deceased immediately prior to his or her death, which accrued to some other person on the death of the deceased.⁴⁵

⁴⁰ For the meaning of a fiduciary interest, see Ch 5 par 5.2.4 n 45. See also Stein (2004) 20–21.

⁴¹ For the meaning of a usufructuary interest, see Ch 5 par 5.2.4 n 42. In *Estate Watkins-Pitchford v CIR* 1955 (2) SA 437 (A) Centlivres CJ described the difference between a usufructuary interest and a fiduciary interest as follows (at 447): “... in the case of a fiduciary interest, the fiduciary has a vested right in the corpus of the fideicommissary property and may on the failure of the *fideicommissarius*, acquire full dominium in the property in respect of which he holds a fiduciary interest, whereas in the case of a usufructuary interest the usufructuary has no vested right in the corpus of the property in respect of which the usufruct is held and can never acquire the full dominium of that property”. See also *CIR v Lukin’s Estate* 1956 (1) SA 617 (A); *Estate Koster v CIR* 1963 (2) SA 716 (C) and Stein (2004) 21.

⁴² The term “annuity” is not defined in the Act, but its characteristics are: (a) it is a fixed annual payment (even if it is divided in installments), (b) it is repetitive, (c) it is chargeable against property or is an obligation of someone and not merely a payment at will and (d) the capital fund (which gave rise to the annuity) should cease to exist. See *ITC 761* (1952) 19 SATC 103; *CIR v Watermeyer* 1965 (4) SA 431 (A) and *KBI v Hogan* 1993 (4) SA 150 (A) (where it was held at 159 that “[a]nnuities differ from other investments in that the capital sum invested is not returnable when the annuity ceases to be payable”). See also Stein (2004) 22.

⁴³ The term “charged against property” means that there is a particular fund or property out of which the annuity is payable: see *CIR v Estate Hobson* 1933 CPD 386 (decided under the Death Duties Act, but still instructive). Both Meyerowitz (2007) par 27.8 and Stein (2004) 23 submit that there must be a burden on the property by virtue of a real right or a subtraction from *dominium*, and not a mere obligation of a person.

⁴⁴ S 3(2)(a).

⁴⁵ S 3(2)(b). In *SIR v Jordaan* 1967 (3) SA 329 (A) the court stated that it does not matter whether the successor’s right is to a greater or lesser annuity than that enjoyed by the deceased. All that is required is that the deceased’s right ceases and the successor’s right of enjoyment accrues as a consequence of the deceased’s death.



A “like interest in property” would, for example, include an interest such as a *usus* or *habitatio*,⁴⁶ and even a vested right to income under a trust.⁴⁷ Since a limited interest only constitutes property if it was held by the deceased just prior to his or her death, it may be tempting to renounce such an interest just prior to death. However, such renunciation would be subject to donations tax.⁴⁸

The Act specifically excludes from the tax base property belonging to a person who was *not ordinarily resident* in the republic at the date of his or her death (which has already been discussed above).⁴⁹

In respect of persons dying on or after 1 January 2009, the Act furthermore excludes so much of any benefit which is due and payable by, or in consequence of, membership or past membership of any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as defined in the Income Tax Act.⁵⁰ This exclusion, which refers to pension fund benefits payable to the deceased estate, was introduced simultaneously with the removal of the provision deeming pension fund benefits (payable to third parties) to be property of the deceased estate (a provision that remains operative only in respect of persons who passed away before 1 January 2009).⁵¹ The removal of the deeming provision in respect of “deemed property” necessitated a corresponding exclusion from “property”.

⁴⁶ See *Estate Watkins-Pitchford* case 448.

⁴⁷ See *CIR v Lazarus' Estate* 1958 (1) SA 311 (A), SATC 379 393 (decided under the Death Duties Act, but still instructive); *CIR v Jordaan* 1967 (3) SA 329 (A) 335 and *ITC 1520* (1991) 54 SATC 168 172–173. See in general Stein (2004) 22 and Strydom LLD Thesis (2000) 231–234.

⁴⁸ Stein (2004) 20; Meyerowitz (2007) par 27.6 n 4 and accompanying text.

⁴⁹ See par 6.2.2.1.

⁵⁰ S 3(2)(i).

⁵¹ See par 6.2.4.2.2.



6.2.4.2 Deemed Property

The estate of a deceased person consists not only of vested proprietary rights and interests, but also of property which is deemed to be the property of the deceased in accordance with the provisions of the Act,⁵² thereby creating a legal fiction.⁵³ Section 3(3) deems the following assets to be property of the deceased:

6.2.4.2.1 Domestic Life Insurance Policies upon the Life of the Deceased

Although the proceeds of a life insurance policy payable to the deceased estate constitutes property of the deceased according to the general description,⁵⁴ the proceeds payable to a third party (the nominated beneficiary) does not fall within the ambit thereof.⁵⁵ To establish neutrality and to counter possible tax avoidance by merely nominating a third party as the beneficiary of the policy benefits, the Act provides that the benefit so

⁵² S 3(1).

⁵³ Meyerowitz (2007) par 27.28.

⁵⁴ In the *Hersov* case, Centlivres CJ (with reference to the proceeds of a life policy payable to a deceased estate) remarked (at 568) that “the Legislature regarded the deceased as having, during his lifetime, a proprietary right in the policy which passed on his death to his estate”. See Meyerowitz (1952) *Taxpayer* 236 *et seq* for a discussion of this case. See also Editorial (1993) *Taxpayer* 65 and Meyerowitz (2007) par 27.31.

⁵⁵ This position has recently been confirmed. In *Love v Santam Life Insurance* 2004 (3) SA 425 (SCA), the court held that the right to the policy proceeds vested in the nominated beneficiaries directly upon their acceptance of the benefits, and not via the estate of the owner of the policy (who was also the life insured under the policy). The proceeds were therefore never part of the deceased owner’s (insolvent) estate. The deceased’s creditors had no claim against the proceeds which were paid out to the beneficiaries. See also *Warricker NNO v Liberty Life Association of Africa Ltd* 2003 (6) SA 272 (W). This position follows from the fact that a life insurance contract (where the proceeds are payable to a nominated beneficiary) is constructed as a *stipulatio alteri*.



recoverable under any policy of insurance, which is a “domestic policy”⁵⁶ upon the life of the deceased,⁵⁷ should be regarded as deemed property of the deceased.⁵⁸

Because of its wide wording, this provision is, however, not restricted to third-party policies. The proceeds of a domestic policy belonging to the estate, although already included as actual property in the estate, is therefore also expressly deemed to be property of the estate.⁵⁹ However, it is the practice to include these proceeds only once, in order to avoid any double taxation.⁶⁰

The only connecting factor between the domestic life policy and the deceased is that the deceased should be the life insured under the policy agreement. Except for the specific exclusions (discussed below), it is immaterial whether or not the deceased affected the policy, had any financial interest in the policy, or paid the premiums in respect thereof.⁶¹ If, however, a Public Benefit Organisation or a surviving spouse is the beneficiary of the policy, the proceeds of the policy would qualify as a deduction in terms of section 4(h) or 4(q) of the Act, respectively.⁶²

⁵⁶ According to s 1 a “domestic policy means any life policy as defined in section 1 of the Long-term Insurance Act of 1998, issued anywhere upon an application made or presented to a representative of an insurer (or to any person on behalf of such a representative) at any place in the Republic, excluding a life policy which has been made payable at a place outside the Republic, at the request of the owner, but including any life policy issued outside the Republic which has subsequently been made payable in the Republic at the request of the owner”. See in general Davis, Beneke and Jooste (2009) par 2.4.2.1.

⁵⁷ Meyerowitz (2007) par 27.32 submits that “on the life of the deceased” means that death is the contingency upon which the amount becomes due.

⁵⁸ S 3(3)(a). In the case of spouses married in community of property, the total value of a domestic policy would be included in the dutiable estate of the first-dying, whether or not the proceeds are payable to the joint estate. See Editorial (1993) *Taxpayer* 66 and Stein (2004) 13.

⁵⁹ Stein (2004) 12; Meyerowitz (2007) par 27.21.

⁶⁰ Stein (2004) 12.

⁶¹ Stein (2004) 38; Meyerowitz (2007) par 27.29. The 1922 Death Duties Act also included life insurance policies, but only if effected by the deceased, and only to the extent that the deceased paid the premiums. See Death Duties Act s 3(4)(a).

⁶² See par 6.5.2.2.



The value included is the amount due and recoverable to the extent that it exceeds the aggregate amount of any premiums or consideration proved to the satisfaction of the Commissioner to have been paid by the person entitled to the benefits under the policy, together with six percent per annum interest calculated on the premiums paid from date of payment to date of death.⁶³

There are, however, three exceptions to this deeming provision.⁶⁴ Firstly, the proceeds of a policy recoverable by the surviving spouse⁶⁵ or child⁶⁶ of the deceased under a duly registered ante-nuptial or post-nuptial contract⁶⁷ are not deemed to be included in the estate.⁶⁸

The second exemption provided for in the Act relates to the proceeds of a policy effected to fund a so-called “buy and sell arrangement”, which is an agreement between partners or shareholders, where it is agreed that, where one of them dies, the deceased partner or shareholder undertakes to sell, and the remaining partners or shareholders undertake to buy the interest of the deceased partner or shareholder. The exemption applies to the proceeds payable in terms of a policy that was taken out or acquired⁶⁹ by a person who on

⁶³ S 3(3)(a). See Meyerowitz (2007) par 27.34 for a discussion on the deduction of premiums.

⁶⁴ Although the Death Duties Act provided for the exclusion of policy benefits that were ceded by the deceased during his lifetime *bona fide* and for full consideration, otherwise than as security for a sum of money or the fulfillment of any obligation (Death Duties Act s 4(a)(x)), such provision was not included in the Estate Duty Act.

⁶⁵ For the purposes of estate duty, the definition of a spouse (in s 1) is similar to the definition contained in the Income Tax Act. See Ch 5 par 5.5.3 n 93.

⁶⁶ A “child in relation to any person” includes any person adopted by him “(a) under the laws of the Republic, or (b) under the law of any country, other than the Republic, provided the adopted person is under such law accorded the status of a legitimate child of the adoptive parent and the adoption was made at the time when the adoptive parent was ordinarily resident in such country” (s 1 “child”).

⁶⁷ It is not clear what is meant with a “duly registered” contract. Meyerowitz (2007) par 27.36 submits that it appears to mean more than mere execution and that it should be registered in a deeds office in the republic as contemplated in the Deeds Registry Act of 1937.

⁶⁸ S 3(3)(a)(i). See in general Davis, Beneke and Jooste (2009) par 15.2.1.

⁶⁹ This will also include policies that have been acquired by cession. See Stein (2004) 40 and SARS *Buy-Sell Arrangements* (2008) 3.



the date of the death of the deceased was a partner or co-shareholder of the deceased, for the purpose of enabling that person to acquire the whole or part of the deceased's interest in the partnership or share (or like interest) in the company and any claim by the deceased against that company, provided that no premium on the policy was borne by the deceased.⁷⁰

The requirements as set out above have given rise to some interpretation issues, anomalies and inequities, such as the following:

- Where the policy was taken out with the purpose of acquiring the whole or part of the deceased's interest, it appears as if it does not matter whether the proceeds were in fact used to acquire such interest. Conversely, where the policy was taken out or acquired for some purpose other than the acquisition of the deceased's interest, the exclusion would not apply (even where the proceeds were in fact used to acquire the interest).⁷¹
- Apparently the premiums would be "paid or borne" by the deceased even where he or she provided the funds in an indirect way, for example where a company paid the premiums of a policy on the life of the deceased and debited the deceased with the amount thereof on loan account.⁷² Joffe points out that, very often, loan accounts are not created in practice or the premiums are split equally (instead of divided accurately), which would render the proceeds dutiable.⁷³
- It is possible that the proceeds of the policy exceed the value of the deceased's interest or shares. If the difference is substantial, the Commissioner could exercise his discretion and disallow the exemption. However, if the difference could be motivated, for instance by a general decrease in that specific type of

⁷⁰ S 3(3)(a)(iA).

⁷¹ Stein (2004) 40; Meyerowitz (2007) par 27.37.

⁷² SARS *Buy-Sell Arrangements* (2008) 3. A contrary view is taken by Davis, Beneke and Jooste (2009) par 2.4.2.1.

⁷³ Joffe (2009) March *De Rebus* 44.



business shortly before the death of the deceased partner or co-shareholder, the exclusion would apparently be allowed.⁷⁴

- Where an employee takes out a policy on the life of his or her employer to enable such employee to finance the purchasing of the business in terms of a buy-and-sell arrangement on the death of the employer, the proceeds of the policy would be dutiable under the Act.⁷⁵
- In practice, attempts have been made to utilise the buy-sell exclusion in the hands of a sole proprietor or sole shareholder (the planner) by setting up a trust and by selling part of the business or shares to the trust. The trust then becomes a partner or co-shareholder and, upon effecting a life policy on the life of the planner, it is contended that the proceeds of the policy (upon the planner's death) would be estate duty-free.⁷⁶ However, because a trust is not a "person" under the Act or in terms of the Interpretation Act,⁷⁷ SARS is of the opinion that a policy acquired by a trust would not qualify for the exclusion.⁷⁸ However, it appears as if SARS would still allow an exemption in the case where a trustee of a trust (being a "person" in terms of the Interpretation Act) acquires a policy on the life of a partner or co-shareholder (of the trustee in his capacity as trustee). This concession would apparently not be applicable if a natural person acquires a policy on the life of the trustee.⁷⁹

⁷⁴ See Stein (2004) 40; Meyerowitz (2007) par 27.37; Davis, Beneke and Jooste (2009) par 2.4.2.2 and SARS *Buy-Sell Arrangements* (2008) 4 (also for some practical examples).

⁷⁵ Joffe (2009) March *De Rebus* 43.

⁷⁶ See Davis, Beneke and Jooste (2009) par 15.2.

⁷⁷ Act 33 of 1957. See also *Philip Frame Trust v CIR* 1991 (2) SA 340 (W), 53 SATC 166.

⁷⁸ SARS *Buy-Sell Arrangements* (2008) 4–5.

⁷⁹ SARS *Buy-Sell Arrangements* (2008) 5. See also La Grange (2003) *Ins & Tax* 16 *et seq.*



The third exemption provided for in the Act is the so-called “key-man exemption”. It is provided that the proceeds payable in terms of a policy, that was not taken out or effected by the deceased or at the instance of the deceased, and in terms of which the benefits are not to be paid into the estate of the deceased, or utilised for the benefit of the deceased, any relative of the deceased, any person dependent for his maintenance upon the deceased, or any company which was at any time a family company in relation to the deceased, would not be deemed to be property in the deceased’s estate, provided that no premium was borne by the deceased.^{80 81}

Similar to the position under the second exemption above, the requirements as set out above have given rise to some interpretation issues, anomalies and inequities:

- A policy would apparently have been “effected by the deceased” if he or she was the contracting party to the insurance contract with the insurer, whether or not he or she was the beneficiary under the policy.⁸² The term “at the instance of the deceased” apparently means “at the request or suggestion” of that person. A policy would therefore be effected at the instance of the deceased if the proposer would not have effected the policy had he not been requested by the deceased to do so.⁸³
- The exemption would not apply where the proceeds are to be utilised for the benefit of the deceased (or his or her estate), a relative, a dependant or a family company. A “relative” refers to the spouse of the deceased or anybody related to

⁸⁰ Premiums would have been “paid or borne” by the deceased even if the deceased provided the funds in an indirect way, for example if a company paid the premiums of a policy on the life of the deceased and debited the deceased with the amount thereof on loan account. See SARS *Key-man Policies* (2008) 3.

⁸¹ S 3(3)(a)(ii). See in general Editorial (1993) *Taxpayer* (B) 68; Meyerowitz (2007) pars 27.38–27.42. Apparently SARS would require (a) copies of the resolution taken by the company to take out such policy and (b) application made for the policy and other documentation to prove that the proceeds of the policy were not applied to benefit the estate, a relative, a dependant or a family company as envisaged in the subsection. See SARS *Key-man Policies* (2008) 3–5.

⁸² Meyerowitz (2007) par 27.39; SARS *Key-man Policies* (2008) 3.

⁸³ Stein (2004) 42; Meyerowitz (2007) par 27.39; SARS *Key-man Policies* (2008) 3.



the deceased or such spouse within the third degree of consanguinity, including any spouse of anybody so related.⁸⁴ A “family company” is defined as “any company (other than a company whose shares are quoted on a recognised stock exchange) which at any relevant time was controlled or capable of being controlled directly or indirectly, whether through a majority of the shares thereof or any other interest therein or in any other matter whatsoever, by the deceased or by the deceased and one or more of his [or her] relatives”.⁸⁵ In view of the fact that the connection can be established “at any relevant time”, it means that, if a company constituted a “family company” in relation to the deceased at any given time in the past, any future policy proceeds payable on the death of such person would be dutiable.⁸⁶ Meyerowitz submits that the payment or benefit should be linked to some legal obligation, arrangement or undertaking in favour of such relative, dependant or family company.⁸⁷ This requirement can nevertheless have some harsh results. Where, for example, a shareholder (who owns a 10 percent shareholding in a company), stands personal surety for the company and the company takes out a life policy on the shareholder’s life to ensure that the bank can be repaid and the suretyship cancelled on the death of the shareholder, a strict application of the Act would render the proceeds of the policy dutiable, in view of the fact that it could be argued that the shareholder’s estate would be indirectly benefiting from the policy proceeds in that it would be relieved from the suretyship. However, it could be argued that the real liability to repay the loan rests with the company and that the company was in actual fact the real beneficiary under the policy.⁸⁸

⁸⁴ S 1 “relative”.

⁸⁵ S 1 “family company”.

⁸⁶ See Joffe (2005) *Ins & Tax* 19 and Joffe (2009) April *De Rebus* 41.

⁸⁷ Meyerowitz (2007) pars 27.41–27.42.

⁸⁸ Joffe (2005) *Ins & Tax* 19; Joffe (2009) April *De Rebus* 42.



- If only a portion of the policy benefits are payable to or utilised for the benefit of the deceased estate, a relative, a dependant or a family company, the question arises whether a pro rata exclusion would be allowed. Stein submits that the balance should qualify as an exemption.⁸⁹ Joffe, on the other hand, is of the opinion that the section does not allow for apportionment.⁹⁰ SARS also takes the approach that the proceeds should either qualify for the exemption or be subject to estate duty.⁹¹
- In a case where the deceased owned, for example, only 48 percent of the shares in a company, where two other persons (unrelated to the deceased) owned 26 percent each, and where the deceased was the only decision maker and key individual in the business, the question arises whether any proceeds payable in respect of a key-man policy on the life of the deceased would be exempt from estate duty. Apparently, SARS has never taken the approach to charge duty on a policy where the assured shareholder has owned less than 50 percent of the shareholding in the company. However, Joffe mentions that it could be open for SARS to argue that the deceased shareholder in fact controlled the company as required.⁹²

6.2.4.2.2 Retirement Benefits

Since the introduction of the Act in 1955, certain retirement benefits (with the exclusion of annuities) have been included as deemed property in the estate of the person as a result of whose death the benefits were payable.⁹³ In respect of persons dying on or after 1 January 2009, the deeming provision has been omitted from the Act.

⁸⁹ Stein (2004) 42.

⁹⁰ Joffe (2009) *April De Rebus* 42.

⁹¹ SARS *Key-man Policies* (2008) 4 (apparently a mere reversionary interest in the policy by the estate, for example where a beneficiary repudiates his benefit, would not disqualify the exemption).

⁹² Joffe (2009) *April De Rebus* 42.

⁹³ S 3(3)(3)*bis* provided that the amount of any benefit which is due and payable by, or in consequence of the membership or past membership of, any fund on or as a result of the death of the deceased, to the extent that it exceeds the total amount of all the contributions paid by the beneficiary, together with interest at 6% Footnote continues on the next page



6.2.4.2.3 Property Donated under a *Donatio Mortis Causa* / No Benefit until Death

Because a *donatio mortis causa*⁹⁴ and a donation, in terms of which the donee will not obtain any benefit until the death of the donor, are exempt from donations tax,⁹⁵ these donations are included in the deceased estate of the donor, unless such property is otherwise included as “property” in the deceased estate.⁹⁶

6.2.4.2.4 Accrual Claims

Any claim for accrual that the estate of the deceased may have against his or her former spouse, to whom he or she was married out of community of property, in respect of section 3 of the Matrimonial Property Act,⁹⁷ is deemed to be property of the deceased at the date of his or her death.⁹⁸

per annum calculated upon such contributions from the date of payment to the date of death, is deemed to be property in the deceased's estate. However, an annuity, except for the commuted part thereof, payable by a pension fund, a provident fund or a retirement annuity fund, as respectively defined in section 1 of the Income Tax Act, was excluded from this deeming provision. See in general Stein (2004) 43–44 and Davis, Beneke and Jooste (2009) par 2.4.3. Benefits payable by a fund, administered under the control of the Minister of Social Welfare and Pensions, to the widow, child or other dependant of a deceased member of such fund are not dutiable in terms of the General Pensions Act 29 of 1979 s 22. See Meyerowitz (2007) par 27.43.

⁹⁴ See Ch 3 par 3.3.2.2.1 n 123 for the meaning of a *donatio mortis causa*.

⁹⁵ In terms of Income Tax Act ss 56(1)(c) and (d). See Ch 5 par 5.5.3.

⁹⁶ S 3(3)(b) proviso. This proviso was introduced by the Revenue Laws Amendment Act 2005 to cater for a scheme where the property is included in the deceased estate, but the donee claims the donation as a debt against the estate. See *CSARS v Marx NO* 2006 (4) 195 (C) (which case was decided before the amendment) and Explanatory Memorandum on the Taxation Laws Amendment Bill (2005) 3. The proviso is only applicable in respect of persons dying on or after 8 November 2005. See also Olivier (2007) *TSAR* 589 *et seq* for further reading.

⁹⁷ Act 88 of 1984.

⁹⁸ S 3(3)(cA). See in general Meyerowitz (2007) par 27.52.



6.2.4.2.5 *Property which the Deceased was Competent to Dispose of for his or her Own Benefit or for the Benefit of his or her Estate (Section 3(3)(d) Deemed Property)*

Included in the deceased estate is property,⁹⁹ not otherwise chargeable or dutiable under the provisions of the Act, of which the deceased was, immediately prior to his or her death, competent to dispose of for his or her own benefit or the benefit of his or her estate (the so-called “section 3(3)(d) deemed property”).¹⁰⁰ A person shall be considered to have been able to dispose of property if he or she had the power (if he or she were *sui iuris*) to appropriate or dispose of such property as he or she so wished, whether exercisable by will, power of appointment or in any other matter.¹⁰¹ The deceased will also be regarded as having the power to dispose of property if he or she, under a deed of donation, settlement, trust or other disposition retained the power to revoke or vary the provisions thereof, relating to such property.¹⁰² The power to revoke, appropriate or dispose shall be deemed to exist if the deceased could have obtained such power directly or indirectly by the exercise, either with or without notice, of power exercisable by him or her or with his or her consent.¹⁰³

6.3 VALUATION

For the purposes of the valuation of property, the Act distinguishes between property that was realised during the course of the liquidation and distribution process and property that was not so realised, except in the case of stocks or shares not quoted on a stock exchange (in respect of which a special rule applies whether or not the stocks were

⁹⁹ The term “property” includes the profits of any property (s 3(5)(a)).

¹⁰⁰ S 3(3)(d). The section will, however, not apply to the deceased’s power to dispose of his or her spouse’s share in the joint estate, in the instance where the deceased was married in community of property (s 3(5)(d)). If the deceased, on the other hand, was able to dispose of property for the benefit of the joint estate, then s 3(3)(d) could be invoked. See Meyerowitz (2007) par 27.51.

¹⁰¹ S 3(5)(b)(i).

¹⁰² S 3(5)(b)(ii).

¹⁰³ S 3(5)(c).



realised). In respect of unrealised property, provision is made for a general rule (fair market value) as well as special rules in respect of usufructuary, fiduciary or other like interests, annuities, bare *dominium* property, section 3(3)(d) deemed property and property comprised in a *donatio mortis causa*. Provision is also made for a favourable valuation rule for agricultural property (this rule will more fully be discussed in paragraph 6.5.1 below). Property should in general be valued on the date of the death of the deceased.

6.3.1 Stocks or Shares Not Quoted on Stock Exchange: Special Rule

In the case of stocks or shares in a company not quoted on any stock exchange,¹⁰⁴ the value must be determined according to the provisions of section 5(1)(f)*bis* (whether or not the stocks or shares were realised in the liquidation process), which provides for the following rules:¹⁰⁵

- no regard shall be had to any provision in the memorandum and articles of association, founding statement, association agreement or rules of the company, restricting the transferability of the shares therein, but it shall be assumed that such shares were freely transferable;¹⁰⁶
- no regard shall be had to any provision in the memorandum and articles of association, founding statement, association agreement or rules of the company, whereby or whereunder the value of the shares of the deceased or any other member is to be determined;¹⁰⁷
- if upon a winding-up of the company the deceased would have been entitled to share in the assets of the company to a greater extent *pro tanto* to his shareholding or membership than other shareholders or members, no lesser value shall be placed on

¹⁰⁴ The modern term used for purposes of the law of securities is a “securities exchange”. See Securities Services Act 36 of 2004.

¹⁰⁵ S 5(1)(f)*bis*. See in general Stein (2004) 58–59; Meyerowitz (2007) par 29.7.

¹⁰⁶ S 5(1)(f)*bis*(i).

¹⁰⁷ S 5(1)(f)*bis*(ii).



the shares held by the deceased than the amount to which he would have been so entitled if the company had been in the course of winding-up and the said amount had been determined as at the date of death;¹⁰⁸

- no regards shall be had to any provision or arrangement resulting in any variation of the rights attaching to the shares through or on account of the death of the deceased;¹⁰⁹
- account shall be taken of any power or control exercisable by the deceased and the company where under he was entitled or empowered to vary or cancel any rights attaching to any class of shares therein, including by way of redemption of preference shares, if, by the exercise of such power he could have conferred upon himself any benefit or advantage in respect of the assets or profits of the company;¹¹⁰
- in the case where the company owns immovable property on which *bona fide* farming operations are being carried on in the republic, a special provision applies (see paragraph 6.5.1 below).

6.3.2 Property Realised During the Liquidation and Distribution Process

Except for stocks or shares not quoted on a stock exchange (in respect of which a special rule applies),¹¹¹ the purchase price of property which has been disposed of in terms of a *bona fide* sales agreement¹¹² in the course of the liquidation of the deceased estate (including agricultural property)¹¹³ shall constitute the value of such property for purposes

¹⁰⁸ S 5(1)(f)bis(iii).

¹⁰⁹ S 5(1)(f)bis(iv).

¹¹⁰ S 5(1)(f)bis(v).

¹¹¹ See par 6.3.1.

¹¹² Whether the sale constitutes a *bona fide* sales agreement in the course of the liquidation of the estate is made a matter of opinion by the Commissioner, whose decision is conclusive, and only subject to review under the narrow grounds of *mala fides*, gross unreasonableness or misconstruction of the terms and objects of the Act. See *CIR v City Deep Ltd* 1924 AD 298 and *Holden's Estate v CIR* 1960 (3) SA 497 AD.

¹¹³ Where property is sold in terms of an agreement that was entered into by the deceased during his lifetime, but delivery has not been effected on the date of his death, then the agreement will not constitute a transaction in the course of liquidation. See *CIR v Estate Kirsch* 1951 (3) SA 496 (A) and *CIR v Whiteaway* 1933 TPD 486 (although these cases were decided under the Death Duties Act of 1922, they are still Footnote continues on the next page

of the Act.¹¹⁴ This general rule is subject to the proviso that, where conditions have been imposed by any person whomsoever, as a consequence of which the value of the property could or would be reduced for any reason at or after the moment of death, the value of the property should be determined as though those conditions had not been imposed.¹¹⁵

6.3.3 Unrealised Property

Where the property has not been realised during the course of the liquidation process, the Act provides for a general rule, as well as some special rules, as will more fully be set out in the discussion below.

6.3.3.1 The General Rule

In terms of the general rule for unrealised property, which will apply in the absence of any special rule, the fair market value at the date of death of the deceased will constitute the value for estate duty purposes.¹¹⁶ “Fair market value” means “the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm’s length in an open market”.¹¹⁷ Similar to the general valuation rule for purposes of donations tax,¹¹⁸ this general rule is subject to the proviso that, where the value of property could or would be reduced for any reason at or after the moment of death, as a result of conditions imposed by any person whatsoever, the value of the property shall,

instructive). See also *CIR v Estate Streicher* 2004 (SCA), 66 SATC 282, where the court held that a sales agreement entered into by an heir in advance of him receiving transfer from the estate does not constitute a sales agreement entered into during the course of liquidation of the estate. See discussion by Stein (2004) 58 and Editorial (2004) *Taxpayer* 176 *et seq.*

¹¹⁴ S 5(1)(a). See in general Meyerowitz (2007) par 29.2 and Davis, Beneke and Jooste (2009) par 2.7.2.

¹¹⁵ S 5(1)(g) proviso. See in general Stein (2004) 57–58; Meyerowitz (2007) par 29.2.

¹¹⁶ S 5(1)(g). See in general Stein (2004) 61–62; Meyerowitz (2007) par 29.3.

¹¹⁷ S 1.

¹¹⁸ See Ch 5 par 5.3.1.



unless the Commissioner otherwise directs, be determined as though such conditions had not been imposed.¹¹⁹

6.3.3.2 *Usufructuary, Fiduciary or Other Like Interests*

A usufructuary, fiduciary or other like interest, which was enjoyed by the deceased prior to his or her death, is valued by capitalising the annual value of the interest at 12 percent¹²⁰ to the extent to which the person, who upon the cessation of the said interest upon the death of the deceased (hereafter beneficiary), becomes entitled to any right of enjoyment of such property, whatever the nature of such right of enjoyment may be.¹²¹ The extent to which the beneficiary would be regarded as having the right to enjoyment is established with reference to such person's life expectancy, or if such right of enjoyment is to be held for a lesser period than the life of such beneficiary, over such lesser period.¹²² This is calculated by means of tables which furnish the value of R1 per annum capitalised at 12 percent over the expectation of life at various ages for both male and female (Tables A (life expectancy) and B (fixed periods) were published under the regulations under the Act).¹²³ The first tables were published in 1956,¹²⁴ applicable to persons dying on or after 14 April 1956, but before 1 April 1977, because a revised version of the tables was published in 1977 (applicable to persons dying on or after 1 April 1977; these tables still

¹¹⁹ S 5(1)(g) proviso. See *CIR v Sive's Estate* 1963 (3) SA 847 (A) and Stein (2004) 63.

¹²⁰ The annual value is equal to 12% upon the fair market value of the full ownership value of the property subject to the limited interest.

¹²¹ S 5(1)(b). See in general Stein (2004) 23–29 and Meyerowitz (2007) par 29.8. In *SIR v Jordaan* 1967 (3) SA 329 (A) it was held that it is sufficient if a person, on the cessation of the deceased's right and in consequence of his death, becomes entitled to some extent to such right of enjoyment, whatever its nature and extent may be. If a beneficiary, however, obtains a fiduciary right in property subject to a usufruct, such fiduciary right does not constitute a "right of enjoyment" and is not capable of being valued for purposes of estate duty. See *Visser NO v CIR* 1968 (2) SA 78 (O).

¹²² S 5(1)(b).

¹²³ See in general Stein (2004) 25 and Meyerowitz (2007) par 29.10.

¹²⁴ Government Notice No 641 of 13 April 1956 (see appendices to the Act).



apply).¹²⁵ The Act does not, however, provide for the taking into account of a condition imposed on such usufructuary or other like interest.¹²⁶ The beneficiary's health must also be ignored for the purposes of the calculation of his or her life expectancy, even in a case where he or she may be terminally ill.¹²⁷ Where more than one beneficiary becomes entitled to a usufructuary interest, each beneficiary's interest must be ascertained by allocating the annual value attributable to each beneficiary and by capitalising each beneficiary's interest over his or her particular life expectancy.¹²⁸

The general valuation rule is subject to two specific provisos where the right of enjoyment accrues to the bare *dominium* owner, which will more fully be discussed in Chapter 7.¹²⁹ In addition to these limitations, it is provided that where it is not possible to ascertain the beneficiary upon the death of the deceased the value so established shall be determined by capitalising the annual value over a period of 50 years, unless the Commissioner and the executor agree to a lesser period, having regard to the circumstances.¹³⁰ Also, where the beneficiary is not a natural person, the annual value will be capitalised over a period of 50 years.¹³¹ Furthermore, where the Commissioner is satisfied that the property cannot be expected to produce an annual yield of twelve

¹²⁵ Government Notice No R1942 of 23 September 1977 (see appendices to the Act).

¹²⁶ *CIR v Snyman's Estate* 1972 (1) SA 1 (A).

¹²⁷ Stein (2007) *Tax Planning* 159–160.

¹²⁸ Stein (2007) *Tax Planning* 160.

¹²⁹ See Ch 7 par 7.4.4.1.

¹³⁰ S 5(1)(b) third proviso. This proviso was inserted subsequent to the decision in *CIR v MacNeillie's Estate* 1961 (3) SA 833 (A), where the court held that an interest to the income of a trust fund, which accrued to the trust capital upon the death of a trust beneficiary, to be kept in trust until some future event, constitutes property as contemplated in the Act in the estate of the deceased trust beneficiary, but which is not capable of being valued in the absence of an ascertainable beneficiary (to whom the right of enjoyment accrues as a result of the death of the trust beneficiary). In *Jackson and Others v SIR* 1969 (3) SA 217 (A) 226 it was held that the proviso even finds application where the vesting of the right of enjoyment is postponed until some future event.

¹³¹ S 5(3).

percent, the Commissioner may fix a percentage that he considers to represent the annual yield.^{132 133}

6.3.3.3 Annuities

Currently the Act contains a complicated set of valuation rules for annuities, distinguishing among (a) annuities charged on property, (b) annuities not charged on property and (c) insurance policy benefits or pension fund benefits taking the form of annuities.

6.3.3.3.1 Annuities Charged upon Property

All annuities charged upon property, irrespective of whether they accrue to some other person upon the death of the deceased, are deemed to be the property of the deceased estate.¹³⁴ Such an annuity must be valued at the annual value capitalised at 12 percent over the expectation of life of the person¹³⁵ to whom the said right accrues on the death of the deceased, or if it is to be held over a lesser period, such lesser period.¹³⁶ If, however, the annuity does not accrue to some other person, the value is capitalised at 12 percent

¹³² S 5(2). Uncertainty prevails as to whether the Commissioner should assess the possible annual yield at the moment of death (or for that matter any period before death) or whether the Commissioner must have regard to the probabilities concerning the annual yield after death (especially during the period of enjoyment of the interest). For further reading, see Meyerowitz (1994) *Taxpayer* 22, 24; Meyerowitz (2000) *Taxpayer* 229; Meyerowitz (2001) *Taxpayer* 43; Stein (2007) *Tax Planning* 159 and Davis, Beneke and Jooste (2009) par 2.7.3.2.

¹³³ S 5(2) proviso provides that, where the property subject to the limited interest consists of books, pictures, statuary or other objects of art, the annual value shall be deemed to be the average net receipts (if any) derived by the person entitled to the right of enjoyment over such property during the three years immediately preceding the date of death of the deceased. Unless the books etc were put to commercial use, a limited interest for the right of enjoyment thereof will have no value for estate duty purposes. See in general Meyerowitz (2007) par 29.9 and Davis, Beneke and Jooste (2009) par 2.7.3.2.

¹³⁴ See par 6.2.4.1.

¹³⁵ If the person is not ascertainable until a future date, Meyerowitz (2007) par 29.14 submits that the right cannot be valued as provided for in the Act and estate duty will consequently not be payable (in analogy of the *Macneillie's Estate* case).

¹³⁶ S 5(1)(c)(i). See appendices to the Act for capitalisation tables. See in general Stein (2004) 29–30.



over the life expectancy of the person who on the death of the deceased is the owner of the property upon which the annuity is charged.¹³⁷

6.3.3.3.2 *Annuities Not Charged on Property*

An annuity not charged on property is only included as property in the deceased estate if it accrues to some other person on the death of the deceased.¹³⁸ The value of the annuity must be capitalised at 12 percent over the life expectancy of the person to whom the right to the annuity accrues, or if it is to be held over a lesser period, then such lesser period.¹³⁹

6.3.3.3.3 *Annuities Payable under an Insurance Policy or by Any Fund*

In the case of an annuity that is payable in terms of (a) an insurance policy or (b) in terms of a fund (only in respect of pension benefits payable as a result of a person dying before 1 January 2009) and therefore deemed to be property in the deceased estate,¹⁴⁰ the value of the annuity must be capitalised at 12 percent over the life expectancy of the annuitant, or if it is payable for a lesser period, over such lesser period.¹⁴¹ The rule is subject to the proviso that, if the annuity ceases to be payable within five years after the death of the deceased, by reason of the death of or, in the case where the annuitant is the widow (or widower)¹⁴² of the deceased, because of her (or his) remarriage, the value of the annuity

¹³⁷ S 5(1)(c)(ii). See appendices to the Act for capitalisation tables. See in general Stein (2004) 30.

¹³⁸ See par 6.2.4.1.

¹³⁹ S 5(1)d). See appendices to the Act for capitalisation tables. See in general Meyerowitz (2007) par 29.15.

¹⁴⁰ As provided for in terms of s 3(3)(a) or s 3(3)(a)*bis*.

¹⁴¹ S 5(1)(d)*bis*. See appendices to the Act for capitalisation tables.

¹⁴² The Act refers only to a “widow” (female) and not a “widower” (male). The Interpretation Act 33 of 1957 s 6 states that, in every law (unless the contrary appears), words importing the masculine gender includes females. However, it seems as if no provision is made for the contrary position (words importing the female gender). It may therefore be suggested that the section unfairly discriminates against males in terms of s 9 of the Constitution (see Ch 2 par 2.4.3.3.3).



may not be more than the aggregate of all the amounts which accrued to the annuitant or his or her estate in respect of the annuity.¹⁴³

For all three categories described above, the annuity must be capitalised over a period of 50 years where the beneficiary or owner is not a natural person.¹⁴⁴

6.3.3.4 Bare Dominium in Property

A right of ownership in movable or immovable property, which is subject to a usufructuary or other like interest in favour of a person (referred to as “bare *dominium* property”), is valued by deducting from the fair market value the value of such interest.¹⁴⁵ Although the Act (as has been described above) provides for specific valuation rules for usufructuary and other like interests, the valuation rule for the bare *dominium* property contains its own set of rules for the valuation of these interests. According to these rules, a usufruct or annuity is to be valued by capitalising at 12 percent the annual value of the interest or annuity over the life expectancy of the usufructuary or annuitant, or if such interest is to be held for a lesser period, such lesser period.¹⁴⁶ In the case of any other interest, such as a *usus*, *habitatio* or grazing rights, the Commissioner may determine the annual yield of such interest, which annual value must then be capitalised at 12 percent over the life expectancy of the person entitled to such interest, or lesser period.¹⁴⁷

¹⁴³ S 5(1)(d)*bis* proviso. See in general Stein (2004) 44–45. Any application for a refund should be made by the claimant to the Master’s Office which issued the original assessment. See Meyerowitz (2007) par 29.16 for an example.

¹⁴⁴ S 5(3).

¹⁴⁵ S 5(1)(f). See in general Stein (2004) 30–31.

¹⁴⁶ S 5(1)(f)(i) and (ii). See appendices to the Act for capitalisation tables. See in general Meyerowitz (2007) pars 29.18–29.19 for examples. If the usufructuary or annuitant is not a natural person, the period will be 50 years (s 5(3)).

¹⁴⁷ S 5(1)(f)(iii). See Meyerowitz (2007) par 29.20 for an example.



6.3.3.5 Section 3(3)(d) Property

Property which the deceased was competent to dispose of and included in the deceased estate in terms of section 3(3)(d) will be valued as follows:

- Where such property consists of profits, by capitalising at 12 percent the annual value of such profits over the life expectancy of the deceased immediately prior to his or her death;
- In the case of any other property, the fair market value of such property at the date of death of the deceased less any expenses and liabilities which the deceased would have had to bear or assume if he had at that date exercised his power of disposition.¹⁴⁸

6.3.3.6 Donations Mortis Causa

A *donatio mortis causa*¹⁴⁹ must be valued according to section 62 of the Income Tax Act,¹⁵⁰ which provides for the valuation of donated property.¹⁵¹ The property should be valued when the donation is deemed to take effect, which would be the date of death of the donor in the case of a *donatio mortis causa*.¹⁵²

6.4 TAXPAYER AND PAYMENT OF THE TAX

All duty is payable in the first instance by and recoverable from the executor of the deceased estate (in his or her capacity as such).¹⁵³ The executor is responsible for the

¹⁴⁸ S 5(1)(f)ter. See in general Meyerowitz (2007) par 29.23.

¹⁴⁹ See Ch 3 par 3.3.2.2.1 n 123 for the meaning of a *donatio mortis causa*.

¹⁵⁰ S 5(1)(e). See in general Stein (2004) 49–51 and Davis, Beneke and Jooste (2009) par 2.7.7.

¹⁵¹ See Ch 5 par 5.3.

¹⁵² Meyerowitz (2007) par 29.24; Davis, Beneke and Jooste (2009) par 2.7.7; King and Victor (2008/2009) par 13.11.3.

¹⁵³ S 12. However, the executor may be held personally liable if he has parted with the possession or control of property under his administration without first paying the estate duty. In such instance, the executor will be jointly and severally liable with the person to whom the assets have been distributed (s 19). When the Footnote continues on the next page



submission of an estate duty return,¹⁵⁴ which may be adjusted by the Commissioner.¹⁵⁵ Payment of the duty should be made on or before a date set out in the estate duty assessment issued subsequent to the receipt of the return.¹⁵⁶ Interest at a rate of six percent is chargeable on any outstanding duties. Interest also becomes automatically chargeable after a period of 12 months after the deceased's death.¹⁵⁷

The executor may, however, recover duty from the heir, recipient or successor in the instances set out below:

- where the duty is levied on property which consists of a usufructuary, fiduciary or other like interest in property or annuity included in the deceased estate, the person to whom the advantage accrues (the successor) would be liable for the duty;¹⁵⁸
- where the duty is levied on the proceeds of a life insurance policy which is recoverable by any person other than the executor, the beneficiary would be liable for the duty;¹⁵⁹
- where the duty is levied on benefits from funds which accrue to a person other than the executor, then such person would be liable for the duty;¹⁶⁰ and
- where the duty is levied on a *donatio mortis causa*, the donee would be liable for the duty.¹⁶¹

executor pays the duty, it is submitted that he has a right of recourse against either the estate or the person liable for the duty, or even the person to whom the property was distributed and from which the Commissioner was entitled to claim the duty. See Meyerowitz (2007) par 30.14.

¹⁵⁴ S 7.

¹⁵⁵ S 8.

¹⁵⁶ S 9.

¹⁵⁷ S 10 (unless extension has been granted by the Commissioner).

¹⁵⁸ S 11(a)(i).

¹⁵⁹ S 11(a)(ii).

¹⁶⁰ S 11(b)(iA).

¹⁶¹ S 11(b)(ii).



The deceased estate would therefore be liable for duty in respect of any other ordinary property of the deceased, the proceeds of life insurance benefits payable to the deceased estate, fund benefits payable to the deceased estate, a claim under the accrual system and property which the deceased was competent to dispose of.¹⁶² This liability must be satisfied out of the estate,¹⁶³ and more specifically, the residue of the estate, unless the deceased has provided by will that a legacy would bear the estate duty attributable to it.¹⁶⁴ If the residue of the estate is insufficient, the duty must be met *pro rata* from the legacies.¹⁶⁵

6.5 RELIEF MECHANISMS

Relief can take various forms. Under the Estate Duty Act, relief is mainly granted by virtue of (a) a special valuation rule for agricultural property and (b) the allowance of certain deductions against the property (and deemed property) of the deceased estate.

6.5.1 Preferential Valuation: Agricultural Property

Where agricultural property¹⁶⁶ has been realised during the liquidation of the deceased estate, the purchase price obtained would constitute the value for estate duty purposes according to the general rule (as described in paragraph 6.3.3.1 above). Where, however, such property has not been so realised, the Act provides for a favourable valuation method in a fashion similar to that provided for under the donations tax provisions.¹⁶⁷ The

¹⁶² See in general Meyerowitz (2007) par 30.14; King and Victor (2008/2009) par 13.7 and Davis, Beneke and Jooste (2009) par 2.8.

¹⁶³ S 12.

¹⁶⁴ Meyerowitz (2007) par 30.14.

¹⁶⁵ Meyerowitz (2007) par 30.14 (if there are any pre-legacies, the other legacies must first be exhausted).

¹⁶⁶ Meaning immovable property on which a *bona fide* farming undertaking is being carried on in the republic (s 1 “fair market value”).

¹⁶⁷ See Ch 5 par 5.5.2.



“fair market value” may, apart from being established in terms of the main definition,¹⁶⁸ alternatively be determined by reducing the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm’s length in an open market by 30 percent.¹⁶⁹ In respect of agricultural property, in so far as it is relevant for the purposes of determining the valuation of the shares in a company, the value may also be determined by reducing the market value of such property by 30 percent.¹⁷⁰

6.5.2 Allowable Deductions

The net value of the estate is determined by subtracting from the total value of property and deemed property the deductions allowable in terms of section 4 of the Act. For convenience, these deductions are categorised under deductible expenses, deductible exemptions and the primary rebate, which will be more fully discussed below.

6.5.2.1 Deductible Expenses

The Act allows for the deduction of the following expenses:

- so much of the funeral, tombstone and death-bed expenses of the deceased, which the Commissioner considers to be fair and reasonable;¹⁷¹
- all costs which have been allowed by the Master of the High Court in the administration and liquidation of the deceased estate, other than expenses incurred

¹⁶⁸ Mitchell (2006) *Tax Planning* 43 highlights the fact that the executor has the choice to value the agricultural property either at its market value or at its market value less 30%. Where the value of the dutiable estate is less than the primary rebate (R3.5 million), it might be beneficial for the heirs to value the property at market value (not market value less 30%), in view of the fact that the base cost of the property for purposes of CGT would be higher.

¹⁶⁹ S 1.

¹⁷⁰ S 5(1A). See also definition of “fair market value” in s 1.

¹⁷¹ S 4(a). See in general Meyerowitz (2007) par 28.2. In determining the half-share of the surviving spouse, where such spouse was married to the deceased in community of property, the funeral and death-bed expenses of the deceased are charges against the deceased’s share of the joint estate only. See Meyerowitz (2007) par 28.27.



in respect of any income accruing to the estate after the date of death;¹⁷²

- all the expenditure incurred in carrying out the requirements of the Master or the Commissioner in pursuance of the provisions of the Act;¹⁷³
- all debts due by the deceased to persons ordinarily resident¹⁷⁴ in the republic, which are proved to the satisfaction of the Commissioner to have been discharged from property included in the estate;^{175 176}
- debts due to persons ordinarily resident outside the republic discharged from property included in the estate, but only to the extent that such debts exceed the value of any assets of the deceased situated outside the republic and not included in the deceased estate;¹⁷⁷ and

¹⁷² S 4(c). See in general Stein (2004) 70 and Meyerowitz (2007) pars 28.8–28.11 (referring to the usual charges such as advertisement costs, costs in respect of security furnished by the executor, executor’s commission, Master’s fees, valuation expenses, legal and accounting fees, realisation costs, transfer costs and costs of maintenance of estate assets).

¹⁷³ S 4(d). See in general Stein (2004) 70 (where the writer refers to e.g. the cost of a security bond required by the Master) and Meyerowitz (2007) par 28.12 (where the writer refers to e.g. the cost of valuations).

¹⁷⁴ For the meaning of “ordinarily resident”, see Ch 5 par 5.2.2.1. Although the Act is silent as to the time when the creditor should have been ordinarily resident in the republic, Meyerowitz (2007) par 28.5 submits that it should be interpreted as to be at the time of death of the deceased.

¹⁷⁵ S 4(b). See in general Meyerowitz (2007) pars 28.3–28.6. It is submitted that “debts due” would also include debts in respect of which the deceased has incurred a liability prior to his or her death, but which are due and payable at some time after the date of death. See *Myer NO v CIR* 1956 (4) SA 342 (T) and *ITC 1773* (2003) 66 SATC 251. See also Stein (2004) 71 and Meyerowitz (2007) par 28.4.

¹⁷⁶ To counter the avoidance scheme where property donated under a *donatio mortis causa* or a section 56(1)(d) donation is deemed to be included in the deceased estate (see par 6.2.4.2.3), but effectively omitted from the dutiable estate by virtue of the deduction of the corresponding claims against the estate as debts due by the deceased, the Act introduced provisions to exclude such claims as allowable deductions. Ss 4(b) proviso and 4(f) proviso (applicable to the estates of persons dying on or after 8 November 2005). Prior to the inclusion of these provisos, both donations tax and estate duty could have been avoided through the use of these donations. See Jooste (2004) *SALJ* 744 and Botha (2006) *Ins & Tax* 36 *et seq* for a description of a typical tax avoidance technique based on these donations.

¹⁷⁷ S 4(f). See in general Stein (2004) 72 and Meyerowitz (2007) par 28.14. See also n 176 directly above.



- the amount of any claim for accrual against the estate acquired by the surviving spouse of the deceased, who was married out of community of property to the deceased, in terms of the Matrimonial Property Act of 1984.¹⁷⁸

6.5.2.2 Exemptions

The Act provides that the following may be deducted against the value of the deceased estate:

- the value of any property included in the estate (which has not been allowed as a deduction otherwise) which accrues to –
 - any public benefit organisation approved by the Commissioner;¹⁷⁹ or
 - certain institutions, boards or bodies exempt from income tax in terms of section 10(1)(cA) of the Income Tax Act, that have as their sole and principal object the carrying on of any public benefit activity approved by the Commissioner;¹⁸⁰ or
 - the state; or
 - any municipality;^{181 182}
- the value of all books, pictures, statuary or other objects of art (hereafter “cultural property”), or so much of the value of any shares in a body corporate as is attributable to such body corporate’s ownership of cultural property, where such cultural property have been lent under a notarial deed to the State or any local authority within the republic or to any public institution within the republic for the advancement of

¹⁷⁸ Estate Duty Act s 4(1A). For the calculation of the accrual claim, see Davis, Beneke and Jooste (2009) par 10.4.

¹⁷⁹ The organisation should be exempt from income tax in terms of section 10(1)(cN) of the Income Tax Act 58 of 1962. See in general Davis, Beneke and Jooste (2009) par 2.5.9 for a discussion on the meaning of a “public benefit organisation”. One of the requirements is that at least 85% of the organisation’s activities should be carried out for the benefit of persons in the republic.

¹⁸⁰ As contemplated in terms of section 30 of the Income Tax Act 58 of 1962.

¹⁸¹ As defined in terms of section 1 of the Income Tax Act 58 of 1962.

¹⁸² S 4(h). See in general Stein (2004) 72 and Meyerowitz (2007) par 28.16.



science or art or of a charitable, educational or religious nature, for a period not less than thirty years, and where the deceased died during such period;¹⁸³

- subject to certain provisos,¹⁸⁴ the value of any property included in the estate, which had not been allowable as a deduction under any of the other provisions, which “accrues” to the surviving spouse of the deceased;¹⁸⁵
- any interest included as property in the deceased estate under the provisions of section 3(2)(a) (such as a fiduciary, usufructuary or other like interest), where such interest was held by the deceased by virtue of a donation to him or her by the person to whom the right of enjoyment of the property, in which the deceased held the interest, accrues upon the death of the deceased (or where the interest consists of a right to an annuity charged upon property, where such an annuity was held by the deceased by virtue of a donation to him by the person who is the owner of the burdened property);¹⁸⁶
- the value of any improvements made to property (included in the deceased estate) at the expense of the person to whom the property accrues at the death of the deceased, provided that the improvements were made during the lifetime of the deceased and with his or her consent;¹⁸⁷

¹⁸³ S 4(o). See in general Meyerowitz (2007) par 28.25.

¹⁸⁴ The deduction provided for in s 4(q) has, since 1987, been subject to two provisos. Firstly, the deduction shall be reduced by any amount that the surviving spouse is required in terms of the will of the deceased to dispose of to any other person or trust. This proviso is aimed at preventing a deduction where property is bequeathed to a surviving spouse with a requirement to pass it on to another person. Secondly, no deduction shall be allowed in respect of any property which accrues to a trust established by the deceased for the benefit of the surviving spouse, if the trustee of such a trust has a discretion to allocate such property, or any income there from, to any person other than the surviving spouse. A number of interpretation issues and anomalies exist in relation to the two provisos, but these fall outside the scope of this thesis. For further reading, see Editorial (1992) *Taxpayer* 161; Stein (2004) 75–78; Meyerowitz (2007) par 28.18; King and Victor (2008/2009) par 13.4.14 and Davis, Beneke and Jooste (2009) pars 2.5.16, 2.5A and 15.4.

¹⁸⁵ S 4(q). See in general Stein (2004) 75; Meyerowitz (2007) pars 28.17 and 29.22.

¹⁸⁶ S 4(g). Meyerowitz points out the unusual distinction between an annuity and any other interest in that the Act does not require that the enjoyment of such an annuity should revert to the owner of the property (burdened with the annuity), but only that the donor should still be the owner of the property (upon the death of the person who enjoyed such an annuity).

¹⁸⁷ S 4(i). See in general Stein (2004) 73–74 and Meyerowitz (2007) par 28.23.



- the value of any improvements made to property subject to a fiduciary, usufructuary or other like interest, where the value of such interest (which ceased upon the death of the deceased) had been enhanced by the improvements at the expense of the person to whom the enjoyment of the property upon the death of the deceased accrues, provided that the improvements were effected during the lifetime of the deceased and with his or her consent;¹⁸⁸ and
- the value of property, deemed to be property of the deceased in terms of section 3(3) of the Act¹⁸⁹ (as has not been allowed as a deduction under any of the other provisions), as the Commissioner is satisfied has been taken into account under the provisions of section 5(1)(f)*bis*¹⁹⁰ in the determination of the value of any company shares or a member's interest in a close corporation included as property in the estate.¹⁹¹

For a long period of time SARS had the practice of calculating any benefit that “accrues” to a residuary heir for purposes of computing a deduction in terms of section 4(g), 4(h) or 4(q), by reducing the deduction by the amount of estate duty that was payable.¹⁹² The practice was, however, overturned by the Supreme Court of Appeal in *Commissioner for the South African Revenue Service v Executor Frith's Estate*,¹⁹³ where the court ruled that the value of the deduction should be established with reference to the deceased's will (and not the liquidation and distribution account)¹⁹⁴ and that “any suggestion that one

¹⁸⁸ S 4(j). See in general Stein (2004) 74.

¹⁸⁹ See par 6.2.4.2.

¹⁹⁰ See par 6.3.1.

¹⁹¹ S 4(p). See Dillon (2006) *Ins & Tax 22 et seq* for some examples. The reason for this provision is to deduct the value of deemed property, to the extent that it has been taken into account in the valuation of shares or a member's interest held by the deceased, from the deceased estate, in view of the fact that the value of the deemed property has already been included in the estate, and to therefore restrict an artificial increase in the deceased estate. See Stein (2004) 79; Meyerowitz (2007) par 28.26.

¹⁹² See discussion by Stein (2004) 76–78 (with examples) and Davis, Beneke and Jooste (2009) par 2.5A.

¹⁹³ 2001 (2) SA 261 (SCA). See Editorial (2001) *Taxpayer 8 et seq* for case discussion.

¹⁹⁴ *Frith* case 275 and 277.



must engage in arithmetic or algebraic gymnastics when applying it” cannot be accepted.¹⁹⁵

6.5.2.3 *The Primary Rebate (s 4A)*

The primary rebate allowed as a deduction against the net estate is currently an amount of R3.5 million.¹⁹⁶ In view of the fact that any benefit acquired by a spouse from the estate of a deceased spouse is exempt from estate duty, a primary rebate would be left unutilised in the case where a spouse bequeaths his or her total estate to the surviving spouse. A common estate planning technique developed whereby a testator bequeaths assets to the value of the primary rebate to, for example, a family trust, with the balance of the estate outright to his or her surviving spouse. The purpose of such a structure is to ensure that both spouses’ primary rebates would be utilised to pass assets tax-free to children.¹⁹⁷ In view of the fact that these schemes create compliance costs and are mainly used by wealthy taxpayers who can afford professional estate planning advice,¹⁹⁸ the Taxation Laws Amendment Act of 2009¹⁹⁹ implemented a roll-over in respect of a deceased person’s unused rebate to his or her surviving spouse.²⁰⁰

¹⁹⁵ *Frith* case 275. Although the outcome of the case cannot be faulted, some commentators have suggested that the court could have arrived at its decision in a better fashion. Van der Linde and Franzsen (2001) *TSAR* 819 *et seq* argue that an “accrual” for purposes of the Act can only be computed by reference to the “property” or “deemed property” which accrues to the beneficiary. They also refer to the history of section 4(q), being a formula developed with reference to the spousal deduction that was allowed in respect of the levying of succession duty under the Death Duties Act, a duty levied on the *acquisition* of an inheritance by a beneficiary. Although the valuation of the benefit that accrues to the surviving spouse under the provisions of succession duty would have accounted for any duty payable, in view of the fact that the duty was levied on the actual amount acquired by the beneficiary, this was contrary to the nature of estate duty, a transferor-based tax that was levied with reference to property of the deceased estate.

¹⁹⁶ S 4A (the R3.5 million rebate is applicable to persons dying on or after 1 March 2007).

¹⁹⁷ See e.g. Duncan (2004) July *De Rebus* 33; King and Victor (2008/2009) par 13.5.1 and Davis, Beneke and Jooste (2009) par 9.2.

¹⁹⁸ See Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill (2009) par 6.1.

¹⁹⁹ Act 17 of 2009.

²⁰⁰ S 4A (as amended by s 5(1) of Act 17 of 2009 with effect from 1 January 2010). The amendment makes provision for multiple spouses. See Explanatory Memorandum on the Taxation Laws Amendment Bill (2009) 89–90.



6.6 TREATMENT OF TRUSTS

There are various ways to benefit a trust under a person's will.²⁰¹ In *Kohlberg v Burnett*²⁰² the Appellate Division (as it then was) held that a bequest to an *inter vivos* trust is legal and effective. Although the trust is not a legal person, the trustees are entitled to act on behalf of the trust and to hold in their capacities as trustees property for the purposes of the trust.²⁰³ In view of the fact that the Estate Duty Act levies the tax with reference to the property of a deceased (on the date of his or her death), any bequest to a trust or to a person to be administered in trust would not affect the taxability of the estate. The tax base does not relate to the completion of a transfer. It does not matter when the bequest vests in the heir. As a consequence, the issue whether or not a trust has (on behalf of the beneficiaries) inherited from the estate is generally not relevant. The focal point is not the acceptance of any benefit, which has posed some serious issues in respect of donations to trusts, as has been pointed out above.²⁰⁴ However, where the identity of the beneficiary is relevant, for example in the determination of the value of a usufructuary interest enjoyed by the deceased prior to his or her death, the Act has introduced provisions to the effect that, where a beneficiary is unascertainable, the annual value of the interest must be capitalised over a period of 50 years.²⁰⁵

If the trust is a discretionary trust, it is accepted in practice that a beneficiary's interest in the trust, being only a contingent interest, would not fall into his or her deceased estate upon his or her death.²⁰⁶ Estate duty could therefore be postponed indefinitely. This aspect will be addressed in more detail in Chapter 7.²⁰⁷

²⁰¹ See Kernick (2008) April *De Rebus* 50–51 for further reading.

²⁰² 1986 (3) SA 12 (A).

²⁰³ See Ch 5 par 5.6.2.

²⁰⁴ See Ch 5 pars 5.6.2 and 5.6.3.

²⁰⁵ See par 6.3.3.2. This amendment was effected subsequent to the *MacNeillie's Estate* case.

²⁰⁶ See Strydom LLD Thesis (2000) 250–251 for further reading.

²⁰⁷ See Ch 7 par 7.4.6.



6.7 GENERAL ANTI-AVOIDANCE RULE

Except for specific anti-avoidance measures such as section 3(3)(d)²⁰⁸ and the valuation rule for unquoted shares in section 5(1)(f)*bis*,²⁰⁹ the Estate Duty Act does not contain a statutory general anti-avoidance rule, such as is provided for in the Income Tax Act, Value-Added Tax Act²¹⁰ and Transfer Duty Act.²¹¹ The income tax general anti-avoidance rule applies within the ambit of estate duty, but only to a limited extent. Where the planner's intention was to save estate duty as a consequence of which he or she saved income tax, the Commissioner may assess the planner on income tax (but not estate duty) as if the transaction, scheme or arrangement has never been entered into.²¹²

The Katz Commission did not favour the introduction of a general anti-avoidance measure for purposes of estate duty. The reasons advanced were (a) at the time when the transaction is challenged, the founder would have died (which would make the entire issue of evidence difficult); (b) there would be much uncertainty (which would undermine sensible estate planning) and (c) it would result in a wasteful proliferation of litigation. The commission instead supported the introduction of some additional specific anti-avoidance measures such as can be found in the United Kingdom system.²¹³ However, none of these additional measures have since been introduced.

In 2008 the Draft Revenue Laws Amendment Act proposed to introduce a general anti-avoidance rule, similar to the rule contained in the Transfer Duty Act, to bring the Act in

²⁰⁸ See par 6.2.4.2.5.

²⁰⁹ See par 6.3.1.

²¹⁰ Act 89 of 1991.

²¹¹ Act 40 of 1949.

²¹² King and Victor (2008/2009) par 13.12.

²¹³ Fourth Interim Katz Report (1997) pars 9.4 and 9.5.



line with the other fiscal statutes.²¹⁴ It was proposed that the Act be amended by the insertion of section 25B (which was proposed to come into operation on 23 September 2009).²¹⁵

Following the publication of the draft legislation, commentators called on the legislature to reconsider the proposition. The main objection was that the rule was not specifically tailored for purposes of estate duty, because of the reference to the *bona fide* business purpose test. Estate planning primarily involves family matters, and decisions are usually motivated by considerations which could not be categorised as “arm’s length” in a business context. It was therefore deduced that the proposed formulation was inappropriate. Apparently, the Law Society of South Africa Estate Committee suggested that the alternative approach as provided for in the general anti-avoidance rule of the Income Tax Act, which relates to arrangements other than a business context,²¹⁶ could serve as a useful benchmark.²¹⁷

The Portfolio Committee on Finance announced that the National Treasury had agreed to withdraw and reconsider the proposed general anti-avoidance rule, but vowed that current estate duty freezing techniques would be addressed in the short term.²¹⁸

²¹⁴ Draft Explanatory Memorandum on the Revenue Laws Amendment Bill (2008) 79, available at www.finance.gov.za/legislation/Draft_Bills (accessed 16 August 2009).

²¹⁵ Draft Revenue Laws Amendment Bill (2008) par 4, available at www.finance.gov.za/legislation/Draft_Bills (accessed 16 August 2009).

²¹⁶ See Ch 5 par 5.7.

²¹⁷ Editorial (2008) November *De Rebus* 18.

²¹⁸ See Response Document of the Portfolio Committee on Finance *Report Back Hearings on the Revenue Laws and Bills 2008* (21 October 2008), available at www.finance.gov.za/legislation/Bills (accessed on 16 July 2009); Sabinet Cape Town Office *Legislative Information* “News From Parliament: National Treasury Provides Responses to Public Hearings on Proposed Revenue Law Amendments” (12/09/2008), available at http://www.sabinet.co.za/sabinetlaw/news_par808.html (last visited 22 October 2008).



6.8 CAPITAL GAINS TAX

6.8.1 Capital Gains Tax Consequences

In terms of paragraph 40 of the Eighth Schedule to the Income Tax Act, a deceased person is deemed to dispose of all his or her assets (except for those transferred to a spouse and for assets consisting of domestic life insurance policies or retirement savings) to the deceased estate for an amount received or accrued to equal to the market value of the assets on the date of death.²¹⁹

6.8.2 Interaction with Estate Duty

Any capital gains tax liability incurred by the deceased estate as a result of the deemed realisation at death will constitute an allowable deduction (under section 4(b)) against the value of the dutiable estate for purposes of estate duty.

In addition, the Eighth Schedule grants a concession where the capital gains tax exceeds 50 percent of the net value of the estate for estate duty purposes. In such a case, the heir is permitted to take the asset that would otherwise have to be sold to provide liquidity for the payment of the capital gains tax, and to pay the tax within three years after the executor has been given permission to distribute the estate.²²⁰

²¹⁹ For further reading on capital gains tax and deceased estates, see Davis, Beneke and Jooste (2009) par 2A.7 and De Koker and Williams Vol 3 (2009) pars 24.121–24.125.

²²⁰ Par 41 Eighth Schedule to the Income Tax Act. This relief was introduced because “[t]here may be cases where a significant capital gains tax charge arises due to the growth in the value of the assets although the deceased estate is heavily indebted and would not be liable for estate duty”. See Explanatory Memorandum on the Taxation Laws Amendment Bill (2001) 74.



6.9 CONCLUSIONS

This chapter provided an overview of the main characteristics of the estate duty regime. The following chapter will provide a discussion on some key policy issues and problematic aspects relating to donations tax and estate duty in the South African tax system.

CHAPTER 7
POLICY ISSUES AND PROBLEMATIC ASPECTS
RELATING TO THE SOUTH AFRICAN
WEALTH TRANSFER TAX SYSTEM

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7.1 INTRODUCTION

Following on the discussion of the main framework and features of the current South African wealth transfer tax system in Chapters 5 and 6, this chapter points out key policy issues that will have to be considered. Paragraph 7.2 outlines the lack of integration between the taxation of *inter vivos* transfers and transfers on death under the current regimes and paragraph 7.3 subsequently identifies a number of significant problem areas. Paragraph 7.4 reopens the centuries-old debate on whether transferor-based taxation should be preferred over recipient-based taxation. This debate is located in a South African context.

7.2 THE INTEGRATION OF THE TAXATION OF *INTER VIVOS* TRANSFERS AND TRANSFERS ON DEATH

7.2.1 The Issue of Integration

In the light of the various discrepancies that exist between the taxation of *inter vivos* transfers and transfers on death under the current regimes (as will more fully be pointed out below), the first purpose of this study is to establish to what extent the taxation of the two types of transfers should be integrated under the South African wealth transfer tax system.



7.2.2 Current Discrepancies

7.2.2.1 Different Statutes

Wealth transfer taxation is currently provided for by virtue of two separate fiscal regimes. Estate duty is levied in terms of the Estate Duty Act,¹ whereas donations tax is provided for in Part V of the Income Tax Act.² The Margo Commission and the Katz Commission proposed that both legislative regimes should ideally be replaced by a single integrated legislative regime, referred to as “capital transfer tax”.³ Government has not yet acted on these recommendations.

7.2.2.2 Jurisdictional Basis

Both estate duty and donations tax are primarily levied on a worldwide basis. In addition, for the purposes of estate duty, property located, registered or enforceable in South Africa belonging to a person who is not ordinarily resident in the republic at the date of his or her death will be subject to estate duty. Complementary to the worldwide basis, estate duty is therefore levied on a *situs* basis as well. By contrast, local property donated by a non-resident does not fall within the ambit of donations tax, implying that the jurisdictional basis for donations tax does not extend to a *situs* basis.⁴ Some scholars mention rightly that it is odd that non-residents are liable for estate duty in respect of property situated in the republic, but are not liable for donations tax if such property is donated.⁵

¹ Act 45 of 1955.

² Act 58 of 1962.

³ See Ch 1 par 1.1 and Ch 3 par 3.3.2.3.

⁴ See Ch 5 par 5.2.2 and Ch 6 par 6.2.2.

⁵ Davis, Beneke and Jooste (2009) pars 2.3.3 and 2.9.1.



Also, the jurisdictional basis for estate duty is determined with reference to a person “ordinarily resident” in the republic,⁶ whilst the jurisdictional basis for donations tax is established with reference to a “resident”, which term (as defined) includes a person “ordinarily resident” in the republic as well as a person who satisfies the physical presence test for a particular year of assessment.⁷

7.2.2.3 Double Taxation Relief

Because of the fact that *inter vivos* transfers and transfers on death are taxed in terms of two different statutory regimes, the double taxation agreements concluded with other countries in the realm of wealth transfer taxation do not necessarily apply to both types of transfers. In fact, all the double taxation agreements entered into, with the exception of the agreement concluded with the United Kingdom, provide relief towards transfers on death only.⁸ Furthermore, the Estate Duty Act provides for unilateral relief in the case of double taxation, whereas the unilateral relief provided for in the Income Tax Act does not extend to donations tax.⁹

Double taxation may, for example, occur where a resident donates an asset located in a foreign country (which is not exempt from donations tax). Suppose that A, who has been a South African resident since his birth, owns property in the United States which he purchased as an investment. If A donates the property, he will be liable for South African donations tax. Assuming that the United States (transferor-based) federal gift tax applies to the transaction, A will also be liable for that tax. Because the double tax agreement entered into with the United States applies to transfers on death only, A will not be entitled to relief in terms thereof. In addition, A cannot rely on any unilateral relief

⁶ See Ch 6 par 6.2.2.1.

⁷ See Ch 5 par 5.2.2.1.

⁸ See Ch 5 par 5.2.3 read with Ch 6 par 6.2.3.

⁹ See Ch 5 par 5.2.3 read with Ch 6 par 6.2.3.

provisions. Where, however, A does not donate the United States asset, but bequeaths it to his son, then A's deceased estate will be entitled to relief in terms of the United States double taxation agreement for the double taxation produced as a result of the operation of South African estate duty and the United States federal estate tax.

7.2.2.4 Valuation Rules

The Estate Duty Act contains special rules for the valuation of unquoted shares,¹⁰ whereas the Income Tax Act does not offer any corresponding provisions for the purposes of donations tax.

Also, for the purposes of estate duty, usufructuary, fiduciary and other like interests and annuities are valued with reference to the life expectancy of the beneficiary (unless the interest is to be enjoyed for a shorter period),¹¹ whereas for donations tax purposes these interests are primarily valued with reference to the life expectancy of the donor (unless the interest is to be enjoyed for a shorter period).¹² Because these valuation issues are inextricably linked to the approach towards limited interests in general, these issues will more fully be addressed under paragraph 7.4.4 below.

7.2.2.5 Exemptions

If one compares the exemptions under the donations tax provisions with the exemptions provided for the purposes of estate duty,¹³ it is evident that both regimes offer exemptions for the Government, municipalities, public benefit organisations and certain institutions exempt from income tax (although the wording used under the statutes differs slightly). Furthermore, both regimes provide for the exemption of transfers between spouses.

¹⁰ See Ch 6 par 6.3.1.

¹¹ See Ch 6 pars 6.3.3.2 and 6.3.3.3.

¹² See Ch 5 par 5.3.2 and 5.3.3.

¹³ See Ch 5 par 5.5.3 and Ch 6 par 6.5.2.2.



The rest of the exemptions offered under both regimes differ to a large extent. Because of the difference in nature between transfers that occur during life and transfers that occur on death, it is understandable that there are discrepancies under the regimes. For example, the provision for the exemption of maintenance payments, donations cancelled within six months and certain voluntary awards (that are required to be included in the gross income of the recipient) are generally relevant in the realm of lifetime transfers. Similarly, the Estate Duty Act contains some exemptions as a consequence of the special circumstances that exist on the death of a person, such as the exemption provided for cultural property lent under a notarial deed to the State and the exemption offered for improvements effected to property by an heir.

However, it would seem that there are a number of discrepancies that are unwarranted. For example, donations to or by the following institutions are exempt from donations tax (but no corresponding exemption is granted where these institutions inherit from a deceased estate): any traditional council, traditional community or any tribe; a political party; a recreational club approved by the Commissioner; certain pension and retirement funds, a trade union, chamber of commerce or industries, a local publicity association approved by the Commissioner; a company, society or association established to promote the common interests of its members and a body corporate, share block company and association of persons (whose receipts and accruals are derived by way of levies from its members or shareholders).

7.2.2.6 General Anti-avoidance Rule

Because donations tax is provided for in the Income Tax Act, the general anti-avoidance measure is also applicable for the purposes of donations tax.¹⁴ On the other hand, the

¹⁴ See Ch 5 par 5.7.



Estate Duty Act does not enjoy the advantage of these provisions. In particular, there is no general anti-avoidance rule in operation for the purposes of estate duty.¹⁵

7.3 TRANSFEROR-BASED TAX VERSUS RECIPIENT-BASED TAX

When the first national legislation, namely the Death Duties Act,¹⁶ was replaced by donations tax (levied in terms of income tax legislation) and estate duty (levied in terms of the Estate Duty Act) in 1955, it became evident that South Africa followed the example of common-law countries by preferring transferor-based taxation to recipient-based taxation.¹⁷ It is to be noted, though, that traces of recipient-based taxation were left behind or later adopted in the estate duty regime, such as the following:

- The deduction provided for any amount that “accrues” to certain institutions of a charitable nature;¹⁸
- The deduction provided for any benefit that “accrues” to the surviving spouse;¹⁹
- A usufructuary, fiduciary or other like interest and an annuity is primarily valued with reference to the life expectancy of the beneficiary (the successor), unless the interest is to be enjoyed for a shorter period;²⁰
- The beneficiary is in some instances accountable for the estate duty attributable to the property included in the deceased estate, such as the beneficiary of life insurance benefits and the person to whom the right of enjoyment of property accrues on the death of the deceased.²¹

¹⁵ See Ch 6 par 6.7.

¹⁶ Act 29 of 1922.

¹⁷ See Ch 3 pars 3.3.2.2 and 3.4(i).

¹⁸ S 4(h) of the Estate Duty Act. See Ch 6 par 6.5.2.2.

¹⁹ S 4(q) of the Estate Duty Act. See Ch 6 par 6.5.2.2.

²⁰ See Ch 6 pars 6.3.3.2 and 6.3.3.3. See also par 7.4.5.5, where it is explained that limited interests were basically valued with reference to the circumstances of the beneficiary for purposes of the Death Duties Act.

²¹ See Ch 6 par 6.4.



Although transferor-based taxation was supported by the Franzsen Commission (1970), the Margo Commission (1986) and the Katz Commission (in 1995),²² it was concluded that the possibility of the adoption of recipient-based taxation was not properly considered by any one of these commissions.²³ It was also explained that capital gains tax was only recently introduced into the South African tax system. As a consequence, the Margo Commission and the Katz Commission, which both rejected the idea of a capital gains tax, were not confronted with the double taxation produced by the levying of capital gains tax together with transferor-based wealth transfer taxation.²⁴

Because it was concluded in chapter 4 that transferor-based taxation (together with a deemed-realisation capital gains tax approach) is unjustifiable and recipient-based taxation has substantive theoretical appeal,²⁵ this thesis aims to explore whether or not a transition from a transferor-based regime to a recipient-based system would offer a better way to tax wealth transfers in the South African tax system. Administrative viability should not be disregarded, especially because administrative convenience represents one of the main reasons why estate taxation has generally been preferred in a number of common-law countries.²⁶ A caveat was indeed noted in Chapter 4 on the administrative feasibility of recipient-based taxation.²⁷ The fact that estate duty and donations tax are well-established in the South African law should also be taken into consideration.²⁸

²² See Ch 3 par 3.3.2.3.

²³ See Ch 3 par 3.4(i).

²⁴ See Ch 3 par 3.4(i).

²⁵ See Ch 4 par 4.6(i).

²⁶ See Ch 3 par 3.2.3.

²⁷ See Ch 4 pars 4.4.4.1 and 4.6(e).

²⁸ See Ch 4 par 4.4.2.



To arrive at a well-considered answer to the transferor-based tax/recipient-based tax debate, it is necessary to identify the significant problem areas under the current regimes. These are outlined in paragraph 7.4 directly below.

7.4 SELECTED PROBLEM AREAS

7.4.1 Jurisdictional Basis

Apart from the discrepancies in the jurisdictional basis of the donations tax regime in contrast to that of the estate duty regime pointed out above, a second issue relates to the demarcation of the worldwide basis of taxation under both regimes. The Katz Commission considered the extension of the tax base (for the purposes of both estate duty and donations tax) to all assets worldwide, but recommended that such an extension would exceed the enforcement capabilities of the tax authorities.²⁹ If one considers that estate duty and donations tax are already primarily levied on a worldwide basis,³⁰ it is submitted that what was actually considered is whether it is still justifiable to exclude certain foreign assets (as respectively listed in Chapters 5³¹ and 6³² above) from the tax base. It is submitted that the commission's recommendation is, in the words of Davis, Beneke and Jooste, "surprising", because the exclusion of certain foreign properties from the tax base must in itself create administrative difficulties for SARS.³³

²⁹ Katz Report (Fourth Interim) par 13.3.

³⁰ See par 7.2.2.2.

³¹ See Ch 5 par 5.2.2.1.

³² See Ch 6 par 6.2.2.1.

³³ Davis, Beneke and Jooste (2009) par 18.3.6.



7.4.2 The Characteristics of a Donation

The question whether the statutory definition of a donation, primarily including any disposal of property “for which nothing was received in return [that is], for which no consideration was received”,³⁴ also embraces the common-law meaning of a donation (a *donatio mera*) has for a long period been a controversial issue.³⁵ A common-law *donatio mera* can be described as an agreement which has been induced by disinterested benevolence or sheer liberality, whereby a person (the donor) under no legal obligation undertakes to give something to another person (the donee), or to waive a right in such person’s favour, in return for which the donor receives no consideration nor expects any future advantage. The donor must have an intention to donate (*animo donandi*). Furthermore, the estate of the donor must be impoverished and the estate of the donee enriched.³⁶

The Supreme Court of Appeal has recently clarified the position in *Welch’s Estate v CIR*,³⁷ where Marais JA (with Zulman and Cloete JJA concurring) held that the legislature has not eliminated from the statutory definition the characteristic which the common law regards as essential to a donation, namely, that the disposition must be motivated by “pure liberality or disinterested benevolence”.³⁸ It seems therefore as if a donation as referred to in the principal levying provision effectively embraces the elements of a donation under the common law, requiring (a) an intention to donate; (b) impoverishment on the side of the transferor and (c) enrichment on the side of the recipient.

³⁴ *ITC 1448* (1988) 51 SATC 58 63.

³⁵ See e.g. Meyerowitz on Income Tax (2001/2002) par 31.5, where the writer suggested that the provision for a specific statutory definition implies that the common-law characteristics of a donation are not required.

³⁶ See *Avis v Verseput* 1943 AD 331 347–353; *Estate Sayle v CIR* 1945 AD 388 394; *Ovenstone v SIR* 1980 (2) SA 721 (A) 736–737; *CIR v Estate Hulett* 1990 (2) SA 786 (A) 794; Owens in *LAWSA* (2005) pars 300–315, 321–323 and authority cited there; Sonnekus (2005) *THRHR* 154–159.

³⁷ 2004 (2) SA 586 (SCA), 66 SATC 303.

³⁸ *Welch* case 314 (par 30).



However, the question arises whether or not the disposition referred to in section 58(1) should also depict these characteristics. Should the deeming provision for example be restricted to transactions entered into with the intention to donate (*animus donandi*), or was the object to also include ordinary commercial transactions where the motive to donate is absent? Scholars seem to disagree. Some have expressed the view that the intention of the legislature could never have been to bring transactions within the ambit of the Act where the intention to donate is absent.³⁹ Others submit that the section can apply to any disposal of property for any motive, if the Commissioner is of the opinion that the consideration given is not adequate.⁴⁰ It seems also as if the judiciary does not require an intention to donate to be present for the provision to be invoked.⁴¹ Although the Commissioner has apparently never invoked section 58(1) in transactions negotiated at arm's length,⁴² it is submitted that it is undesirable that ordinary commercial transactions are arguably not sheltered from the tax base. This submission is bolstered if it is considered that the Commissioner may simply avoid proving *animus donandi* by merely invoking section 58(1), instead of relying on the primary charging provision.⁴³

³⁹ See Urquhart (1983) *SA Company Law J* 16–21 and Davis, Beneke and Jooste (2009) pars 2.9.4 and 13.8.

⁴⁰ See Meyerowitz on Income Tax (2007/2008) par 31.5 and De Koker and Williams Vol 3 (2009) par 23.5.

⁴¹ See *CIR v Estate Kohler* 1953 (2) SA 584 (A); *Estate Furman & Others v CIR* 1962 (3) SA 517 (A); *ITC 1167* (1971) 34 SATC 48 (where the taxpayer sold his right to fell timber for a price below market value to a company whose shareholders were his major children); *ITC 1329* (1980) 43 SATC 62 (where the taxpayer renounced her usufructuary rights to her children for inadequate consideration); *ITC 1387* (1984) 46 SATC 121 (where the deceased's son, who adiated under a joint will massing his estate with the estate of his deceased father, was held to be liable for donations tax because he gave up more than he received); *ITC 1599* (1995) 58 SATC 88 (where the taxpayer sold his shares in a company to a trust, of which his children were the beneficiaries, for a consideration less than market value). See in general the discussion by Silke (1996) *Tax Planning* 89 *et seq.* See, however, Davis, Beneke and Jooste (2009) par 13.8 for a contrary view.

⁴² Silke (1996) *Tax Planning* 95; Davis, Beneke and Jooste (2009) par 2.9.4.

⁴³ An attempt to tax a transfer under s 58(1) may, however, involve intricate valuation issues (in view of the fact that the gratuitous part of the transfer has to be established). For example, in the *Welch* case the Commissioner did not rely on section 58 (as it then was), presumably because it was difficult, if not impossible, to calculate the value of the contingent interests of the ultimate capital beneficiaries.



In addition, the question may be posed whether the donor should be impoverished and the donee enriched. The position seems to be unclear. There is Appellate Division case law providing authority that similar provisions under the former Death Duties Act and the Estate Duty Act (as it then read, before the transition of the deeming provision to the income tax legislation)⁴⁴ did not require impoverishment on the side of the donor.⁴⁵ These cases dealt with value-shifting arrangements where companies allotted shares to an incoming shareholder for inadequate consideration. The problem in this area is that, although the acquiring shareholder's estate is enriched, the person making the disposition (the company) is not impoverished. In both cases it was held that the transactions constituted dispositions as required (in the absence of the deeming provisions requiring impoverishment). However, the former provisions referred to a disposition whereby a person becomes "entitled" to property, thereby implying some form of enrichment, but not necessarily impoverishment.⁴⁶ In view of the fact that the current provision focuses on the donor and because it has been confirmed that the concept of a "disposition" implies a transferor and a recipient,⁴⁷ it is submitted that the provision (in its current form) implicitly requires some form of impoverishment and enrichment.⁴⁸ It is therefore arguable that value-shifting arrangements fall outside the scope of section 58(1) as it currently reads, which is unwarranted.

⁴⁴ At that point in time, certain donations were included in the estate duty tax base. See Ch 3 par 3.3.2.2.

⁴⁵ *CIR v Estate Kohler* 1953 (2) SA 584 (A) (decided under the provisions of the Death Duties Act) and *Estate Furman & Others v CIR* 1962 (3) SA 517 (A) (decided under a former provision of the Estate Duty Act).

⁴⁶ See the Death Duties Act s 3(6) and Estate Duty Act s 3(4)(a) (which has since been repealed). S 3(4)(a) stated: "any disposition whereby any person becomes entitled to receive or acquire any property, for a consideration which, in the opinion of the Commissioner, is not a full consideration for that property, shall, to the extent to which the fair market value of the property exceeds the said consideration, be deemed to be a donation."

⁴⁷ See Ch 5 par 5.2.1.

⁴⁸ *Cf De Koker and Williams Vol 3 (2009) par 23.5. Meyerowitz on Income Tax (2007/2008) par 31.15 mentions the issue, but does not express an opinion.*



7.4.3 The Treatment of Life Insurance Benefits

It was pointed out in Chapter 6 that life policy benefits payable to the insured's deceased estate constitute "property" for the purposes of estate duty. To cater for the situation where the policy benefits are recoverable by a third party (usually the nominated beneficiary), the Estate Duty Act specifically includes as "deemed property" the benefits in the deceased estate of the insured (provided that the policy constitutes a "domestic policy").⁴⁹ However, these third party policies are treated on a recipient basis, because the estate duty attributable to the benefits is recoverable from the beneficiary of the policy.⁵⁰ This explains why any premiums payable by the beneficiary (plus interest at six percent) is deductible from the proceeds.⁵¹

On one level, the issue relates to the justification of a recipient approach within a transferor-based regime, where the focus is on the transferor. The problem with life insurance benefits from the angle of transferor-based taxation is that the policy benefits are not channelled through the deceased estate of the insured.⁵² However, the mere inclusion of the benefits in the deceased estate would create a harsh result if the beneficiary's position is not taken into account. Although it is therefore understandable that the benefits are treated from the perspective of the beneficiary, it is not conducive to horizontal equity in the system. It was already pointed out in Chapter 4 that heirs are treated unequally under the estate duty regime, because the main burden of the tax falls on the residuary heir.⁵³ The allocation of the tax liability to certain heirs only, such as life insurance beneficiaries and successors to limited interests,⁵⁴ amplifies the equality issue.

⁴⁹ See Ch 6 par 6.2.4.2.1.

⁵⁰ See Ch 6 par 6.4.

⁵¹ See Ch 6 par 6.2.4.2.1.

⁵² See Ch 6 par 6.2.4.2.1 n 55.

⁵³ See Ch 4 par 4.4.1.3.

⁵⁴ See Ch 6 par 6.4.

On a second level, the question may be posed whether it is justifiable to include policy benefits payable to third parties to the extent that the deceased did not contribute to such benefits. Where, for example, a third party were responsible for all the premiums on a life policy, he would have given adequate consideration for such benefits. It is arguable that to allow such person a deduction for the premiums only negates the very nature of a life insurance policy, where the amount of the premiums is actuarially calculated to reflect the risk factors (and not only the contribution to capital).

A third issue relates to the exclusions offered under the deeming provision. To neutralise the hardship caused by its wide scope, the Estate Duty Act allows for certain exclusions, namely benefits recoverable by a surviving spouse or child (in terms of certain nuptial contracts); benefits payable under a buy-sell arrangement and key-man policy benefits. It was pointed out in Chapter 6 that the strict requirements applicable to these exclusions (especially in regard to benefits payable under a buy-sell arrangement and key-man policy benefits) have given rise to interpretation issues, anomalies and inequities.⁵⁵ Moreover, because of all these requirements numerous sophisticated tax planning schemes were developed to ensure that policies could be categorised under one of the available options.

As a consequence, the Minister of Finance, in his budget speech of 1 February 2008, proposed to exempt in general a certain amount of life insurance benefits from estate duty (as long as that policy was not created shortly before death).⁵⁶ However, this proposal was withdrawn. The Treasury's Chief Director of Tax Policy told Parliament's Finance Committee that taxpayers could make their savings in one vehicle and then get it into their estate tax-free, which could initiate a significant avoidance problem.⁵⁷

⁵⁵ See Ch 6 par 6.2.4.2.1.

⁵⁶ Department of the Treasury *Budget Tax Proposals* (2008/2009) 30, available at <http://www.treasury.gov.za/documents/national%20budget/2008/guides/Budget%20Proposals%202008.pdf> (accessed on 21 October 2008).

⁵⁷ Hamlyn "Treasury Changes Its Mind on Estate Duty Exemption" *Mail & Guardian Online* (20/10/2008), available at www.mg.co.za/article/2008-10-20-treasury-changes-its-mind-on-estateduty-exemption

Footnote continues on the next page



7.4.4 The Treatment of Limited Interests and Bare *Dominium* Property

7.4.4.1 General

Limited interests such as usufructuary and other like interests (including a vested interest to the income of a trust), annuities and fideicommissary interests⁵⁸ (hereafter “limited interests”) and bare *dominium* property pose problems for wealth transfer tax systems on various levels, such as the accommodation thereof in the tax base, which is inextricably linked to the valuation rules. The South African system provides an example of a system where limited interests and bare *dominium* property are valued with reference to actuarial values.

Before embarking on an analysis of the accommodation of these interests in the tax base, it is significant to point out that, for the purposes of donations tax, a limited interest is valued with reference to the life expectancy of the donor, unless the interest is to be enjoyed for a shorter period.⁵⁹ The focus is on the value of the property “given away” by the donor, who is also primarily responsible for the payment of donations tax – which is in line with a transferor-based tax. However, for the purposes of estate duty an interest is valued over the life expectancy of the beneficiary (the successive interest holder or the bare *dominium* owner), unless the interest is to be enjoyed for a shorter period.⁶⁰ An

(accessed on 21 October 2008). See also Response Document of the Portfolio Committee on Finance *Report Back Hearings on the Revenue Laws and Bills 2008* (21 October 2008), available at www.finance.gov.za/legislation/Bills (accessed on 16 July 2009).

⁵⁸ The question may be posed whether it is justifiable to value a fiduciary interest (where the holder has *dominium* in the underlying property) similar to a usufructuary interest (where the holder does not have *dominium* in the underlying property). According to the Explanatory Memorandum on the Estate Duty Bill (1955) 8, the determination of the precise nature of an interest could sometimes involve intricate questions of law, which a uniform valuation regime would eliminate. It is submitted that the approach is justifiable, especially if one considers that it is often difficult to classify a trust beneficiary’s interest to the underlying trust property. See Strydom LLD Thesis (2000) 235, where the author submits that a vested right of a capital beneficiary can often be compared to a fiduciary interest.

⁵⁹ See Ch 5 par 5.3.2.

⁶⁰ See Ch 6 pars 6.3.3.2 and 6.3.3.3.



exemption is also offered for the value of any improvements effected to property during the lifetime of the deceased by the person who becomes entitled to the right of enjoyment of the property on the death of the deceased.⁶¹ In addition, the beneficiary will ultimately bear the burden of the tax attributable to the cessation of the interest.⁶² The interest is therefore valued from the perspective of the beneficiary. For the purposes of both donations tax and estate duty, the bare *dominium* property is valued as the difference between the fair market value of the underlying property and the particular interest (which interest is calculated with reference to the life expectancy of the interest holder).⁶³

The discussion below will analyse the approach to limited interests by referring to (a) the position of bare *dominium* property (b) the creation of limited interests and (c) the termination of limited interests.

7.4.4.2 The Position of Bare Dominium Property

For the purposes of donations tax and estate duty, the transfer of bare *dominium* property (whether *inter vivos* or on death) is immediately chargeable and not deferred until it materialises into full ownership. This position is sometimes exploited to conceal a passive transfer of wealth through passage of time, as will appear from the example below.

Example 1

A transfers the bare *dominium* in property worth R1 million to his son B (for no consideration) and retains a 20-year usufruct in the property for himself. A will be liable for donations tax on the value of the bare *dominium*, R103 672 (calculated as the difference between the market value of the underlying property and

⁶¹ See Ch 6 par 6.5.2.2. Meyerowitz par 28.24 argues (it is submitted, correctly) that, instead of providing for an allowable deduction in this way, it would be simpler to adapt the relevant valuation rules.

⁶² See Ch 6 par 6.4.

⁶³ See Ch 5 par 5.3.4 and Ch 6 par 6.3.3.4.



the value of the usufruct).⁶⁴ However, the accrual of the right of enjoyment of the property after the lapse of 20 years will not constitute a donation.⁶⁵

This scheme is especially attractive considering that it is likely that the low present value of the bare *dominium* property on date of initial acquisition is likely to fit into an exemption threshold for the purposes of donations tax.

The Margo Commission deemed it advisable to treat the holders of limited interests as having an interest in an appropriate portion of the full *dominium* of the underlying property itself.⁶⁶ Although it seems, at first glance, as if such a proposition would minimise the manipulation of the actuarial values associated with limited interests (which will more fully be explained in the paragraphs below), such an approach would require that the taxation of bare *dominium* property be deferred until it materialises into full ownership, which represents a totally different approach.

7.4.4.3 The Creation of Limited Interests

Where a person, during his or her lifetime, grants a limited interest to another for inadequate consideration, such an act would constitute a disposition for the purposes of donations tax. It is therefore possible for an owner of property to “split” the property during his or her lifetime. The donations tax would then be calculated on the respective interests. However, where a testator “splits” property at his or her death by for example bequeathing property subject to a usufruct or an annuity, the splitting of the property would have no effect on the estate duty calculation, because the duty is calculated on the

⁶⁴ Calculated as follows: R1 000 000 – R896 328 (R1 000 000 x 12% x 7.4694) = R103 672.

⁶⁵ The lapse of an interest does not constitute an occasion of charge. It is to be noted that, if the wealth holder does not survive the 20-year period, the cessation of the usufruct will be dutiable for the purposes of estate duty. See par 7.4.4.4. For further reading, see Muller (2007) *De Iure* 353 *et seq* and Davis, Beneke and Jooste (2009) pars 12.5 and 12.7. This scheme is apparently also used in the US, where a transferor-based estate tax is also levied (providing for actuarial values in the case of limited interests). See Dodge (2009) *Hastings Law J* 1051 for a more detailed discussion.

⁶⁶ Margo Report (1986) par 20.57.

property of the deceased estate (at the moment before death). It is evident from the example below that the *inter vivos* splitting of interests may be abused to save a significant amount of tax where the donor is older than the beneficiary (because the donor's age would be relevant for calculating the donations tax on the usufruct, whereas the beneficiary's age would be relevant for calculating the bare *dominium*). For the purposes of this thesis, this effect will be referred to as the "aged donor" phenomenon.

Example 2

- 2.1 A (male, age 74) bequeaths property worth R1 million to his wife subject to a lifelong usufruct in favour of his grandchild B (male, age 24). Ignoring any exemptions and rebates, A's deceased estate would be liable for estate duty on R1 million.
- 2.2 A (aged 74) donates (during his life) a usufruct over land worth R1 million to his grandchild B (aged 24) and thereafter transfers the *bare dominium* to his wife (for no consideration). The value of the usufruct subject to donations tax would be determined with reference to A's life expectancy, which would be calculated at R568 188.⁶⁷ However, the value of the bare *dominium* subject to donations tax would be determined with reference to the life expectancy of the much younger B. The value of the bare *dominium* would therefore amount to R7 649.⁶⁸ In total, A would be liable for donations tax on only R575 837.

It is possible under South African law to create a successive interest. A person may, for example, transfer property (*inter vivos* or on death) to another person subject to a usufruct in favour of a third person with the burden that another person will, on the termination of the first usufruct, be entitled to a successive usufruct over the property. Because the South African wealth transfer tax base operates on a transferor basis, the acquisition of the successive usufruct by the successive usufructuary will not constitute a taxable event. However, the termination of the successive usufruct may have some tax consequences, as is evident from the discussion below.

⁶⁷ Calculated as follows: R1 000 000 x 12% x 4.7349.

⁶⁸ Calculated as follows: R1 000 000 – (R1 000 000 x 12% x 8.26959).



7.4.4.4 *The Termination of Limited Interests*

A limited interest may be terminated through lapse of time, death or renunciation. Under the donations tax regime, the lapse of an interest through passage of time does not constitute a taxable event.⁶⁹ This is understandable if one considers the underlying nature of the tax, because there is nothing left of the interest to “give away”.

Although the holder of a limited interest may generally not transfer his or her interest, such a holder may renounce the interest in favour of the successor to the enjoyment of the property. Because such an act “transfers” a benefit to another, the renunciation of an interest is understandably captured as a chargeable transfer under the donations tax base.⁷⁰

A contentious issue for the purposes of wealth transfer taxation is the termination of an interest on the death of an interest holder, especially where the taxation of the bare *dominium* is not deferred until its materialisation into full ownership, such as in the South African system. The issue is that an untimely death may also be seen as the “transfer” of a benefit to the successor similar to the position under a renunciation as explained above. However, it is arguable that a benefit conveyed through a renunciation is intentional, whereas death occurs (usually) unintentionally. The South African legislature opted for the view that a passive “transfer” of the enjoyment of property on the death of the interest holder should be accommodated in the tax base, as a consequence of which the termination of an interest enjoyed immediately before the death of an interest holder is specifically included as a chargeable event for the purposes of estate duty.⁷¹

Although both renunciation and death constitute chargeable events under the tax base, the calculation of a renounced interest varies considerably from the calculation of an interest that ceases on death, because a renounced interest is valued from the perspective of what

⁶⁹ Meyerowitz on Income Tax (2007/2008) par 31.4.

⁷⁰ See Ch 5 par 5.2.1.

⁷¹ See Ch 6 par 6.2.4.1.



is “given away” by the transferor, whereas an interest that ceases on death is valued from the perspective of the successor. Suppose, for example, that a person (A) grants a 10-year usufruct to another person (B) for no consideration and transfers the bare *dominium* to a third person (C), who provides adequate consideration for the bare *dominium*. If B renounces the usufruct eight years later, the renounced interest will be calculated with reference to the unexpired two-year period. However, in the case where B dies eight years later, the indirect “transfer” of wealth will for estate duty purposes be calculated with reference to C’s life expectancy and not the two-year period. It should be clear that C would be in a detrimental position on B’s death, especially where C is very young. If one considers that, even from a recipient point of view, C’s “gain” is only the extended two years of enjoyment, it seems as though the estate duty angle includes even *more* than the successor’s gain.

The position of the successor, and especially the bare *dominium* owner, is therefore unenviable. In an attempt to mitigate some of the harsh consequences, the Estate Duty Act provides for the following limitations where the enjoyment of the property accrues to the bare *dominium* owner:

- The value of a ceasing *usufructuary* interest may be reduced by any amount equal to the consideration (previously) paid by the beneficiary for the bare *dominium*, plus interest thereon at six percent per annum from the date of payment to the date of death of the deceased (the section 5(1)(b) first proviso);⁷²
- The value of a ceasing *usufructuary* interest should not exceed the value of the full ownership less the value of the bare *dominium* when such bare *dominium* was first acquired under the disposition creating the limited interest that was held by the deceased (the section 5(1)(b) second proviso).⁷³

⁷² S 5(1)(b) first proviso. See in general Meyerowitz (2007) par 29.11.

⁷³ S 5(1)(b) second proviso. See in general Meyerowitz (2007) par 29.12 and Davis, Beneke and Jooste (2009) par 2.7.3.5. To illustrate, suppose that on A’s death the value of a property is R1 million. In terms of A’s will the bare *dominium* in the property is bequeathed to C, subject to a lifelong usufruct in favour of B. The R1 million will be dutiable in A’s deceased estate. Suppose furthermore that the value of the usufruct on A’s death is R400 000 and the value of the bare *dominium* R600 000. Assume, for the sake of simplicity, Footnote continues on the next page

What seems unfortunate is that the two provisos apply only on the cessation of a *usufructuary interest*. Where the owner of property burdened with an annuity (who is also treated as having bare *dominium* in the underlying property) acquires the benefit of the full property on the cessation of the annuity on the death of the annuitant, the above limitations are not correspondingly applicable. Furthermore, because a fiduciary heir cannot be regarded as a bare *dominium* owner, the relief provided does not extend to the case where a fideicommissary interest ceases on the death of the fideicommissary heir.

The examples below will attempt to illustrate some of the anomalies created by the approach chosen by the legislature and will also point out that the two section 5(1)(b) provisos do not always effectively eliminate the inequities. For the sake of simplicity, exemptions and rebates are ignored except where it is crucial to illustrate the effect of a specific exemption (such as the spousal exemption in example 7 below). It should also be noted that, although the examples are mainly referring to usufructuary interests, the same anomalies will arise in the case of annuities (charged against property) and fiduciary interests – except that in these cases the complications may even be worse because of the absence of the operation of the section 5(1)(b) provisos.

Example 3A:

- 3A.1 During his life, A (male, 69) grants a lifelong usufruct over land valued at R1 million to B (female, 64) and simultaneously sells the bare *dominium* to C (male, 30). C provides adequate consideration for the bare *dominium* in the amount of R165 356, calculated as the difference between the market value of the land and the value of the usufructuary interest with reference to the life expectancy of B (R1 million – R834 644).⁷⁴
- 3A.2 Suppose B renounces the usufructuary interest in favour of C one month later, then B (the donor) will be liable for donations tax on the renunciation of the interest, calculated with reference to her own life expectancy. B will therefore have to account for donations tax on R834 644.

that the market value of the property is still R1 million on B's death and that the value of the ceasing interest is R700 000. The limitation reduces the value to the value of the usufruct created in A's will, namely R400 000.

⁷⁴ R1 000 000 – (R1 000 000 x 12% x 6.95537).



3A.3 However, suppose that B does not renounce the interest, but passes away one month after the creation thereof, then C (the bare *dominium* owner) will be liable for estate duty on the cessation of B's usufructuary interest. The duty will be calculated in accordance with the primary valuation rule with reference to C's life expectancy at that point in time:

Value of usufructuary interest: R1 million x 12% x 8.22694	R 987 233
Less section 5(1)(b) first proviso (consideration paid)	<u>(R165 356)</u>
	R 821 877
According to section 5(1)(b) second proviso, limited to	<u>R 834 644</u> ⁷⁵
C will consequently be liable for estate duty on	R 821 877

If the tax consequences of the renunciation are compared with the cessation on death, the results are as follows:

a) Taxable value on renunciation one month later	R 834 644
b) Taxable value on death on month later – before the operation of the provisos	R 987 233
c) Taxable value on death – taking the provisos into account	R 821 877
<i>(Difference between a and c is R12 767)</i>	

Example 3B:

3B.1 The facts are similar to the facts in 3A.1 above.

3B.2 Suppose B (at age 74) renounces the usufructuary interest in favour of C ten years after the creation of the usufruct, when the value of the property is R1.5 million. B (the donor) will be liable for donations tax on the renunciation of the interest, calculated with reference to her own life expectancy at that point in time, namely R1 000 337.⁷⁶

3B.3 However, suppose that B does not renounce the interest, but passes away 10 years after the creation thereof, then C (at age 40) will be liable for estate duty calculated in accordance with the primary valuation rule with reference to C's life expectancy at that point in time:

Value of usufructuary interest: R1.5 million x 12% x 8.04030	R 1 447 254
Less section 5(1)(b) first proviso	<u>(R 264 569)</u>
(consideration paid plus interest at 6%)	R 1 182 685
According to section 5(1)(b) second proviso, limited to	<u>R 1 334 644</u> ⁷⁷
C will consequently be liable for estate duty on	R 1 182 685

⁷⁵ Calculated as follows: R1 000 000 – R165 356.

⁷⁶ Calculated as follows: R1 500 000 x 12% x 5.55743.

⁷⁷ Calculated as follows: R1 500 000 – R165 356.



If the tax consequences of the renunciation are compared with the cessation on death, the results are as follows:

- | | |
|---|--------------------|
| a) Taxable value on renunciation 10 years later | R 1 000 337 |
| b) Taxable value on death 10 years later – before the operation of the provisos | R 1 447 254 |
| c) Taxable value on death – taking the provisos into account | R 1 182 685 |

(Difference between a and c is R182 348)

Examples 3A and 3B illustrate that the operation of the two section 5(1)(b) provisos mitigate the punitive effect on the much younger C (who paid full consideration for the bare *dominium!*). It is significant to note that the net value of the ceasing interest in examples 3A.3 and 3B.3 is reduced by the operation of the provisos to an amount that is close to the value of the renounced interest in examples 3A.2 and 3B.2.

It is arguable that it would make more sense instead to value for estate duty purposes a ceasing interest with reference to the unexpired period of the interest (which is “given away”), which would be calculated with reference to the life expectancy of the interest holder just prior to his or her death (in the case of a lifelong usufruct) or the unexpired period of a fixed-period interest. Such an approach would create neutrality between the renunciation of a usufruct and a cessation thereof on death and there would be no need for complicated provisos. Under such a valuation approach the taxable value of the renounced usufruct in examples 3A.2 and 3B.2 would be equal to the taxable value of the ceasing usufruct in examples 3A.3 and 3B.3.

Furthermore, the proposition to value lifelong interests with reference to the life expectancy of the interest holder (for the purposes of estate duty) is bolstered by the fact that the theoretical underpinning of the provisos lacks a rational justification to a certain extent. In respect of the first proviso, it is submitted that it does not make sense to allow a deduction against the value of the ceasing usufruct for the consideration paid in respect of the prior acquisition of the bare *dominium*, because such consideration was already taken into account to assess whether the initial acquisition of the bare *dominium* constituted a donation. For example, the initial acquisition of the bare *dominium* by C in example 3A.1



above does not constitute a donation, because the consideration equals the market value of the bare *dominium* at that point in time. The value of bare *dominium* (R165 356) less the consideration (R165 356) equals zero, as a consequence of which there is no donations tax liability (on the initial acquisition). Why should the consideration (once again) be taken into account when C acquires full *dominium* in the property on the death of the usufructuary (as illustrated in examples 3A.3 and 3B.3 above)?

The operation of the second proviso, namely to limit the value of the ceasing usufruct (in the hands of the beneficiary) to the “growth” in the value of the bare *dominium* (on initial acquisition) to the value of full ownership (on cessation of the usufruct), would conceptually be justifiable where the bare *dominium* owner was liable for donations tax or estate duty on the initial acquisition of the bare *dominium* or where such person paid full consideration for the bare *dominium* (such as in the examples above), because it would eliminate the possibility of double taxation.⁷⁸ However, where the bare *dominium* owner acquired the bare *dominium* as a donation, the *donor* would have been liable for donations tax. Similarly, where the bare *dominium* owner acquired the bare *dominium* as an inheritance, the *deceased estate* of the previous owner would have been liable for estate duty. It is suggested that the operation of the proviso is not truly justifiable in these instances, except to act as an artificial measure to mitigate the harsh tax consequences for the bare *dominium* owner brought about by the application of a recipient-based approach to limited interests in a transferor-based estate duty regime.

Moreover, example 4 below illustrates that the provisos do not always effectively eliminate the difference in the value of a renounced usufruct and a usufruct that ceases on death. It will also be shown (in example 5) that the second proviso operates only where

⁷⁸ For argument’s sake, suppose that a bare *dominium* owner pays donations tax on the acquisition of bare *dominium* valued at R400 000. Suppose furthermore that the bare *dominium* owner later acquires full ownership of the property on the death of the usufructuary when the value of the full property is R1 million. If the value of the ceasing usufructuary interest (valued with reference to the life expectancy of the bare *dominium* owner) amounts to R700 000, the taxation of such interest in the hands of the bare *dominium* owner would amount to double taxation to the extent that the value of the ceasing interest exceeds the increase in value from R400 000 to R1 million (R600 000).



the bare *dominium* was acquired under the *same disposition* that created the ceasing usufructuary interest, which may even worsen the dilemma.

Example 4:

- 4.1 During his life, A (male, 69) grants a 10-year usufruct over land valued at R1 million to B (female, 64) and simultaneously transfers the bare *dominium* to C (male, 29). C provides adequate consideration for the bare *dominium* in the amount of R321 976, calculated as the difference between the market value of the land and the value of the 10-year usufructuary interest (R1 million – R678 024).⁷⁹
- 4.2 Suppose B renounces the usufructuary interest in favour of C 9 years after the creation of the usufruct, when the value of the property is R1.5 million. B (the donor) will be liable for donations tax on the renunciation of the interest, calculated with reference to the remaining period of the usufruct (1 year). B will therefore be liable for donations tax on R160 722.⁸⁰
- 4.3 However, suppose that B does not renounce the interest, but passes away 9 years after the creation thereof, then C (at age 38) will be liable for estate duty calculated in accordance with the primary valuation rule with reference to C's life expectancy at that point in time:

Value of usufructuary interest: R1.5 million x 12% x 8.06781	R 1 452 206
Less section 5(1)(b) first proviso (consideration paid plus interest at 6%)	<u>(R 495 843)</u> ⁸¹
According to section 5(1)(b) second proviso, limited to	<u>R 678 024</u> ⁸²
C will consequently be liable for estate duty on	R 678 024

If the tax consequences of the renunciation are compared with the cessation on death, the results are as follows:

- | | |
|--|------------------|
| a) Taxable value on renunciation 9 years later | R 160 722 |
| b) Taxable value on death 9 years later – before the operation of the provisos | R 1 452 206 |
| c) Taxable value on death – taking the provisos into account | R 678 024 |

(Difference between a and c is R517 302)

⁷⁹ R1 000 000 – (R1 000 000 x 12% x 5.6502).

⁸⁰ R1 500 000 x 12% x 0.8929.

⁸¹ Calculated as follows: R321 976 + (R321 976 x 6% x 9 years).

⁸² Calculated as follows: R1 500 000 – R321 976.

**Example 5:**

5.1 During his life, A (male, 69) grants a 10-year usufruct over land valued at R1 million to B (female, 64) and transfers the bare *dominium* to C (male, 29) four months later. C provides adequate consideration for the bare *dominium* in the amount of R360 616, calculated as the difference between the market value of the land and the value of the 9 year 8 months usufructuary interest (R1 million – R639 384).⁸³

5.2 Suppose B renounces the usufructuary interest in favour of C 1 year before the expiration of the usufruct when the value of the property is R1.5 million. B (the donor) will be liable for donations tax on the renunciation of the interest, calculated with reference to the remaining period of the usufruct (1 year). B will therefore be liable for donations tax on R160 722.⁸⁴

5.3 However, suppose that B does not renounce the interest, but passes away 1 year before the expiration of the usufruct, then C (at age 38) will be liable for estate duty calculated in accordance with the primary valuation rule with reference to C's life expectancy at that point in time:

Value of usufructuary interest: R1.5 million x 12% x 8.06781	R 1 452 206
Less section 5(1)(b) first proviso (consideration paid plus interest at 6%)	<u>(R 548 136)</u> ⁸⁵ R 904 070
Note: Section 5(1)(b) second proviso not applicable, Because bare <i>dominium</i> not acquired under the disposition that created the usufruct	-
C will consequently be liable for estate duty on	R 904 070

If the tax consequences of the renunciation are compared with the cessation on death, the results are as follows:

a) Taxable value on renunciation 9 years later	R 160 722
b) Taxable value on death 9 years later – before the operation of the provisos	R 1 452 206
c) Taxable value on death – taking the provisos into account	R 904 070

(Difference between a and c is R582 626)

⁸³ R1 000 000 – (R1 000 000 x 12% x 5.3282). The corresponding factor is the factor for a nine-year period, because fractions of a year are to be disregarded.

⁸⁴ Calculated as follows: R1 500 000 x 12% x 0.8929.

⁸⁵ Calculated as follows: R360 616 + (R360 616 x 6% x 8 years and 8 months). The interest is calculated from date of payment of consideration (4 months after creation of usufruct) to the date of cessation of the interest (1 year before the expiration of the usufruct = 8 years and 8 months).

What seems awkward is that the legislature provides special acknowledgement for the unenviable position of the bare *dominium* owner where that person previously donated a usufructuary interest (or an annuity)⁸⁶ and where the right of enjoyment of the property reverts to him or her on the death of the usufructuary (or the annuitant), in which case a full exemption is offered under the Act,⁸⁷ as will be illustrated by the example below:

Example 6:

- 6.1 During his life, A (male, 69) grants a 10-year usufruct over land valued at R1 million to B (female, 64), retaining the bare *dominium* for himself. A (being the donor) will be liable for donations tax on the value of the 10-year usufructuary interest (valued at R678 024).⁸⁸ Where B dies one day after the creation of the usufruct, A (being the beneficiary) will not be liable for estate duty on his “gain” (the early termination of the usufructuary interest), because of the operation of the exemption.
- 6.2 Suppose that, when A donated the usufructuary interest to B, he did not retain the bare *dominium* in the property, but simultaneously transferred it to C (male, age 29), who provided adequate consideration for the bare *dominium* in the amount of R321 976 (R1 million - R678 024). Where B dies one day after the creation of the usufruct and the transfer of the bare *dominium* to C, C will be liable for estate duty on the value of the usufructuary interest (the “gain”) calculated with reference to his life expectancy at that point in time, which will amount to:

Value of usufructuary interest according to primary valuation rules	R987 233 ⁸⁹
Less: Section 5(1)(b) first proviso (consideration)	<u>R321 976</u>
	R665 257
According to section 5(1)(b) second proviso limited to	<u>R678 024</u>
Estate duty payable on	R665 257

An exemption is presumably offered to A in example 6.1 above because estate duty (in its current recipient-based form) taxes a “transfer” which had already been covered by the

⁸⁶ Unlike the section 5(1)(b) provisos, this exemption is also applicable to the owner of property who burdened his property with an annuity (to the extent that he or she did not receive adequate consideration therefore), where the annuity ceases as a result of the death of the annuitant.

⁸⁷ See Estate Duty Act s 4(g). See Ch 6 par 6.5.2.2.

⁸⁸ R1 000 000 – (R1 000 000 x 12% x 5.6502).

⁸⁹ Calculated as follows: R1 million x 12% x 8.22694.



levying of donations tax in the hands of A (note that the system does not provide a credit for any donations tax paid “too much” for a usufructuary interest that lasted only a day). The *fiscus* therefore collects tax on only R678 024. However, under example 6.2 the *fiscus* effectively collects tax on R1 343 281 (donations tax payable by A on R678 024 as well as estate duty payable by C on R665 257). It is evident that in 6.1 the “excessive” donations tax paid is effectively cancelled by the exemption offered in respect of estate duty, whereas in example 6.2 no such “correction” occurs. Although, from a holistic point of view, something seems awkward about the difference in approach between examples 6.1 and 6.2, it is understandable that some form of relief is offered to A (in example 6.1 above) who would, in the absence of some form of relief, be liable for donations tax (as the donor) as well as estate duty (as the beneficiary). What needs to be understood here is that the awkward position of the bare *dominium* owner in A’s position (in the absence of some form of relief), is created by the difference in the valuation approach to limited interests under the donations tax regime (where a transferor-based approach is applied) in contrast to the approach followed under the estate duty regime (where a recipient-based approach is applied).

The difference in approaches has also inspired some estate planning schemes, such as the scheme whereby successive usufructs are used to manipulate the tax position. In practice the scheme is commonly referred to as the “one-year usufruct scheme”, the operation of which is illustrated by way of an example below.⁹⁰

Example 7:

A (male, 69) bequeaths property valued at R1 million to ABC Family Trust, subject to the lifelong usufruct in favour of his spouse B (female, age 64). A’s will contains a further provision that, upon B’s death, his son C (age 30) will be entitled to a successive usufruct over the property for a period of one year. The full value of the property (R1 million) will be included in A’s deceased estate on his death, but the value of B’s usufruct (valued with reference to her life expectancy at that stage) will be allowed as an exemption.

⁹⁰ See Divaris (2009) *Tax Planning* 23–24 for further reading on this avoidance scheme. See also Davis, Beneke and Jooste (2009) par 12.3 for a discussion on similar schemes (utilising the shorter period for valuation purposes).



Suppose that B dies 10 years later (at age 74) when the property is worth R1.5 million, then the value of the ceasing usufruct in B's deceased estate (in respect of which C will ultimately be accountable) will be determined over the period of one year only. Estate duty will therefore be payable on R160 722.⁹¹ On the lapse of the usufruct one year later, there will be no estate duty or donations tax consequences. Should A's will not have provided for the successive usufruct, then the value of the ceasing usufruct in B's deceased estate (in respect of which the trust as the beneficiary would ultimately have been accountable for) would have amounted to R1 494 810 (because in the case of a person other than a natural person an interest must be valued over 50 years). The estate duty liability on B's death has been significantly reduced by the intervening one-year usufruct.

To counter the one-year usufruct scheme and similar schemes, the Draft Taxation Laws Amendment Bill 2009 proposed that interests should only be valued with reference to the life expectancies of the beneficiaries and that the reference to the lesser period should be omitted from the Act.⁹² It is most surprising that a corresponding amendment to the Income Tax Act (Part V) was not also proposed. Fortunately, in August 2009 the Standing Committee on Finance announced that the proposed amendment was withdrawn for reconsideration, because it would unfairly penalise all other usufructs. The Committee acknowledged the concern that successive usufructs are often set up for legitimate reasons.⁹³

It is submitted that the suggested solution offered only an artificial way to deal with the issue and negated the true nature of the problem, namely the recipient-based approach to usufructuary interests under the estate duty regime (in contrast to the transferor-based approach under the donations tax regime). Should estate duty on the usufruct that ceases on B's death in example 7 above have been calculated over the life expectancy of the

⁹¹ Calculated as follows: R1 500 000 x 12% x 0.8929.

⁹² Draft Taxation Laws Amendment Bill (2009) s 6(1)(a) and 6(2), available at <http://www.sars.gov.za> (accessed on 24 July 2009). See also Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill 2009 par 6.2, available at <http://www.sars.gov.za> (accessed on 24 July 2009).

⁹³ Standing Committee on Finance *Report-back Hearings on the Taxation Law Amendment Bills 2009: Final Response Document* (2009) par 2.6.2, available at <http://www.sars.gov.za> (accessed on 30 September 2009).



usufructuary immediately before her death, then B's deceased estate would have been liable for estate duty on the value of R970 007.⁹⁴ This would have been the position whether the right of enjoyment accrues to the trust (as the bare *dominium* owner) or the child (for a year).

7.4.4.5 The Treatment of Limited Interests under the Death Duties Act

The recipient-based valuation approach followed for the purposes of estate duty was adopted from the Death Duties Act of 1922, where limited interests were valued on a recipient basis for the purposes of both estate duty and succession duty. Because the complications in the area of limited interests was apparently one of the factors that contributed to the need to reform the death duties system in 1955,⁹⁵ it is worthwhile to briefly consider the position of limited interests (treated on a recipient basis) under the Death Duties Act, especially considering that this thesis explores the possibility of replacing the current South African transferor-based regime with a recipient-based system.

The following example suffices to illustrate the basic treatment of limited interests for the purposes of death duties (ignoring any exemptions and rebates and assuming the Death Duties Act applies in its form just prior to its repeal):⁹⁶

Example 8

A bequeaths a farm to D subject to a lifelong usufruct in favour of B. A's will provides that, on B's death, C will be entitled to a successive usufruct for the duration of his life. On A's death, A's deceased estate will be liable for estate duty on the value of the farm. B will be liable for succession duty on the value of the usufruct, calculated with reference to B's life expectancy and the market value of the farm on A's death. D (the bare *dominium* owner) will also be liable for succession duty on the value of the bare *dominium*

⁹⁴ Calculated as follows: R1 500 000 x 12% x 5.38893.

⁹⁵ See Ch 3 par 3.3.2.2.2 n 146 and accompanying text.

⁹⁶ For the position of limited interests under the Death Duties Act (just prior to its repeal), see Kriel (1953) 52, 83–96.



(valued as the difference between the market value of the farm and a usufruct calculated with reference to the life expectancy of the younger of B and C). On B's death, property will be deemed to pass to C and estate duty (recoverable from C) will be payable on the ceasing usufruct calculated with reference to C's life expectancy and the market value of the farm on the death of B. In addition to estate duty, C will also be liable for succession duty on the successive usufruct valued identically as for the purposes of estate duty. On C's death, D (the bare *dominium* owner) will be liable for estate duty (as well as succession duty) on the difference between the market value of the farm (on C's death) and the value of the bare *dominium* when it was first created on A's death. D will therefore be liable for succession duty on A's death and estate duty (and succession duty) on C's death.

It is evident from the above example that the treatment of limited interests was extremely complicated. What added insult to injury is the fact that the bare *dominium* owner's tax liability (on the materialisation of the bare *dominium* into full ownership) could only be ascertained with reference to the value of the bare *dominium* as reflected in the deceased estate of the original testator. In the case where the bare *dominium* was created before the effective date of the Death Duties Act (1 July 1922) the valuation was even more problematic. It is therefore understandable that the treatment of limited interests was an administrative nightmare under the Death Duties Act.

7.4.5 Estate Freezing Techniques

7.4.5.1 General

Where a wealth holder (the "estate planner") owns significant growth assets, a commonly used estate planning technique is to "peg" the value of the assets by disposing of the assets during the planner's lifetime to his or her heirs or other entities (sometimes referred to as "estate freezing"). The purchase consideration is usually left outstanding on loan account, usually interest-free, repayable on demand. On the death of the planner, the only significant asset is the outstanding balance on loan account. However, very often the loan accounts have been extinguished through the operation of prescription and the debtor's failure to claim the performance in time. Very often entities such as companies or trusts are also incorporated in these plans. A transfer of the assets to a company has



inter alia the advantage that the estate planner can remain in control of the assets through the utilisation of preference shares. The following paragraphs will explain the position of interest-free loans, the failure to claim performance as well as preference shares under the current wealth transfer tax system.

7.4.5.2 *Interest-free Loans*

The well-embedded use of interest-free or low-interest loans has often been scrutinised for whether or not the lack of charging market-related interest constitutes a donation for the purpose of donations tax. Scholars generally conclude that the failure to charge interest does not constitute the waiver of a “right”,⁹⁷ although some commentators have pointed to the possibility that an interest-free fixed period loan (as opposed to a demand loan) may be construed as a section 58(1) disposition for inadequate consideration (valued at the difference between the face value and the present value of the loan).⁹⁸ Although the issue is far from settled, it is apparently the general practice of SARS not to levy donations tax on interest-free loans.⁹⁹ This is, however, no guarantee that it would not be attempted in the future. However, the broader policy consideration is whether some measures should be adopted to render the granting of an interest-free (or low interest) loan taxable. The Margo Commission recommended by the majority of the commissioners that the lack of interest charged should be regarded as a taxable capital transfer, to prevent erosion of the tax base.¹⁰⁰ The minority’s view was instead to ignore interest-free or low-interest loans, in view of the fact that any proposed provision for the taxation of the interest would raise very little revenue and would only result in the

⁹⁷ For further reading see Editorial (1968) *Income Tax Reporter* 65 *et seq*; Editorial (1978) *SA Company Law J F-15 et seq*; Van Dorsten (1986) *SA Comm Law J 71 et seq*; Meyerowitz (2008) *Taxpayer* 110; Stark (2008) *De Iure* 174 *et seq* and Olivier (2008) *TSAR* 151 *et seq*.

⁹⁸ Davis, Beneke and Jooste (2009) par 13.6.

⁹⁹ De Koker and Williams Vol 3 (2009) par 23.3; Davis, Beneke and Jooste (2009) pars 2.9.6A and 13.6; King and Victor (2008/2009) par 12.4.

¹⁰⁰ Margo Report (1986) par 20.56. Loans payable on demand would require the setting of a standard rate of interest.

creation of new avoidance schemes.¹⁰¹ The government noted the recommendation, but indicated that the issue required some further investigation.¹⁰² In 1997, the Katz Commission evaluated the position once again. The commission reported that effective action against interest-free and low-interest loans has been relatively rare in foreign jurisdictions and that the complexities involved outweigh the advantages.¹⁰³

7.4.5.3 Failure to Claim Performance

Commentators seem to agree that the mere failure to institute a claim for an outstanding performance does not constitute a renunciation of a “right”.¹⁰⁴ The allowing of a right to prescribe could therefore effectively “remove” an asset from a creditor’s estate without any adverse tax consequences.

7.4.5.4 Preference Shares

To facilitate control over assets transferred by a planner to a company, the planner is usually issued with sufficient preference shares in such company to secure control over the other shareholders. The preference shares are typically issued with a low dividend rate attached thereto without a right to participate in any surplus on a winding-up or deregistration of the company, thereby effectively minimising the value of the shares in the planner’s estate. Although the shares could be issued as consideration for the assets transferred, this is usually not done in view of the danger that the Commissioner may invoke section 58(1) of the Income Tax Act if the value of the shares constitutes inadequate consideration. The assets are therefore typically sold by the planner to the company with the purchase price payable on demand. In order to avoid the invoking of

¹⁰¹ Margo Report (1986) par 20.56.

¹⁰² Deloitte Haskins & Sells (1988) 52.

¹⁰³ Fourth Interim Katz Report (1997) pars 7.1–7.8.

¹⁰⁴ See Meyerowitz on Income Tax (2007/2008) par 31.4 and Davis, Beneke and Jooste (2009) par 11.4.



section 3(3)(d)¹⁰⁵ or section 5(1)(f)*bis*¹⁰⁶ of the Estate Duty Act, the wealth holder is usually afforded less than 75 percent control of the overall votes of the company. The Katz Commission considered the issue of preference shares, but rejected any specific measures to remedy the problem in keeping with its approach to avoid unnecessary legislative complexity. However, it was mentioned that section 5(1)(f)*bis* of the Estate Duty Act could be appropriately amended to assist the problem in some way.¹⁰⁷ Although the government accepted this recommendation, it has not acted on it to date.¹⁰⁸

7.4.6 Discretionary Trusts

Very often an estate planner transfers assets to a discretionary trust. The initial transfer into trust will constitute a donation to the extent that it was made for inadequate consideration (because of the special provisions deeming the trustees to be the recipient under any donation to a trust).¹⁰⁹ Because of the conduit-pipe nature of a trust, the regime offers an exemption in respect of any subsequent distribution of the property to a beneficiary.¹¹⁰ At the heart of the problem lies the fact that the trust property would not form part of the deceased estate of a contingent beneficiary nor would a disposal of a contingent interest constitute a donation for the purposes of donations tax. In view of the fact that the assets are typically held for a period extending beyond one generation, a discretionary trust has transpired to be a useful tool in deferring the payment of estate

¹⁰⁵ See Ch 6 par 6.2.4.2.5.

¹⁰⁶ See Ch 6 par 6.3.1.

¹⁰⁷ Fourth Interim Katz Report (1997) par 8.3.

¹⁰⁸ For further reading on tax avoidance through preference shares, see Davis, Beneke and Jooste (2009) pars 13.7 and 13.8.

¹⁰⁹ The trustees are deemed to acquire the property on behalf of the beneficiaries for purposes of donations tax. See Ch 5 pars 5.2.1 and 5.6.3.

¹¹⁰ See Ch 5 par 5.5.3.

duty for one or more generations, especially in the light of the absence of a rule against perpetuities.¹¹¹

The Franzsen Commission rejected submissions suggesting that any appreciation in the value of the assets transferred to a discretionary trust should be subject to donations tax or estate duty.¹¹² The Commission nevertheless recommended that a section similar to the general anti-avoidance rule of the Income Tax Act should be inserted in the Estate Duty Act to counter possible tax avoidance schemes.¹¹³

The Margo Commission recommended that trusts should be subjected to capital transfer tax after the lapse of a certain period of time, for example fifteen years, to the extent that the beneficiaries have not obtained vested rights.¹¹⁴ Although this recommendation was supported by the government, it was never implemented.

More or less a decade later, the Katz Commission endorsed the proposal of the Margo Commission that trusts should be subjected to capital transfer tax at periodic intervals on the value of their net assets (the “periodic tax”), notwithstanding the complexity of the legislation that would be required to achieve this objective. It was proposed that the tax should be levied at the rate applicable to *inter vivos* donations. Although the Commission left open the frequency of the period, it suggested that a period within the range of 25 to 30 years (reflecting more or less a generation) would probably be appropriate.¹¹⁵ In addition, it was recommended that any subsequent vesting of trust assets in beneficiaries should also be subjected to the regime (the “exit tax”), in all circumstances other than

¹¹¹ See Ch 5 par 5.6.1.2.

¹¹² Second Franzsen Report (1970) par 412.

¹¹³ Second Franzsen Report (1970) par 415.

¹¹⁴ Margo Report (1986) par 20.57.

¹¹⁵ Fourth Interim Katz Report (1997) par 10.9.

where to do so would result in double taxation.¹¹⁶ It was furthermore suggested that the value of the distribution subject to the exit tax should be limited to an amount that exceeds the amount on which estate duty or donations tax were paid on the original disposition to the trust.¹¹⁷ It was also suggested that certain special trusts, created for the benefit of mentally or physically disabled children or established for the benefit of employees to provide for risks such as death, disability, unemployment insurance or medical expenses, should be exempt from the proposed provisions.¹¹⁸ In respect of the concern raised that commercial trusts would be detrimentally affected by the proposed regime, the Commission commented that

“[i]f planners wish to use a trust to carry on their business activities as opposed to using a more conventional business form, then they must accept all the consequences of doing so”.¹¹⁹

Other than the principles that have been outlined above, the Commission did not provide any detailed guidelines for the proposed legislation, apparently in view of the fact that some useful precedents in overseas legislation exist. However, Parliament’s Portfolio Committee on Finance rejected the Commission’s proposal on the generation-skipping taxes in view of the administrative difficulties that the proposed regime would have posed for the tax authorities.¹²⁰ Commentators in general also did not support the proposal, mainly because of the complexity, administrative burden, and possible cost-inefficiency that it would bring to the tax system.¹²¹

¹¹⁶ Fourth Interim Katz Report (1997) par 10.12.

¹¹⁷ Fourth Interim Katz Report (1997) par 10.13(a) and (b).

¹¹⁸ Fourth Interim Katz Report (1997) par 10.16.

¹¹⁹ Fourth Interim Katz Report (1997) par 10.7(a).

¹²⁰ Editorial (1998) *Income Tax Reporter* 68.

¹²¹ See, e.g., Strydom LLD Thesis (2000) 375–401 for a more detailed discussion.



7.4.7 Preferential Valuation Rules for Agricultural and/or Business Property

The provision for a preferential valuation method for agricultural property has become a well-embedded characteristic of the donations tax and estate duty regimes. Currently, agricultural property (unless it has been disposed of under a *bona fide* sales agreement in the course of the liquidation of the estate), may be valued at the fair market value of the property less 30 percent.¹²²

On one level the question arises whether preferential valuation is justifiable for certain assets such as agricultural properties. The Franzsen Commission and the Margo Commission were both against special relief for agricultural property mainly because of horizontal equity concerns.¹²³ The Franzsen Commission stressed that it is the duty of every testator to provide for sufficient liquid assets in his or her estate.¹²⁴ Even where a testator had made no provision for the required liquid funds, it was argued that such funds could be obtained by means of mortgage or other loans.¹²⁵ The commission, however, supported the idea that the method of payment should be made as convenient as possible for the heirs, and suggested that the then Secretary for Inland Revenue¹²⁶ should continue to accommodate periodic payments spread over a couple of years.¹²⁷ Inextricably linked to the justification of preferential valuation relief is the question whether the relief offered (in its current form) is adequate, especially in view of the general decline in economic activity over the past few years as a consequence of the global recession.

On a second level the question arises whether the relief should be extended to other forms of business properties. In 1994 the Interim Katz Commission Report conceded that small

¹²² See Ch 5 par 5.5.2 and Ch 6 par 6.5.1.

¹²³ See Second Franzsen Report (1970) par 405 and Margo Report (1986) par 20.61.

¹²⁴ Second Franzsen Report (1970) par 378.

¹²⁵ Second Franzsen Report (1970) par 381.

¹²⁶ Currently known as the Commissioner for the South African Revenue Service (CSARS).

¹²⁷ Second Franzsen Report (1970) par 382.



and medium-sized enterprises constitute a significant share of the South African economy.¹²⁸ The commission, nonetheless, stressed that tax measures cannot be the major tool in the programme of promoting the smaller business sector in South Africa, but can certainly contribute to the creation of a favourable environment for such sector.¹²⁹ The final conclusion of the report did not favour specific tax incentives for small businesses in general.¹³⁰ The report, however, did not deal with incentives in the realm of estate duty.

The absence of some relief for businesses, and especially private businesses, in the realm of estate duty (and for that matter donations tax) is especially surprising if one considers that the capital gains tax legislation provides for a “small business assets” exclusion to offer relief to small business owners who have invested their resources in their businesses.¹³¹

7.4.8 Estate Duty Levied on Estate Duty: The Absence of Grossing-Up Rules

Estate duty and donations tax are levied at the same rate. It seems therefore as if donations tax and estate duty are effectively the same, which means that donations tax is a form of estate duty paid in advance. However, this viewpoint is not quite correct. Davis,

¹²⁸ Interim Katz Report (1994) par 10.1.1.

¹²⁹ Interim Katz Report (1994) par 10.1.2.

¹³⁰ Interim Katz Report (1994) par 10.6.18.

¹³¹ Eighth Schedule to the Income Tax Act par 57. The exclusion (which applies only to natural persons) operates as follows: the first R750 000 of any capital gain made on the disposal of certain business assets should be disregarded. The assets that can qualify for the relief include (a) an active business asset of a sole proprietor; (b) an interest in an active business asset of a partnership and (c) an entire direct interest, which consists of at least 10 percent of the equity of a company, to the extent that the interest relates to active business assets. An “active business asset” is an asset used or held wholly or exclusively for business purposes, but it excludes financial instruments, assets held to produce “passive income” (such as annuities, rental income, foreign exchange gains, royalties or similar income). The exclusion will be available only where (a) the owner has held it for his own benefit for a continuous period of at least five years prior to the disposal; (b) the owner was substantially involved in the operation of the business during that period; (c) the owner has attained the age of 55 years or, if younger, has disposed of the asset or interest in consequence of ill-health, other infirmity, superannuation or death; and (d) all his or her qualifying capital gains must be realised within a period of 24 months, commencing on the date of his first qualifying disposal.



Beneke and Jooste provide the following example: suppose that A intends to give B as much of R120 as he can. Ignoring the annual exemption, A can give B R100 and pay the donations tax of R20. Where, however, A dies, leaving an estate worth R120 to B, the executor of A's estate would have to pay estate duty of R24 (ignoring the primary abatement for the purposes of comparison), which means that the beneficiary would only be entitled to R96. The estate duty amounts to R24 on the payment of R96 (25 percent).¹³² Thus, effectively, "estate duty is levied on estate duty" in the absence of the provision for grossing-up rules in respect of donations.

7.5 CONCLUSIONS

- (a) There are a number of discrepancies between the donations tax base and the estate duty tax base, as well as the valuation rules and exemptions provided for under the two different fiscal regimes levied in terms of two different legislative frameworks. It was shown that, although the Margo Commission and Katz Commission suggested that the taxation of *inter vivos* transfers and transfers on death should be integrated into a single statute, the legislature has not acted on these recommendations to date. In a broader context, the aim of this study is to outline the level of integration that should exist between the taxation of *inter vivos* transfers and transfers on death in a South African context.¹³³
- (b) The possible transition to a recipient-based wealth transfer tax system has never been extensively considered by the South African legislature. It is suggested that such a proposition requires further investigation, especially in view of the strong theoretical appeal of a recipient-based system (as outlined in Chapter 4). In exploring the possibility of replacing the current

¹³² Davis, Beneke and Jooste (2009) par 2.9.1.

¹³³ See par 7.1.



transferor-based system with a recipient-based regime, aspects such as administrative feasibility and certainty of law should be considered.¹³⁴

(c) This chapter also detailed a selection of problem areas that exist under the current regimes. Apart from the issues that relate to the discrepancy between the taxation of *inter vivos* transfers and transfers on death (as referred to in paragraph (a) above), these problem areas include:

- The demarcation of the jurisdictional basis (and in particular the question whether it is justifiable to exclude foreign assets (as respectively listed in Chapters 5¹³⁵ and 6¹³⁶ above) from the tax bases of estate duty and donations tax;¹³⁷
- The characteristics of a donation for purposes of donations tax (which involves aspects such as the accommodation of value-shifting arrangements in the tax base);¹³⁸
- The treatment of life insurance benefits for purposes of estate duty;¹³⁹
- The treatment of limited interests and bare *dominium* for purposes of donations tax and estate duty;¹⁴⁰
- The countering of estate-freezing techniques such as interest-free loans;¹⁴¹
- The treatment of discretionary trusts;¹⁴²

¹³⁴ See par 7.2.

¹³⁵ See Ch 5 par 5.2.2.1.

¹³⁶ See Ch 6 par 6.2.2.1.

¹³⁷ See par 7.4.1.

¹³⁸ See par 7.4.2.

¹³⁹ See par 7.4.3.

¹⁴⁰ See par 7.4.4.

¹⁴¹ See par 7.4.5.

¹⁴² See par 7.4.6.



- Preferential valuation rules for certain properties;¹⁴³ and
 - The absence of grossing-up rules.¹⁴⁴
- (d) Although it falls outside the scope of this study to offer solutions for all these issues, it is significant to compare these problem areas with the problem areas and possible solutions offered by the transferor-based system of the United Kingdom and the recipient-based systems of the Netherlands and Ireland.¹⁴⁵ This is done to establish whether recipient-based taxation offers more appropriate solutions.

The following chapters will provide a discussion of the wealth transfer tax systems of the United Kingdom, the Netherlands and Ireland. Firstly, these systems will be explored for ways and measures to improve the integration between the taxation of transfers on death and *inter vivos* transfers. Secondly, these systems will be evaluated against the background of the problems identified under the current South African system to assess whether a transition to a recipient-based regime would offer a more workable solution. The final comments on these issues will be attended to only in Chapter 11, once the comparative survey has been completed.

¹⁴³ See par 7.4.7.

¹⁴⁴ See par 7.4.8.

¹⁴⁵ See par 7.3.



CHAPTER 8

WEALTH TRANSFER TAXATION IN THE UNITED KINGDOM

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8.1 HISTORICAL ORIENTATION AND INTRODUCTION

8.1.1 Historical Development

In 1894 a modern estate duty replaced most of the early death duties which had been imposed in the United Kingdom over a period of two hundred years since the initial introduction of probate duty in 1694.¹ Estate duty was charged on property passing from a deceased to his or her estate as well as on gifts made in a certain period before death, initially set at one year. No charge on gifts was made if the person survived the “gifts period”, which was amended from time to time.²

To counter the avoidance of estate duty through lifetime transfers and generation-skipping trusts, estate duty was replaced with yet another transferor-based tax, namely capital transfer tax, in 1975. Unlike estate duty, the ambit of capital transfer tax was extended to all capital gifts made during a person’s lifetime. In addition, the legislation introduced a special regime for discretionary trusts.³ Apparently, the lifetime aggregation of gifts acted as a disincentive for the transfer of wealth to younger generations, which led to unwelcome economic results.⁴ As a consequence, the long-standing approach of limiting the taxable gifts to the gifts made by the deceased in a certain period immediately prior to his or her death was reintroduced with the introduction of

¹ See Ch 3 par 3.2.3 n 11 and accompanying text for further reading on the early British death duties. Although probate duty, account duty and temporary estate duty were abolished with the introduction of the modern estate duty in 1894, succession duty and legacy duty remained in force until their eventual abolition in 1949.

² See Ch 3 par 3.2.3 n 13 and accompanying text. For further reading on the scope, structure and provisions of estate duty, see in general Lawton (1970) and Wallington (2002) div A2.

³ For further reading on the scope, structure and provisions of capital transfer tax, see in general Chapman (1980); Jones (1981); Hayton, Marsh, Tiley and Wignall (1984); McCutcheon (1984) and Wallington (2002) div A3.

⁴ Jarman (2006) 4.

inheritance tax in 1984, levied in terms of the Inheritance Tax Act (hereafter “the Act”),⁵ which is, as amended by the annual Finance Acts, still in force today.

Although this tax was, to a large extent, modelled on the earlier estate duty, the legal structure was modernised and the capital transfer tax regime for discretionary trusts was retained.⁶ The new system was generally perceived as being iniquitous, unfair, and complex.⁷ As a consequence, various tax law reform proposals have over the years been put forward.⁸ As already mentioned in Chapter 3, the recently published Mirrlees Review proposed that the current system should ideally be replaced by a recipient-based wealth transfer tax.⁹

8.1.2 Broad Overview of Inheritance Tax¹⁰

Inheritance tax is levied on all chargeable transfers of value made by an individual. The Act distinguishes between lifetime transfers, which mainly involve *inter vivos* gifts, and transfers on death. A lifetime transfer can either be immediately chargeable, or it can qualify as a potentially exempt transfer (a “PET”). In respect of both lifetime transfers and transfers on death, the Act provides for a broad spectrum of reliefs and exemptions.

A lifetime transfer is valued at the difference in the value of the transferor’s estate before and after the transfer. To calculate whether any inheritance is due in respect of an immediately chargeable lifetime transfer, the value of the transfer is aggregated with the

⁵ Act of 1984 c. 51.

⁶ For further reading on the core principles of inheritance tax upon its initial incorporation, see Wallington (2002) div A4.

⁷ See Sandford (1986) *Br Tax Rev* 142 and Walker (1986) *Br Tax Rev* 143–146.

⁸ See Ch 3 par 3.2.3.

⁹ See Ch 3 par 3.2.4.

¹⁰ For a brief outline of the main provisions of inheritance tax, see Tiley (2008) 1262–1273 and HMRC *Inheritance Tax Manual*, available at <http://www.hmrc.gov.uk/MANUALS/inhmanual/index.htm> (accessed on 30 November 2009).

cumulative total of the values transferred by any chargeable transfers made by the transferor during the seven years preceding the transfer. If this total does not exceed the “nil rate band” (a threshold set at £325 000 for the 2009/2010 tax year), no inheritance tax will be due. If, on the other hand, the total exceeds the nil rate band, inheritance tax will be payable on the value in excess of the threshold at a rate of 20 percent.¹¹

In the case of a person’s death, his or her estate comprises all the property to which he or she has been beneficially entitled (after deducting excluded property) and other allowable deductions. To calculate whether inheritance tax is payable in respect of the deceased estate (the deemed transfer on death), the value of the estate is added together with the value of all the immediately chargeable lifetime transfers and PETS. Inheritance tax will then be due on the value exceeding the nil rate band at a rate of 40 percent.¹² A credit is allowed for tax previously paid at 20 percent in respect of the immediately chargeable lifetime transfers included in the total value of the taxable estate. Where the value of the deceased estate reflects property received by the deceased within a period of five years prior to his or her death under a transfer in terms of which inheritance tax was payable, the inheritance tax charged in respect of such property will be reduced by a percentage of the inheritance tax charged on the first transfer (the so-called successive transfers relief). The percentage varies according to the period between the dates on the earlier transfer and the subsequent death.¹³

The Act contains a special regime for “settled property”, which will more fully be discussed in paragraph 8.6.3 below.

¹¹ S 7 read with Sch 1.

¹² S 7 read with Sch 1.

¹³ S 101(2). See in general Wallington (2002) par D1.65 for examples.

8.2 TAX BASE

8.2.1 Lifetime Transfers

Inheritance tax is charged on the value transferred by a chargeable transfer.¹⁴ A chargeable transfer is a transfer of value made by an individual, excluding an exempt transfer. Although the Act provides that inheritance tax is chargeable on dispositions made by an *individual* (which excludes companies and trusts), transfers of value by close companies can be apportioned and charged to inheritance tax in the hands of the participators.¹⁵

A transfer of value is a disposition, including a disposition effected by associated operations,¹⁶ made by the transferor as a result of which the transferor's estate immediately after the disposition is less than it would be but for the disposition and the amount by which it is less is the value transferred by the transfer.¹⁷ Although the term "disposition" is not defined under the Act, it includes any act that results in a loss in value to a person's estate, such as sales (for inadequate consideration), gifts, exchanges, loans, disclaimers, waivers and indeed any act by which the ownership of property or a right in property is lost in whole or in part. The creation, release or other extinguishment of a debt also qualifies as a disposition.¹⁸ Although this primary charging provision does not

¹⁴ S 1.

¹⁵ S 98.

¹⁶ S 272 "disposition". The effect of this provision is that operations (whether directly or indirectly and whether by way of two or more operations) can be associated so that their combined effect on the transferor's estate would be taken into account. Suppose, for example, that a controlling shareholder owns a 60 percent holding in a company. He donates half of the holding to his son, having first transferred half to his wife, who subsequently also transfers the shares to the son. The combined effect of these operations is to pass the controlling interest from father to son. The tax authorities could therefore use the associated operations provisions to tax the transfer of the controlling interest accordingly. See in general Wallington (2002) pars C1.15–C1.16 and Tiley (2008) 1294–1301.

¹⁷ S 3(1).

¹⁸ See in general Wallington (2002) pars C1.12–C1.13, C1.33 and Tiley (2008) 1278–1279.

presuppose any recipient (and for that matter any enrichment), it is apparently uncertain whether or not a disposition would include involuntary or unintentional acts. Both Wallington and Tiley submit that the term probably require some deliberate action by the disposer, as a consequence of which the accidental destruction of an asset would not constitute a disposition.¹⁹

To extend the tax base to cases where a person passively suffers an event which causes a loss to his or her estate, the Act provides that, where a person's estate is diminished as a result of an omission to exercise a right and another person's estate or settled property is increased in consequence thereof, such person will be treated as having made a disposition for value at the time when he or she could have exercised the right, unless the omission was not deliberate.²⁰ A failure to exercise an option, to collect a debt, to vote in respect of shares in a company or to appoint property to oneself under a general power of appointment would in principle all be treated as dispositions (provided that the requirements are complied with).²¹

As a consequence of the fact that the subject of taxation is restricted to natural persons only, the Act provides that any value-shifting arrangement in respect of a close company's unquoted share or loan capital be treated as having been made by the participators of the close company at the time of the alteration.²²

Except where the Act contains a special timing provision,²³ the date of the transfer is the date of the completion of an effective disposition, which should be determined in

¹⁹ Wallington (2002) par C1.12; Tiley (2008) 1278.

²⁰ S 3(3).

²¹ Tiley (2008) 1279–1280.

²² S 98. See in general Wallington (2002) par C1.19.

²³ E.g. an omission to exercise a right is deemed to occur at the latest time when the right could have been exercised (s 3(3)).

accordance with general property law principles.²⁴

Certain transfers are, however, *not* regarded as transfers for value, such as:²⁵

- transfers between unconnected persons made at arm's length not intended to confer gratuitous benefits (ordinary business transactions);²⁶
- maintenance payments to spouses, former spouses, certain dependant relatives or children (under the age of 18 or (if older than 18) until they cease to undergo full-time education or training);²⁷
- dispositions made which are allowable in computing the transferor's income tax or corporation tax;²⁸
- certain contributions to retirement benefits schemes, registered pension plans or certain qualifying non-UK pension schemes;²⁹
- dispositions by close companies into trusts for the benefit of their employees;³⁰
- certain administrative acts in respect of the administration of deceased estates, such as any variation (under a redistribution agreement) or disclaimer (repudiation), election or a renunciation of a claim to a legitim.³¹ This provision only prevents that these dispositions are treated and chargeable as individual transfers of value, in view of the fact that the Act provides elsewhere that these arrangements shall be treated as if they had been made by the deceased

²⁴ Wallington (2002) par C1.31.

²⁵ See ss 10–17. See also in general Wallington (2002) pars C1.42–C1.60 and Tiley (2008) 1284–1289.

²⁶ S 10.

²⁷ S 11.

²⁸ S 12(1).

²⁹ S 12(2).

³⁰ S 13.

³¹ S 17.

immediately before his or her death (and death constitutes a chargeable event under the Act, as more fully discussed in paragraph 8.2.2 below).³²

A lifetime transfer can either be immediately chargeable, or it can qualify as a potentially exempt transfer (a “PET”).³³

8.2.2 Transfers on Death

Transfers on death are, in general, charged as if the deceased had made a transfer of value immediately before his or her death at a value equal to the value of his or her estate immediately before death.³⁴

To counter the avoidance of tax by an individual who transfers an asset in circumstances where he or she continues to have the use and enjoyment of that asset, special rules, commonly referred to as the “gift with reservation of benefit rules”, were introduced in 1986.³⁵ For many years the gift with reservation of benefit rules was easy to circumvent and there were a few well-known arrangements to by-pass the inheritance tax implications, for example the so-called “Ingram”³⁶ and “Eversden”³⁷ schemes. Although

³² See ss 142, 143, 145 and 147. For further reading, see Wallington (2002) par C1.60 and division D4.

³³ See par 8.5.3.2.

³⁴ S 4(1). See in general Wallington (2002) par D1.01 and Tiley (2008) Ch 68.

³⁵ Finance Act 1986 s 102 read with Sch 20. For a discussion of these rules, see Wallington (2002) division C4; Tiley (2008) Ch 69 and McLaughlin (2007) *Taxationweb*, available at <http://www.taxationweb.co.uk/tax-articles/capital-taxes/gifts-with-reservation-the-rules-explained.html> (accessed on 20 June 2009).

³⁶ Following the decision of the House of Lords in the case of *IRC v Ingram* [1999] All ER 1 297, [1999] STC 37, where it was held that the reservation of a leasehold estate, subject to which the reversionary interest was given away, did not constitute a reservation of benefit out of the gift of the freehold estate. For a discussion of the case, see Chamberlain (1999) *Br Tax Rev* 152 *et seq* and Chamberlain and Whitehouse (2005) 23–24.

³⁷ Following the decision of the Court of Appeal (of England and Wales) in the case of *IRC v Eversden* [2003] EWCA siv 668, where it was held that a gift to a donee spouse in trust (and not outright) was excluded from the reservation of benefit rules (in view of the spousal exemption). See Chamberlain and Whitehouse (2005) 24–25 for a discussion of the facts.

legislative provisions were introduced to combat these avoidance techniques,³⁸ a more radical approach was implemented in 2003 when an income tax charge was introduced on pre-owned assets (POAT), a tax that is currently still in force.³⁹

8.2.3 Jurisdictional Basis

The jurisdictional basis of the inheritance tax is determined with reference to the domicile of the transferor or the location of the assets.

8.2.3.1 Domicile

Inheritance tax is primarily chargeable on the worldwide property of persons domiciled⁴⁰ in the United Kingdom.⁴¹

³⁸ See Finance Act 1986 ss 102A–C (anti-*Ingram*) and 102(5A)–(5C) (anti-*Eversden*). See Miller (1999) *Br Tax Rev* 367–370 and Chamberlain (1999) *Br Tax Rev* 430–434 (on a discussion of the anti-*Ingram* provisions). See Chamberlain and Whitehouse (2005) 24–25 for a general discussion on the anti-*Ingram* and anti-*Eversden* avoidance provisions.

³⁹ Finance Act 2004 s 84 read with Sch 15. POAT applies retrospectively to anyone who had carried out an unacceptable inheritance tax scheme since 18 March 1986, the date on which the reservation of benefits rules was introduced. For further reading, see Chamberlain (2004) *Br Tax Rev* 486 *et seq*; Chamberlain and Whitehouse (2005) and Campbell (2006) *Br Tax Rev* 599 *et seq*.

⁴⁰ A person can either have a domicile of origin (in the case of a minor) or a domicile of choice (in the case of a person who has reached the age of majority), but can never be domiciled in more than one country at the same time. Where a person is domiciled in the United Kingdom, he or she will only cease to be so domiciled if he or she emigrates to another country with the intention not to return to the United Kingdom. The person would have to break all ties with the country. See Sonneveldt Doctoral Thesis (2000) 151.

⁴¹ Although the Act does not expressly state this fact, it can be inferred from the exclusion of foreign property of persons domiciled outside the UK (see par 8.2.3.2). See also Jarman (2006) 21. Subject to certain exceptions, s 267 provides that a person who ceased to be so domiciled would for a subsequent period of three calendar years still be deemed to be a domiciliary of the country. Furthermore, a person who has been resident in the UK for income tax purposes in not less than 17 of the 20 years of assessment ending with the year of assessment in which he or she ceased to be so domiciled, would also be regarded as a domiciliary of the country. See in general Sonneveldt Doctoral Thesis (2000) 151 and Jarman (2006) 19–20.

8.2.3.2 Location of Assets

The Act provides that property (other than settled property)⁴² situated⁴³ outside the United Kingdom is excluded from the tax base if the person beneficially entitled to it is an individual domiciled outside the United Kingdom.⁴⁴ The effect of this provision is (except for implying that persons domiciled in the United Kingdom are liable for tax on worldwide assets)⁴⁵ that persons domiciled outside the United Kingdom are only liable for inheritance tax on assets located in the United Kingdom. However, certain types of property owned by persons domiciled elsewhere are specifically excluded from the tax base.⁴⁶

8.2.4 Double Taxation

The Act provides that relief for double taxation can either be afforded through double taxation agreements or through the granting of a tax credit in respect of wealth transfer taxes imposed by overseas territories attributable to property in respect of which inheritance tax is also payable.⁴⁷

⁴² See par 8.6.3.2 for the rules relating to the jurisdictional basis of settled property.

⁴³ The question whether or not property is located in the UK should be answered with reference to the common law. See Sonneveldt Doctoral Thesis (2000) 150.

⁴⁴ S 6(1).

⁴⁵ See par 8.2.3.1.

⁴⁶ S 6(3) excludes from property war certificates, national saving certificates, premium savings bonds, deposits with the National Savings Bank and certified SAYE savings arrangements owned by persons domiciled in the Channel Islands or the Isle of Man. S 6(4) read with s 155(1) provides that emoluments paid by the Government of any designated country to a member of a visiting force of that country (not being a British citizen) and any tangible movable property owned by such person, are excluded property. S 5(1)(b) furthermore excludes certain foreign-owned work of art (owned by a person domiciled outside the UK).

⁴⁷ Ss 158 and 159.

The double taxation agreements that were concluded under the estate duty and capital transfer tax regimes are still in force. The agreements which were concluded with France and Italy under the provisions of estate duty apply to transfers on death only.⁴⁸ Because the tax base was in general extended to cover all lifetime transfers with the introduction of capital transfer tax in 1975, the agreements concluded under that regime with Ireland, South Africa, United States of America, Netherlands and Sweden cover lifetime transfers and transfers on death. With the exception of the agreements entered into with Netherlands and Sweden (which were amended subsequent to the introduction of inheritance tax in 1986 to cater for some changes), the agreements will have to be adapted for the purposes of inheritance tax.⁴⁹ The only agreement entered into under the inheritance tax regime, namely the agreement entered into with Switzerland in 1994, covers transfers on death only,⁵⁰ arguably as a result of the introduction of the PET regime.

A full (unilateral) credit (equal to the amount of the overseas tax) is allowed where the property is situated in the foreign territory imposing the tax.⁵¹ However, provision is also made for a credit (calculated in terms of a specific formula)⁵² where (a) the property is situated neither in the overseas territory nor the United Kingdom, or (b) where the property is situated both in the overseas territory and the United Kingdom.⁵³ Where relief

⁴⁸ The treaties which were concluded with India and Pakistan are of limited effect because these countries have abolished their estate duties. See Tiley (2008) 1487; <http://www.hmrc.gov.uk/CTO/customerguide/page20.htm#11> (accessed on 20 November 2009).

⁴⁹ See Tiley (2008) 1487; HMRC *Inheritance Tax: Customer Guide*, available at <http://www.hmrc.gov.uk/CTO/customerguide/page20.htm#11> (accessed on 20 November 2009).

⁵⁰ See Double Taxation Relief (Taxes on Deceased Persons and Inheritances) (Switzerland) Statutory Instrument 1994/3214.

⁵¹ S 159(2).

⁵² The formula for the credit is $A/(A+B) \times C$, where A = amount inheritance tax payable, B = amount overseas tax payable and C = whichever of A and B is the smaller. See s 159(3).

⁵³ S 159(3).

can be granted in terms of a double taxation agreement or through unilateral relief, it is provided that relief shall be given under whichever method provides the greater relief.⁵⁴

8.2.5 Object of Taxation: Property

The object of taxation is the value of property transferred under a chargeable transfer measured by the net loss to the transferor's estate. It is therefore in general necessary to consider what constitutes the transferor's estate both before and after the transfer (for the purposes of both lifetime transfers and transfers on death). A person's "estate" includes primarily the aggregate of all the "property" to which he or she is or has been beneficially entitled, except that the estate of a person immediately before his or her death does not include excluded property.⁵⁵ "Property" is defined as including "rights and interests of any description, but does not include a settlement power".⁵⁶ ⁵⁷ The definition covers tangible property, intangible rights, debts and other rights capable of being valued.⁵⁸ Property (other than settled property) over which the taxpayer had a "general power" to dispose of as he or she deemed fit (if he or she were *sui iuris*) is also regarded as the property of such taxpayer.⁵⁹

For transfers on death, the Act provides furthermore that any changes in the value of the estate which have occurred by reason of the person's death should be taken into account as if they had occurred before death (but subject to an exception for (i) alterations in rights attached to unquoted shares or securities and (ii) the termination on the death of

⁵⁴ S 159(7).

⁵⁵ S 5(1). For an estate on death generally, see Wallington (2002) par D1.11. See also par 8.2.3.2 n 46 for the meaning of excluded property.

⁵⁶ "Settlement power means any power over, or exercisable (whether directly or indirectly) in relation to, settled property or settlement" (s 47A).

⁵⁷ S 272.

⁵⁸ See in general Wallington (2002) par C2.11. A mere *spes*, or a right which is unenforceable, is not regarded as property (Wallington (2002) par 2.16).

⁵⁹ S 5(2). See in general Wallington (2002) par C2.12.

any interest or the passing of any interest by survivorship).⁶⁰ Thus, a life policy payable on the death of the life insured to his or her estate will form part of the property of the deceased and will be subject to the chargeable transfer on death to his or her deceased estate. The value payable at death, and not the surrender value, will be taken into account. If the policy proceeds are, however, not payable to the deceased estate of the life insured, but to a third party, then the policy proceeds will not form part of the estate of the deceased.⁶¹

8.3 VALUATION

Accept for a few qualifications, property is generally valued in terms of a main valuation rule. Provision is, however, made for some favourable valuation rules in respect of business property and agricultural property, rules that will be more fully discussed in paragraph 8.5.2 below. Property should be valued at the actual date of the transfer.⁶²

8.3.1 Fair Market Value Rule

For the purposes of lifetime transfers, the difference in the total value of the transferor's estate before and after the transfer should be established. In most cases, however, the disposition is a gift of property, which means that the value of the property would represent the value of the chargeable transfer.⁶³ This will, however, not always be the case, especially where the loss to the transferor's estate is greater than the value of the property, for example where the transferor owns 51 percent shares in a company and gives two percent of them away.⁶⁴ For the purposes of transfers at death, the value of all

⁶⁰ S 171. The loss of goodwill on the death of the proprietor would, for example, be taken into account in valuing his or her business share. See Tiley (2008) 1310. For criticism on valuation in hindsight, see McCutcheon (1988) *Br Tax Rev* 431–433. For further reading, see Wallington (2002) par D1.14.

⁶¹ See Wallington (2002) par D1.14 and Tiley (2008) 1407.

⁶² *Duke of Buccleuch v IRC* [1967] 1 AC 506; *Ward v IRC* [1999] STC (SCD) 1.

⁶³ Wallington (2002) pars C2.01, H1.01.

⁶⁴ Wallington (2002) par C1.11. See also par C2.01.

the property owned by the deceased immediately prior to his or her death should be valued.⁶⁵

According to the general rule (in the absence of a qualification), property should be valued at the price which it might reasonably be expected to fetch if sold on the open market at the time of the transfer, provided that the price shall not be reduced on the ground that the whole property is to be placed on the market at one and the same time.⁶⁶ For the purposes of the valuation of unquoted shares, the Act directs that all the information which a prudent prospective purchaser might reasonably require for the purposes of a private agreement at arm's length should be assumed to be available to such prospective purchaser.⁶⁷

Where the right to dispose of any property has been contractually excluded or restricted (by virtue of, for example, an option agreement), the exclusion or restriction would be disregarded except to the extent that consideration in money or money's worth was given for it.⁶⁸ This provision has specifically been designed to counter artificial arrangements such as where the wealth holder has concluded an option agreement to sell property at a price which would be below market value on the date of transfer thereof.⁶⁹

⁶⁵ Wallington (2002) pars D1.14, H1.02.

⁶⁶ S 160. For general guidelines developed by the judiciary, see *IRC v Gray* [1994] STC 360, 371–372 and Wallington (2002) pars H2.02–H2.0.

⁶⁷ S 168. For further reading on the valuation of unquoted shares in practice, see Wallington (2002) pars H3.11 to H3.20; Tiley (2008) 1439 and Sutherland (1996) *Br Tax Rev* 397 *et seq.*

⁶⁸ S 163(1). See in general Wallington (2002) par H1.01 and H2.31. In the case of a lifetime transfer, the provision applies only where the restriction was created after 27 March 1974 (s 163(2)).

⁶⁹ The Act contains a few other specific anti-avoidance measures, such as the “related property rule” (s 161) and the rule providing that the market value of property will be used on the date of the actual delivery where the delivery takes place more than a year after the disposition (s 262). See in general Wallington (2002) pars H1.01 and H2.41.

8.4 TAXPAYER AND PAYMENT OF THE TAX

The transferor is primarily liable for tax due in respect of chargeable lifetime transfers.⁷⁰ If the tax remains unpaid after it ought to have been paid, the person whose estate has been increased by the transfer (i.e. the recipient) or the person in whom the property transferred is vested (beneficially or otherwise) or any person for whose benefit the property has been settled, will be accountable for payment of the tax.⁷¹ The person primarily liable for the tax on the value transferred on death is in general the personal representatives of the deceased.⁷² The Act also extends the liability to the person in whose name the property is vested (beneficially or otherwise) at any time after death, or who is beneficially entitled to an interest in possession, and any person for whose benefit any property was settled at death.⁷³

In respect of tax due on chargeable transfers in respect of settled property, the trustees of the settlement are primarily liable for the payment of the tax.⁷⁴ If the tax remains unpaid after the period it ought to have been paid, the liability is extended to any person entitled (beneficially or not) to an interest in possession of the settled property, any person for whose benefit the settled property or income there from is applied at or after the time of transfer and the settlor, in circumstances where the settlement was made during the lifetime of the settlor and the trustees are not for the time being resident in the United Kingdom.⁷⁵

⁷⁰ Ss 199(1) and 204(6). However, should the tax relate to additional tax due on immediately chargeable transfers or PETS due to the fact that the transferor died within seven years, the transferor (or his personal representatives) will not be so liable. The transferee will be accountable for the additional tax (s 204(7)).

⁷¹ Ss 199(1) and 204(6).

⁷² S 200(1)(a).

⁷³ S 200(1)(c) and (d). The liability is limited to the tax attributable to the extent of the particular property, s 204(3).

⁷⁴ Ss 201(a) and 204(6).

⁷⁵ Ss 201(b),(c),(d) and 204(6).

8.5 RELIEF MECHANISMS

The relief mechanisms provided under the Act take various forms. Firstly, there are dispositions which are treated as not being transfers of value.⁷⁶ Secondly, certain property is regarded as excluded property.⁷⁷ In addition, relief is provided by (a) the allowance of the deduction of accompanying liabilities, (b) the provision for favourable valuation rules for relevant business property and agricultural property, (c) the exemption of certain transfers and the allowance of a tax-free (lifetime) threshold (the so-called “nil rate band”) and (d) the provision for roll-over relief for non-agricultural woodlands.

8.5.1 Liabilities

The Act provides that the chargeable transfer should be measured with reference to the net loss to the transferor’s estate,⁷⁸ which is determined by calculating the difference in the value of the estate before and after the transfer. In calculating the value of an estate at any time, the Act specifies that the liabilities at that time should be taken into account, except as otherwise stated.⁷⁹ Where a liability is due to a person resident outside the United Kingdom, which neither falls to be discharged in the United Kingdom nor is a burden on property in the United Kingdom, such liability shall be taken to reduce the value of property outside the United Kingdom only.⁸⁰

A person’s liability for inheritance tax (chargeable as a result of a chargeable transfer) may be taken into account for the purposes of the value transferred, but not his or her liability for any other tax resulting from the transfer.⁸¹

⁷⁶ See par 8.2.1.

⁷⁷ See par 8.2.3.2 n 46.

⁷⁸ S 3(1).

⁷⁹ S 5(3).

⁸⁰ S 162(5). See in general Wallington (2002) par C2.34.

⁸¹ S 5(4). The transferor’s liability for inheritance tax on the transfer of value shall be calculated without making any allowance for the fact that the tax will not be due immediately (s 162(3)).

Expenses incurred by the transferor (except for his or her liability for inheritance tax) in making the transfer will, if borne by him or her, be left out of account. However, costs borne by the person benefiting from the transfer will be treated as reducing the value transferred.⁸²

For the purposes of transfers on death, an allowance is made for reasonable funeral costs.⁸³ Although executors' remuneration and administration costs are not deductible,⁸⁴ an allowance is granted for administration and realisation costs incurred in respect of foreign property, provided that the costs shall not exceed five percent of the value of that foreign property.⁸⁵

8.5.2 Preferential Valuations

8.5.2.1 Business Property

Special relief for business property was first introduced under the former capital transfer tax legislation in 1976.⁸⁶ Currently, the Act provides that the transfer of "relevant business property" of a "qualifying business"⁸⁷ may qualify for a reduction of either 50 or 100 percent of the value of the property transferred, provided that certain requirements

⁸² S 164.

⁸³ S 172. See in general Wallington (2002) par D1.42.

⁸⁴ Tiley (2008) 1448.

⁸⁵ S 173. See in general Wallington (2002) par D1.43.

⁸⁶ When the tax was first introduced, a 30 percent reduction of the value of business assets was allowed, a share in a partnership or a controlling holding in a company transferred. See Wallington (2002) par G1.01 for a discussion on the historical development of the relief.

⁸⁷ S 103 provides that a "qualifying business" includes a business carried on in the exercise of a profession or vocation unless carried on otherwise as for gain. Subject to certain exceptions, some businesses do not qualify for relief, such as businesses consisting "wholly or mainly" of the dealing in securities, stocks, shares, land or buildings and the making or holding of investments. See s 105(3) read with s 105(4) and Wallington (2002) par G1.12.

are met.⁸⁸ The relief can also be claimed on chargeable occasions arising on relevant business property held in trust.⁸⁹ The relief applies to lifetime transfers and transfers on death, as well as to both foreign and United Kingdom businesses.⁹⁰ It is automatically available and does not have to be claimed by the person liable for the tax.⁹¹ To counter tax avoidance, the Act requires that the property (or qualifying replacement property) must have been owned by the transferor throughout the two years immediately preceding the transfer.⁹²

Where a business is transferred during the life of the transferor, and the transferor (or the transferee) dies within seven years from such transfer, then the business property will only qualify for business relief (on the death transfer) if the business property was owned by the transferee throughout the period between the gift and the death of the transferor (or the earlier death of the transferee), subject to special rules for replacement property. The property should qualify as relevant business property at the time that the gift was made as well as at the time immediately before the death of the transferor (or the transferee).⁹³

⁸⁸ The following “relevant business property” will qualify for the 100 percent relief: property consisting of a business or an interest in a business (such as a share in a partnership) and any unquoted shares in a company. The following “relevant business property” will qualify for the 50 percent relief: quoted shares or securities, which gave the transferor, either by themselves or with other securities, control in the company; land or buildings, machinery or plant owned by the transferor, which was used wholly or mainly for the purposes of a business carried on by a company of which the transferor then had control or by a partnership of which he was then a partner; and land or buildings, machinery or plant, which was used mainly or wholly for the purposes of a business carried on by the transferor where the property was settled, but in respect of which the transferor was beneficially entitled to an interest in possession at the time of the transfer. S 104(a) read with s 105(1)(a), (b) and (bb) (for the 100 % relief) and s 104(b) read with s 105(1)(cc), (d) and (e) (for the 50% relief). See in general Wallington (2002) par G1.51 and Tiley (2008) 1411–1412.

⁸⁹ Wallington (2002) par G1.61.

⁹⁰ Wallington (2002) pars G1.02 and G1.11.

⁹¹ Wallington (2002) par G1.02.

⁹² S 106 read with s 107(1)(a). S 12 provides that assets which were not wholly or mainly used for business purposes within the two-year minimum ownership period preceding the transfer (“excepted assets”) will be excluded from the relief. See in general Wallington (2002) par G1.54.

⁹³ S 113A. See in general Wallington (2002) par G1.91.

8.5.2.2 *Agricultural Property*

Relief is in principle granted to agricultural property, situated in the United Kingdom, the Channel Islands or the Isle of Man, which forms part of a working farm and which is transferred by virtue of a transfer of value (during life or on death).⁹⁴ Where the whole or part of the value transferred is attributable to the agricultural value of agricultural property, the value of such property shall be reduced by either 100 or 50 percent.⁹⁵ The relief also applies to settled property (whether or not any beneficiary has an interest in possession),⁹⁶ as well as to controlling interests in farming companies (to the extent that the value of the shares or securities is attributable to agricultural property).⁹⁷ The relief is automatically available and does not have to be claimed.⁹⁸ In the calculation of the relief, any mortgages or secured liabilities are taken into consideration.⁹⁹

⁹⁴ Agricultural property means agricultural land or pasture situated in the UK, the Channel Island or the Isle of Man and includes “woodland and any building used in connection with the intensive rearing of livestock or fish if the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture; and also includes such cottages, farm buildings and farmhouses, together with the land occupied with them, as are of a character appropriate to the property” (s 115(2) read with s 115(5)). The breeding and rearing of horses on a stud farm shall also be taken to be agricultural (s 115(4)). See also Wallington (2002) par G3.03 and Tiley (2008) 1419 for further reading.

⁹⁵ The transfer will qualify for 100 percent relief in the following instances: where the transferor has vacant possession of agricultural property (or the right to obtain it within the next twelve months); or where the transferor does not have vacant possession because the property has been let on a tenancy, beginning on or after 1 September 1995 (subject to certain transitional arrangements). Relief is due at a lower rate of 50 percent in any other case, principally where the property had been let under a tenancy starting before 1 September 1995 (where the transitional arrangements are not applicable). See s 116(1) read with s 116(2) and Wallington (2002) pars G3.02 and G3.04.

⁹⁶ S 115(1). See in general Wallington (2002) pars G3.51–G3.53.

⁹⁷ S 122. See in general Wallington (2002) pars G3.31–G3.40.

⁹⁸ Wallington par G3.01.

⁹⁹ E.g., A dies owning agricultural land valued at £250 000 let under a tenancy granted before 1 September 1995. The rate of relief is 50%. The agricultural value of the agricultural property transferred amounts to £200 000. The property is subject to a mortgage of £60 000. The chargeable value of the agricultural property is calculated as follows: £200 000–£48 000 ($£200\,000/£250\,000 \times £60\,000$) = £152 000. $50\% \times £152\,000 = £76\,000$. The chargeable value of the non-agricultural property is calculated as follows: £50 000–£12 000 (balance of mortgage) = £38 000. The total chargeable value of the property is therefore £76 000 + £38 000 = £114 000. See <http://www.hmrc.gov.uk/cto/customerguide/page17.htm#8> (accessed on 19 June 2009).



For the application of the relief, the Act requires a minimum period of occupation or ownership. Where the transferor occupied the property for agricultural purposes,¹⁰⁰ the Act requires that he or she must have occupied the property as such for a period of at least two years preceding the transfer. Where, on the other hand, the transferor had not occupied the property as such (for example where it had been let under a tenancy), such transferor must have owned the property for at least seven years before the transfer (during which period it had been occupied for agricultural purposes by him/her or another person).¹⁰¹

Where agricultural property is transferred during the life of the transferor, and the transferor (or the transferee) has died within seven years from such transfer, then the property may only qualify for agricultural relief (on the death transfer) if the property was owned by the transferee throughout the period between the gift and the death of the transferor (or the earlier death of the transferee), subject to special rules for replacement property. The property should also have qualified as agricultural property at the time that the gift was made as well as at the time immediately before the death of the transferor (or the transferee). The property should furthermore have been occupied for agricultural purposes throughout the period between the gift and the death.¹⁰²

Where the conditions for both agricultural and business relief are satisfied, then agricultural relief rather than business relief is available.¹⁰³ However, business relief may be available in respect of agricultural properties which do not qualify for agricultural relief, such as assets of farming businesses other than land and buildings and non-controlling unquoted shareholdings in farming companies.¹⁰⁴

¹⁰⁰ It is provided that occupation by a company which is controlled by the transferor shall be treated as occupation by the transferor (s 119). See in general Wallington (2002) par G3.12.

¹⁰¹ S 117. See in general Wallington (2002) pars G3.11 and G3.21.

¹⁰² S 124A. See in general Wallington (2002) pars G3.81–G3.81C.

¹⁰³ S 114.

¹⁰⁴ Wallington (2002) par G3.01.

Some commentators question the provision for special valuation rules for certain properties in that these rules create horizontal inequality between these properties and other assets.¹⁰⁵

8.5.3 Exempt Transfers

8.5.3.1 Exemptions Applicable to both Lifetime Transfers and Transfers on Death

The following transfers are exempt from tax, whether they occur during life or whether they occur on death:

- provided that certain conditions are met,¹⁰⁶ transfers to a charity,¹⁰⁷ a political party,¹⁰⁸ any registered housing association¹⁰⁹ or an institution such as the National Gallery, the British Museum and the Historic Buildings and Monuments Commission of England, any local authority, any government department, any university or university college in the United Kingdom¹¹⁰ and property that becomes part of a maintenance fund for historic buildings;¹¹¹

¹⁰⁵ See e.g. Sweet & Maxwell (1992) *Br Tax Rev* 238; Tiley (2008) 1259.

¹⁰⁶ For a discussion of these conditions, see Tiley (2008) Ch 75. Broadly speaking, the requirements are as follows: (i) a transfer must not take effect on the termination, after the transfer of value, of any interest or period; (ii) the transfer must not depend on a condition which is not satisfied within 12 months after the transfer; (iii) the gift must not be defeasible (determined 12 months after the transfer); (iv) the interest given must not be less than the donor's gain and (v) the property must not be given for a limited period. See s 23(2)–(5).

¹⁰⁷ S 23. See in general Wallington (2002) pars C3.33 and D2.15.

¹⁰⁸ S 24. See in general Wallington (2002) pars C3.34 and D2.16.

¹⁰⁹ S 24A. See in general Wallington (2002) pars C3.35 and D2.17.

¹¹⁰ S 25 read with Sch 3. See in general Wallington (2002) pars C3.36 and D2.18. See also Stebbings (1996) *Br Tax Rev* 542–543 for a historic description of this exemption that was first introduced in 1896, more than 110 years ago.

¹¹¹ S 27. See in general Wallington (2002) pars C3.38 and D2.20.

- provided that certain conditions are met, a transfer of value which includes national heritage property (such as pictures, books, works of art, land or buildings of national, scientific, historic, artistic or scenic interest) where the transferee gives certain undertakings to preserve the property and allow public access to it;¹¹²
- a loan made to a borrower in one of the exempt categories (such as loans of work of art to a museum);¹¹³
- provided that certain conditions are met, a transfer of value to the extent that the value transferred is attributable to property which becomes comprised in the estate of the transferor's spouse¹¹⁴ or civil partner or, so far as the value transferred is not so attributable, to the extent that the estate is increased (but subject thereto that, where the transferor is domiciled in the United Kingdom, but the transferee-spouse is not so domiciled, the exemption will be limited to £55 000 less any amount previously taken into account for the purposes of the relief);¹¹⁵ and
- provided that certain conditions are met, a transfer of value made by an individual who is beneficially entitled to shares in a company, to the extent that the value transferred is attributable to shares in or securities of the company which become comprised in an employee share purchase trust.¹¹⁶

¹¹² Ss 30–35. See in general Wallington (2002) pars C3.43, D2.24 and division G5.

¹¹³ S 29. See in general Wallington (2002) par C3.42.

¹¹⁴ There is no explicit definition for the term “spouse” in the Act, but under UK law it means lawfully wedded husband or wife. See Wallington (2002) par D2.12. The restriction of the inheritance tax exemption to married couples and couples registered under the Civil Partnership Act was challenged by two sisters (the Burden sisters) who have spent their lives living together. In April 2008 the majority of the judges of the Grand Chamber of the European Court of Human Rights (15 to 2) held in *Burden v United Kingdom* (13378/05) [2008] STC 1305 (ECHR (Grand Chamber)) par 66 that the difference in treatment does not constitute discrimination. Broadly speaking, academic commentators criticised the Grand Chamber's reasoning. See e.g. Sloan (2008) *Cambr Law J* 485; Baker (2008) *Br Tax Rev* 332 and Dempsey (2009) *Scolag Legal J* 38. However, the denial of the favourable tax treatment to the Burden sisters has awakened some emotional criticism in the media. See e.g. Knight “Two Old Ladies and a Blinding Injustice” *The Sunday Times* (17 December 2006), available at <http://www.timesonline.co.uk> (accessed on 8 July 2009).

¹¹⁵ S 18(1) read with ss 18(2) and 18(3)(a) and (b). See in general Wallington (2002) pars C3.32 and D2.14 and Tiley (2008) 1393–1394.

¹¹⁶ S 28. See in general Wallington (2002) par C3.41.

8.5.3.2 Exemptions Applicable to Lifetime Transfers Only

Lifetime transfers that may qualify for PET status include a transfer to (a) another individual, or (b) a disabled trust or (c) a bereaved minor's trust.^{117 118} A PET will in general only be taxable if the transferor dies within seven years after the date of the transfer. If the transferor survives the seven-year period, the transfer is exempt.¹¹⁹ However, where the transferor dies between three and seven years after making the gift, any inheritance tax due is reduced on a sliding scale. This is known as "taper relief".¹²⁰ Tiley questions whether there should be such a marked absence of tax neutrality as to the timing of gifts.¹²¹ It is therefore not surprising that the recently published Mirrlees Review suggested that the life-time exemption of gifts needs to be re-examined, in view of the fact that it has a negative impact on the equity of the system.¹²²

The following gifts are exempt from inheritance tax (whether or not they qualify for PET status):

- a small gift that does not exceed a certain value (£250 for the 2009/2010 tax year);¹²³
- any payments made out of income by the transferor as part of his or her normal expenditure, such as monthly or other regular payments to someone, regular gifts for Christmas and birthdays or anniversaries and regular premiums on a life insurance policy;¹²⁴ and

¹¹⁷ See par 8.6.3.5 for further reading on the bereaved minor's trust.

¹¹⁸ S 3A(1A)(a)–(c). Where the transfer was made before 22 March 2006, the transfers that would have qualified for PET status included a transfer to (a) another individual, or (b) an accumulation and maintenance trust (A&M trust) or (c) a disabled trust. See s 3A(1)(a)–(c). See par 8.6.3.5 n 193 for the meaning of an A&M trust. Note that this type of trust was basically replaced by the bereaved minor's trust as a consequence of the amendments affected to the Act in 2006.

¹¹⁹ S 3A(4) and (5).

¹²⁰ See ss 131–140.

¹²¹ Tiley (2008) 1259.

¹²² Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 17–18.

¹²³ S 20. This exemption does not apply to the first £250 of a larger gift. See Wallington (2002) par C3.24.

¹²⁴ S 21. See in general Wallington (2002) par C3.25 and division G5.

- any gift in consideration of marriage or civil partnership, limited to a certain amount (for the 2009/2010 tax year the limitations are as follows: £5 000 in respect of a gift by a parent to the party of the marriage; £2 500 in respect of gifts by grandparents and other close relatives and £1 000 for all other cases).¹²⁵

In addition, the Act provides for an exemption of £3 000 in respect of lifetime transfers of value made by a transferor in one calendar year.¹²⁶

8.5.3.3 *Exemptions Applicable to Transfers on Death Only*

The Act provides for the exemption of a transfer of value upon the death of a person who died in active service against an enemy or in other services of a warlike nature.¹²⁷

8.5.3.4 *The Nil Rate Band*

The nil rate band (referred to in paragraph 8.1.2 above) is the amount up to which a transferor will not have to pay inheritance tax. The transferor will only pay tax on the value of a transfer that exceeds the aggregate value of all the chargeable transfers made by him or her in the period of seven years immediately preceding the first-mentioned transfer. This may already happen during his or her lifetime, or it may happen at death. The value of the nil rate band is adjusted for inflation on an annual basis.¹²⁸

Since 9 October 2007, a surviving spouse or civil partner may, in addition to his or her own nil rate band, also be entitled to any unused part of his or her deceased former

¹²⁵ S 22. See in general Wallington (2002) par C3.26.

¹²⁶ S 19 (1). Any unutilised balance of the annual exemption may be carried over to the second year (s 19(2)). See in general Wallington (2002) par C3.22.

¹²⁷ The death should be so certified by the Defence Council or the Secretary of State (s 154). See in general Wallington (2002) par D2.11.

¹²⁸ See Sch 1.



spouse or partner's nil rate band.¹²⁹ Broadly speaking, scholars welcomed the amendment as a measure to eliminate the estate planning schemes that existed to ensure that both spouses' rebates are utilised.¹³⁰

8.5.4 Roll-over Relief: Non-Agricultural Woodlands

A special form of relief is available in respect of property in the United Kingdom on which trees and underwood are growing which is transferred on the death of a person and which is not agricultural property within the meaning as described above. If the person liable for the payment of the tax so elects,¹³¹ the payment of inheritance tax in respect of the value of the trees and underwood may be deferred until it has been disposed of (whether together with or apart from the land on which they were growing).¹³² The inheritance tax chargeable on the later disposal will be calculated on the net proceeds of the sale (or the net value of the trees in any other case) at the rate or rates at which it would have been charged on the death of the former transferor.¹³³

The relief will apply only where the deceased was either beneficially entitled to the land throughout a period of five years immediately preceding his or her death, or became entitled to it otherwise than for money or money's worth (i.e. by virtue of a gift or an inheritance).¹³⁴ Unlike the position under the agricultural relief, this relief is not available

¹²⁹ S 8A–C. See <http://www.hmrc.gov.uk/inheritancetax/info/transfer-threshold.htm> (accessed on 1 July 2009).

¹³⁰ See Chamberlain (2007) *Br Tax Rev* 662 *et seq* and Campbell (2008) *Br Tax Rev* 423 *et seq* and Harris (2009) *Busy Practitioner* 4.

¹³¹ An election must be made by notice in writing to the Board within 2 years of the death or such longer period as the Board may allow (s 125(3)).

¹³² Ss 125 and 126. See Wallington (2002) pars G4.01–G4.08 for further reading.

¹³³ Ss 127 and 128.

¹³⁴ S 125(b).

where the woodlands are owned by a company in which the deceased held a controlling shareholding.¹³⁵

8.6 TREATMENT OF SETTLED PROPERTY (TRUSTS)

8.6.1 Trusts: A Classification

Although English trusts¹³⁶ can be classified according to several criteria,¹³⁷ it suffices to, for wealth transfers tax purposes, distinguish between fixed interest trusts and discretionary trusts. A fixed interest trust (or interest in possession trust) is a trust in which a beneficiary has a present fixed entitlement to an ascertainable part of the net income (after any administrative expenses have been deducted). The life tenant, who is regarded as the beneficial owner of the underlying property,¹³⁸ has a so-called “interest in possession” in the trust property, meaning a “present right to the present enjoyment” of the property.¹³⁹ This description was confirmed by the House of Lords in *Pearson v IRC*.¹⁴⁰ The most common type of interest in possession trust is the so-called life interest trust, for example where property is settled in trust for A for life with the remainder to

¹³⁵ Wallington (2002) par G4.01.

¹³⁶ See Ch 5 par 5.6.1.1 for a brief discussion of the origin and development of trusts in England.

¹³⁷ The general classification based on the way in which the trusts are created is (i) express trusts; (ii) resulting trusts, (iii) constructive trusts, and (iv) statutory trusts. See Sonneveldt in Sonneveldt and Van Mens eds (1992) 8–9.

¹³⁸ See Ch 5 par 5.6.1.1.

¹³⁹ Sonneveldt in Sonneveldt and Van Mens eds (1992) 10; Sonneveldt Doctoral Thesis (2000) 153; Jarman (2006) 17–18. See also definition of a interest in possession trust at <http://www.hmrc.gov.uk/trusts/types/bare.htm> (accessed on 21 June 2009).

¹⁴⁰ STC [1980] 318 323. See Wallington (2002) par E1.41 for a comprehensive discussion of the case. Tiley (2008) 1352 mentions that if a person has, for example, a life interest and there is no power to withhold income from him or her short of depriving him or her from capital, that person would have an interest in possession notwithstanding that no income may in fact arise. Where, however, the trustees have the power to accumulate the income, the *Pearson* case has established that the beneficiary would not have an interest in possession. See Tiley (2008) 1351–1352 and Jarman (2006) 18 for a discussion of the case.

B.¹⁴¹ The beneficiary who is entitled to the income of the trust is known as the “life tenant”, whereas the beneficiary who is entitled to the remainder or the reversion of the trust capital is known as the “remainderman”.¹⁴² It is noteworthy to mention that, although a life interest may seem similar to the Roman law usufruct (a concept that can readily be found in many civil-law systems), these concepts are quite different in that a usufructuary interest may not be alienated, whereas a person may dispose of a life interest.¹⁴³ In a discretionary trust the trustees are the legal owners of the property held in trust, which they then administer for the benefit of members of a class of beneficiaries. The beneficiaries do not have interests in possession in the trust property. The trustees have a discretion (conferred on them by the settlor of the trust) to decide how to distribute the income and/or capital of the trust among the beneficiaries.¹⁴⁴

8.6.2 A Brief History on the Development of the Treatment of Trusts for Wealth Transfer Tax Purposes

When estate duty was introduced in 1894, it was provided that a beneficiary with an “interest in possession” in settled property was chargeable to estate duty as if that beneficiary owned the underlying trust property outright.¹⁴⁵ In 1969 the application of the duty was for the first time reformed to extend to discretionary trusts, where beneficiaries do not have interests in possession to the trust property. However, the duty was in general only charged where a deceased was eligible to benefit and indeed benefited from the income within the seven years prior to his or her death. If such beneficiary, for instance,

¹⁴¹ Sonneveldt in Sonneveldt and Van Mens *eds* (1992) 10–11.

¹⁴² Sonneveldt in Sonneveldt and Van Mens *eds* (1992) 10.

¹⁴³ Lyons (2009) *Private Client Business* 34 n 5 and accompanying text.

¹⁴⁴ Sonneveldt in Sonneveldt and Van Mens *eds* (1992) 10.

¹⁴⁵ Coombes (1977) 5; Chamberlain (2006) *Br Tax Rev* 625.

received a third of the trust income during that period, a third of the trust capital would have been subject to duty.¹⁴⁶

Capital transfer tax, which was introduced in 1975, adopted the same approach as estate duty in respect of interests in possession. In respect of discretionary trusts, a much more direct approach was introduced by the implementation of periodic charges on the settled property, the broad aim of which was to provide for a regime akin to a full charge to the tax once a generation. In addition, the cessation of property as relevant property was deemed to be a chargeable transfer by the trust to the beneficiary and was fully taxable. Apparently, this regime was perceived to be relatively onerous. As a consequence, the legislature refined the system in 1982. The regime provided for a 10-year anniversary charge for “relevant property” settlements (discretionary trust funds) as well as exit charges in respect of property that ceased to be so held in trust. Apparently, the relevant property regime was widely accepted to be fair.¹⁴⁷

When capital transfer tax was replaced with inheritance tax in 1984, the dual-system regime for trusts (interest in possession regime (IIP regime) and relevant property regime) was initially replicated in the new legal structure.¹⁴⁸ In view of the fact that inheritance tax, unlike capital transfer tax, taxed lifetime transfers only where they occurred in a stated period before death (the PET regime), the legislation was adapted to provide that a transfer of an asset into an interest in possession trust (on or after 17 March 1987) could also qualify as a PET. This approach was based on the fact that a beneficiary of an interest in possession in settled property was generally treated as having an interest in the property underlying that interest.¹⁴⁹ The transfer could therefore possibly have

¹⁴⁶ Report by Chancellor of the Exchequer *Cmnd 4930* (1972) 3.

¹⁴⁷ Chamberlain (2006) *Br Tax Rev* 626; Jarman (2006) 4 and 43.

¹⁴⁸ Jarman (2006) 4.

¹⁴⁹ S 49 (prior to its amendment in 2006).

escaped tax if the transferor did not die within the seven-year period.¹⁵⁰ However, the operation of the PET regime in respect of interest in possession trusts (IIP trusts) was the backbone of many effective estate planning techniques.¹⁵¹ To counter this form of tax avoidance, the Act was amended (with effect from 22 March 2006) to provide that most interests in possession would not be treated as the outright property of the beneficiary anymore. The relevant property regime was furthermore extended to operate in respect of most IIP trusts.¹⁵² The new regime will be discussed more fully below.

8.6.3 Treatment of Trusts under the Inheritance Tax Act: The Contemporary Position

8.6.3.1 General: The Meaning of Settled Property, Interest in Possession and Reversionary Interest

The Inheritance Tax Act contains a special regime for “settled property” in Part III of the Act. Before embarking on a discussion on this regime, it is firstly necessary to evaluate the meaning of the term “settled property”. In terms of the Act, settled property includes property held in trust for successive beneficiaries or for any person subject to a contingency (such as the future birth of a beneficiary). It also includes property held in trust where the trustees have the power to accumulate the trust income or where such income is payable at the discretion of the trustees (or someone else). The term furthermore includes property charged or burdened (otherwise than for full consideration

¹⁵⁰ See Sonneveldt Doctoral Thesis (2000) 156; Tiley (2008) 1345 and Jarman (2006) 35.

¹⁵¹ It was, for example, very common on the death of a life tenant for the assets to pass to an interest in possession trust for the benefit of the deceased’s spouse (which would have qualified as an exempt transfer). If the spouse’s interest in possession was consequently terminated, for example by transferring the interest to a child, and the spouse survived the seven-year period, the transfer of the interest could have qualified as a PET and could therefore have escaped inheritance tax indefinitely. See Chamberlain (2006) *Br Tax Rev* 630; Jarman (2006) 5 and Tiley (2008) 1347.

¹⁵² See Whitehouse (2006) *Br Tax Rev* 206 *et seq*; Chamberlain (2006) *Br Tax Rev* 625 *et seq* and Jarman (2006) 5–13 for a broad overview of the changes effected by the 2006 amendments.

in money or money's worth) with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period. The concept also extends to property that is held under similar arrangements governed by the laws of another country.¹⁵³ Although the description of settled property principally includes property held in trust, it also deems certain other property (other than trust property) to be settled property, for example a lease of property which is for life or lives, or for a period ascertainable only by reference to a death (unless the lease was granted for full consideration).¹⁵⁴ For inheritance tax purposes, each item of settled property is regarded as having its own identity. For example, where one item of settled property within a trust may be used at the discretion of the trustees, whereas another item within the same trust is set aside for the benefit of a disabled person, each item will be treated separately.¹⁵⁵

In view of the fact that the Act does not contain a special definition for an interest in possession (except for Scotland only),¹⁵⁶ its meaning is established by reference to the principles of ordinary trust and property law, which have already been described above as a "present right to the present enjoyment of property".¹⁵⁷ In practice, the taxing authorities treat a foreign usufruct as the equivalent of a life interest in a settlement, despite their apparent differences.¹⁵⁸ A "reversionary interest" refers to "a future interest under a settlement, whether it is vested or contingent (including an interest expectant on the termination of an interest in possession ...)".¹⁵⁹ Thus, under United Kingdom law, bare

¹⁵³ S 43 (1) and (2). See in general Wallington (2002) pars E1.11–E1.16. For arrangements that fall outside the definition, see Wallington (2002) par E1.17.

¹⁵⁴ S 43(3). See in general Wallington (2002) par H2.22; Tiley (2008) 1341–1343 and Jarman (2006) 30.

¹⁵⁵ HMRC *Inheritance Tax and Settled Property*, available at <http://www.hmrc.gov.uk/trusts/iht/intro.htm> (accessed on 29 June 2009).

¹⁵⁶ Tiley (2008) 1351 n 3 mentions that s 46 refers to "an interest of any kind under a settlement actually being enjoyed by the person in right of that interest".

¹⁵⁷ See par 8.6.1.

¹⁵⁸ Lyons (2009) *Private Client Business* 40.

¹⁵⁹ S 47.



dominium property will be classified as a reversionary interest. Because limited interests and bare *dominium* is a problematic area under the South African law, the approach to these interests under the inheritance tax regime will be discussed more fully in paragraph 8.7 below.

8.6.3.2 *Jurisdictional Basis*

Settled property (other than a reversionary interest in such property), situated outside the United Kingdom, is excluded from the tax base if the settlor was domiciled outside the United Kingdom when the settlement was made.¹⁶⁰ The settled property will, however, not be excluded if a person is or was at any time entitled to an interest in possession in the property at a time when he or she was domiciled in the United Kingdom and the entitlement arose as a result of a disposition made on or after 5 December 2005 for a consideration in money or money's worth.¹⁶¹ A reversionary interest in such settled property, situated outside the United Kingdom, will also be excluded from the tax base where the person beneficially entitled to it is not domiciled in the United Kingdom.¹⁶² If the person, however, subsequently acquires United Kingdom domicile, the reversion will lose its exclusion.¹⁶³

¹⁶⁰ S 48(3)(a). Jarman (2006) 22 mentions that the establishment of a so-called "excluded property settlement" has therefore become near-standard planning for a person who is planning to live in the UK but is not yet domiciled in the country.

¹⁶¹ S 48 (3B). This provision was inserted to counter the popular estate planning scheme whereby a UK domiciled taxpayer purchased substantial life and reversionary interests in an offshore settlement established by a non-UK domiciled settler. See Campbell (2006) *Br Tax Rev* 44–45. It has been said that, although the purpose of the amendment is laudable, its wording is wider than its purpose requires and may have an adverse effect on innocent UK emigrants, resulting in unnecessary double taxation. See Harper (2006) *Br Tax Rev* 638–642.

¹⁶² S 48(3)(b) read together with s 6(1).

¹⁶³ Jarman (2006) 22.

The following discussion will set out the contemporary inheritance tax consequences (subsequent to the amendments that were effected on 22 March 2006) in relation to fixed trusts, discretionary trusts and special purpose/charitable trusts.

8.6.3.3 Fixed Interest Trusts (Interest in Possession Trusts)

Although the *inter vivos* creation of an interest in possession settlement could usually have qualified as a PET prior to the 2006 changes, such a creation will now generally qualify as an immediately chargeable transfer, unless the transfer creates a disabled person's interest, which may still qualify as a PET under the new rules.¹⁶⁴

In the instance where a beneficiary became beneficially entitled to an interest in possession prior to 22 March 2006, the Act provides that such an interest will still continue to be treated according to the old IIP regime. The underlying settled property will therefore be regarded as the outright property of the beneficiary.¹⁶⁵ As a consequence, any subsequent disposal or termination of such an interest (during the lifetime of the beneficiary) will (except to the extent that it constitutes excluded property) be deemed to constitute a transfer of value equal to the value of the underlying property reduced by the value of any consideration received.¹⁶⁶ Furthermore, in the event of the beneficiary's death, the underlying settled property will (except to the extent that it comprises excluded property) form part of the beneficiary's deceased estate.¹⁶⁷ All the usual reliefs and exemptions on death will be available.¹⁶⁸

¹⁶⁴ HMRC *Inheritance Tax on Transfers into Trust*, available at <http://www.hmrc.gov.uk/trusts/iht/transfers-in.htm> (accessed on 27 June 2009); Whitehouse (2006) *Br Tax Rev* 209; Jarman (2006) 72.

¹⁶⁵ Ss 49(1) and (1B). However, where the trust is revocable (a so-called "grantor trust"), the assets held in trust will still be regarded as part of the settlor's estate. See Lupoi (2000) 104.

¹⁶⁶ S 52(1) and (2) read with ss 51, 49 and 52(2). See in general Jarman (2006) 31.

¹⁶⁷ S 49 read with s 4. See in general Jarman (2006) 31.

¹⁶⁸ S 49 read with s 4. See in general Jarman (2006) 31. For the purposes of both lifetime transfers and transfers on death, the transfer will not be chargeable where the interest in possession reverts to the settlor, or where the settlor's spouse or his or her widow or widower domiciled in the UK becomes beneficially entitled to such an interest, unless such person acquired a reversionary interest in the property for a

Footnote continues on the next page

On the other hand, where a beneficiary becomes beneficially entitled to an interest in possession on or after 22 March 2006, the beneficiary will not be regarded as the outright owner of the underlying settled property (save for a few exceptions, namely where the interest constitutes an immediate post-death interest,¹⁶⁹ a disabled person's interest¹⁷⁰ or a transitional serial interest¹⁷¹).¹⁷² The effect of this provision is that any subsequent disposal, termination or death (of the beneficiary) will not constitute a chargeable event.¹⁷³ However, such an IIP trust will now be subject to the special "relevant property" regime applicable to discretionary trusts, which includes the 10-year anniversary charge and the exit charges, as will be discussed more fully in paragraph 8.6.3.4 below.

In keeping with the rule to either attribute the full value of an interest in possession to the beneficiary, or to subject the IIP trust to the relevant property regime, a reversionary

consideration in money or money's worth. See ss 53(3)–(5) and 54(1)–(3) and 54(2A). See also Jarman (2006) 38.

¹⁶⁹ An "immediate post-death interest" is an interest in possession in settled property created by a will or under the law relating to intestacy where the beneficiary becomes beneficially entitled to the interest on the death of the testator or intestate. Such an interest would continue to be treated according to the old IIP rules. As a consequence, there would be no 10-yearly charge. See s 49A.

¹⁷⁰ A "disabled person's interest" is an interest under a trust set up for someone with a mental or physical disability. Such an interest would continue to be treated according to the old IIP rules. As a consequence, there would be no 10-yearly charge. See s 89.

¹⁷¹ In view of the fact that the 2006 amendments were far-reaching in respect of most IIPs, the legislature provided for a transitional period. Before 5 October 2008, a beneficiary (who became beneficially entitled to an interest in possession before 22 March 2006) could choose to pass on his or her interests in possession to other beneficiaries (for example his/her children). This was called the making of a "transitional serial interest" (TSI). If such a TSI trust was set up before 5 October 2008, the beneficiaries can continue to be treated according to the old IIP rules. As a consequence, there would be no 10-yearly charge. See s 49C. After 5 October 2008, a TSI can no longer be created during the life of the IIP beneficiary and the trust will become subject to the relevant property regime applicable to discretionary trusts. However, a TSI can still be created after such date at the death of the beneficiary. The Act provides for two instances. Firstly, where the IIP beneficiary is succeeded on death by his or her spouse or civil partner or where the underlying property constitutes a contract of life insurance. See ss 49D and 49E.

¹⁷² S 49(1A). The definition of "estate" in s 5 was furthermore amended to exclude interests in possession of which the beneficiaries became entitled on or after 22 March 2006, except for immediate post-death interests, disabled persons' interests and transitional serial interests. These last mentioned interests will still form part of the beneficiaries' estates.

¹⁷³ See Jarman (2006) Ch 5 for further reading.

interest in is principle excluded property.¹⁷⁴ There are exceptions to this rule, most of which were introduced to counter tax avoidance mechanisms. The exclusion is, for example, not applicable where a reversionary interest has been acquired for a consideration in money or money's worth,¹⁷⁵ where such an interest is an interest to which either the settlor or his spouse or civil partner is or has been beneficially entitled,¹⁷⁶ or where it constitutes an interest expectant on the termination of a lease for life (or a period ascertainable only by reference to a death).¹⁷⁷

8.6.3.4 *Discretionary Trusts*

The creation of a settlement in a non-interest in possession trust (usually a discretionary trust), whether by will or during lifetime, will usually be an immediately chargeable transfer for value.

The Act provides for a special regime in respect of "relevant property" settlements, which includes a 10-year anniversary charge and an exit charge. Effectively, the regime treats the trust as a separate entity. Relevant property refers in principle to property where there is no interest in possession.¹⁷⁸ In 2006 the definition of relevant property was amended to include most interests in possession (acquired on or after 22 March 2006 where the interest does not constitute an immediate post-death interest, a disabled person's interest and a transitional serial interest).¹⁷⁹ However, certain properties are excluded from the

¹⁷⁴ S 48(1).

¹⁷⁵ S 48(1)(a).

¹⁷⁶ S 48(1)(b). This provision applies to reversionary interests granted under settlements made after 16 April 1976 (s 48(2)).

¹⁷⁷ S 48(1)(c). See in general Tiley (2008) 1365–1367.

¹⁷⁸ S 58(1).

¹⁷⁹ S 58 (1A), (1B) and (1C). The revenue office (HMRC) stated that the new rules would apply to new trusts as well as additions to existing trusts. Whether the additions to existing trust would qualify as new settlements is, however, arguable. Chamberlain (2006) *Br Tax Rev* 628 submits that it is highly unlikely that the courts will determine that additions to existing trusts will be regarded as separate settlements in the light of the decision by the Court of Appeal in *IRC v Rysaffe Trustee Company (CI) Ltd* [2003] STC 536, in Footnote continues on the next page

concept of relevant property, such as property held for charitable purposes, property held for the purposes of a registered pension scheme, property comprised in a trade or professional compensation fund and property settled in maintenance funds for historic buildings, accumulation and maintenance trusts, trusts for bereaved minors and age 18-15 trusts.¹⁸⁰ The special fiscal regime applicable to some of these favoured trusts will be discussed in paragraph 8.6.3.5 below.

The 10-year anniversary charge (the “periodic charge”) arises on the tenth anniversary of the commencement of the settlement¹⁸¹ and then at the end of each subsequent 10-year period during the life of the settlement.¹⁸² The tax is calculated on the assumption that a chargeable transfer of value is made of the value of the relevant property held in trust immediately before the anniversary.¹⁸³ The amount of the transfer (together with all other chargeable transfers made by the transferor within the previous seven years) in excess of the nil rate band, will be subject to the periodic charge at a maximum rate of 30 percent of the lifetime rate, which is currently six percent (30 percent x 20 percent).¹⁸⁴ Both Whitehouse and Chamberlain mention that, although it has been claimed that a rate of six percent is far from penal, an increase in the rate to, for example, 10 percent would have the same effect as an annual wealth tax on trusts of one percent per year.¹⁸⁵

which it was held that the general law of trusts applies in establishing how many settlements there are and that the associated operations rules in s 268 cannot operate to reduce the number of separate settlements to one settlement. See also Wallington (2002) par E1.18.

¹⁸⁰ S 58.

¹⁸¹ A settlement is deemed to commence for the purposes of the Act on the date when property first became comprised in it. See s 61. It is sometimes difficult to establish whether an addition to an existing settlement constitutes a separate settlement or whether it forms part of the original settlement. See comment in n 179 above and Wallington (2002) par E3.12.

¹⁸² S 64.

¹⁸³ S 64.

¹⁸⁴ S 66.

¹⁸⁵ Whitehouse (2006) *Br Tax Rev* 209; Chamberlain (2006) *Br Tax Rev* 637.

The exit charge (also known as proportionate charge) arises, broadly speaking, where property ceases to be relevant property, for instance where it is distributed to a beneficiary.¹⁸⁶ A charge will however not arise where property is transferred out of the trust within three months of the commencement of the trust or following a 10-year anniversary.¹⁸⁷ The amount on which the tax is charged is the amount by which the value of the relevant property in the trust is decreased as a result of the event giving rise to the charge, reduced by the inheritance tax paid out of the relevant property.¹⁸⁸ The rate of charge is calculated in accordance with a complex set of rules. Where the chargeable event precedes the first 10-year anniversary charge, the rate of charge is a fraction of the rate that will be charged at the first 10-year anniversary.¹⁸⁹ However, where the chargeable event follows any anniversary charge, the rate of charge is a fraction of the rate that was charged at the last anniversary.¹⁹⁰ The fraction is calculated as a one-fortieth for each completed quarter (three months) which has passed since either the creation of the trust or the last 10-year anniversary. For example, where property is distributed two and a half years after the trust was created, the rate of charge will be calculated as 1.5 percent (10/40 of the full 10-yearly charge).¹⁹¹

8.6.3.5 Special Trusts

Since the incorporation of capital transfer tax in 1975, various types of trusts have been protected from the stringent rules applicable to relevant property settlements, the most prominent being the accumulation and maintenance trusts (A&M trusts). Special provision has since been incorporated for registered pension schemes, professional

¹⁸⁶ S 65(1). See Tiley (2008) 1378–1381 for example calculations of the exit charge. See also Wallington (2002) par E3.22.

¹⁸⁷ S 65(4).

¹⁸⁸ S 65(2).

¹⁸⁹ S 68.

¹⁹⁰ S 69.

¹⁹¹ See Tiley (2008) Ch 72 for further reading on the relevant property charges.

compensation funds, charitable trusts, pre-1978 protective trusts, employee benefit trusts, heritage property maintenance funds and bereaved minor trusts.¹⁹² However, the amendments to the Act in 2006 has effectively phased out any further future protection for A&M trusts.¹⁹³ With the exception of this radical change, the amendments to the provisions relating to the other favoured trusts were minimal.¹⁹⁴ A new category of age 18–25 trusts was also introduced. The following paragraphs provide a discussion of the protection afforded to the more prominent special trusts, namely the bereaved minor trust and the (new) 18-to-25 trust.

A bereaved minor trust, which can only be set up under a will (or by statutory provision in the case of intestacy) must benefit a minor child of the testator and must provide for the capital to vest at his or her 18th birthday.¹⁹⁵ Unlike A&M trusts there is no flexibility to select among the minor children. No 10-year anniversary and exit charges will be imposed on settlements in bereaved minor trusts. The acquisition of the property by the minor or the death of such minor before age 18 will furthermore not attract inheritance tax.¹⁹⁶

¹⁹² See Tiley (2008) Ch 73 and Jarman (2006) Ch 6, 7 for further reading.

¹⁹³ An A&M trust is a discretionary trust where the trust property was held or accumulated for the maintenance, education or benefit of beneficiaries until they reach the age of 25. The property settled in such a trust was not subject to the relevant property regime. As a consequence of the amendments affected to the Act in 2006, the protection will only continue to apply where the trustees have changed the terms of the trust before 6 April 2008 to provide that the beneficiaries would become absolutely entitled to the property on or before their 18th birthday. Trustees also had the option to transform the trust to an 18-to-25 trust (where the beneficiaries would become absolutely entitled to the property between their 18th and 25th birthdays), in which event any future distribution would become subject to the 18-to-25 exit charge. If nothing was done to change the terms of an existing A&M trust before 6 April 2008, the trust would have become a relevant property settlement on such date. See Jarman (2006) Ch 7. For criticism on the phasing out of this long-standing special regime, see Harper (2006) *Br Tax Rev* 395 *et seq.*

¹⁹⁴ See Jarman (2006) Ch 6 for further reading.

¹⁹⁵ S 71A.

¹⁹⁶ See Jarman (2006) 128–138 and Whitehouse (2008) *Private Client Business* 58–60.

A genre for age 18–25 trusts was introduced in 2006 in response to criticism that 18 is a very young age to take control and management of assets. Whereas the property has to vest before age 18 in the case of a bereaved minor trust, the 18–25 trust requires the trust capital to vest before age 25. Similar to a bereaved minor trust, the 18–25 trust will not be subject to the 10-year anniversary and exit charges whilst the beneficiary is under the age of 18. If the beneficiary dies after the age of 18 but before attaining 25, a special exit charge will be imposed (the maximum rate of charge will be 4,2 percent, namely $28/40 \times 6$ percent). This will also be the case where the trust ends after the beneficiary has attained the age of 18 or where it becomes held on relevant property regimes. There is no tax charged if a 10-year anniversary occurs during this period.¹⁹⁷

8.7 TREATMENT OF LIMITED INTERESTS AND BARE *DOMINIUM*

It is evident from the discussion in paragraph 8.6.3.1 above that the inheritance tax regime accommodates limited interests and bare *dominium* property under the settled property regime. The treatment of these interests is similar to the treatment of fixed interests under the IIP regime and differs depending on whether the limited interest was created before or after 22 March 2006.

8.7.1 The Position Prior to 22 March 2006

8.7.1.1 The Position of Bare Dominium

For the purposes of the pre-2006 regime the transfer of bare *dominium* (being regarded as a “reversionary interest”) is excluded from the tax base, but for a few exceptions to counter tax-avoidance (for example where the reversionary interest holder derives a

¹⁹⁷ S 71D. See Jarman (2006) 138–150 and Whitehouse (2008) *Private Client Business* 58–60 for further reading.

benefit from a transfer).¹⁹⁸ See example 1 below for an illustration. It should be evident that the deferral approach largely prevents taxpayers from concealing a passive transfer of property through passage of time.

8.7.1.2 The Creation of Limited Interests

The granting of a limited interest (for inadequate consideration) is regarded as a chargeable transfer, the value of which is determined equal to the value of the underlying property. No valuation concession is granted for the fact that the interest holder may only enjoy the interest for a certain period (whether the transfer occurs during lifetime or on death).

Example 1

- 1.1 On 1 March 2005 A (domiciled in the UK) donates a lifelong usufruct over his South African property worth £1 million to his son B. Ignoring any exemptions, PETS and rebates, A (the donor) will be liable for inheritance tax on the full value of the property (£1 million). When B (a domiciliary of the UK) dies 5 years later, his deceased estate will be liable for inheritance tax on the full value of the underlying property (say, £1.5 million) on the date of his death.
- 1.2 On 1 March 2005 A (domiciled in the UK) bequeaths South African property worth £1 million to his grandson C subject to a lifelong usufruct in favour of his son B. Ignoring any exemptions and rebates, A's deceased estate will (on A's death) be liable for inheritance tax on the property valued at £1 million. When B (a domiciliary of the UK) dies 5 years later, his deceased estate will be liable for inheritance tax on the full value of the underlying property (say, £1.5 million) on the date of his death.

In the case of successive interests, the position will be as follows:

Example 2:

A (domiciled in the UK) bequeaths bare *dominium* in South African property valued at €1 million to his son D subject to a lifelong usufruct in favour of B. A's will provides that, on B's death, C will be entitled to a lifelong successive interest in the property. Ignoring any exemptions and rebates, A's deceased estate will be liable for inheritance tax on €1 million. On the death of B (a UK domiciliary), B's deceased estate will

¹⁹⁸ See par 8.6.3.3.

become liable for inheritance tax on the full value of the underlying property (as valued on B's death). On the death of C (a UK domiciliary), C's deceased estate will become liable for inheritance tax on the full value of the underlying property (as valued on C's death).

8.7.1.3 *The Termination of Limited Interests*

The subsequent termination of a limited interest (through passage of time, on the death of an interest holder or upon renunciation) is treated as if the interest holder transfers the underlying property to the successive interest holder/the bare *dominium* owner. The transfer is regarded to occur between the interest holder and the successive interest holder/bare *dominium* owner (and not between the original owner and the successive interest holder/bare *dominium* owner).

One consequence of this approach is that any consideration paid for the bare *dominium* by the bare *dominium* owner to the original owner cannot be taken into consideration, as will more fully appear from the example below:

Example 3

A (domiciled in the UK) donates a usufruct over property worth £1 million to his son B and transfers the bare *dominium* in the property to his daughter C, who provides consideration to A for the bare *dominium* in the amount of £300 000. Ignoring any exemptions (including PETS) and rebates, A will in principle be liable for inheritance tax on the full value of the property (£1 million), notwithstanding the fact that he received consideration for the bare *dominium*. On the death of B (a UK domiciliary), B's deceased estate will be liable for inheritance tax on the full value of the underlying property. On the death of C (a UK domiciliary), C's deceased estate will be liable for inheritance tax on the full value of the underlying property.

8.7.2 **The Position After 22 March 2006**

Where the limited interest was created on or after 22 March 2006, the relevant property regime would, except for a few special cases, be applicable. Where, for example, a wealth holder grants a usufruct over property to a person, the granting of the usufruct would be treated as an immediately chargeable lifetime transfer. The "settlement" (meaning the property subject to the usufruct) would be liable for the periodic and exit charges. The

distribution of the property (on the termination of an interest) would not constitute a taxable event.

8.8 GENERAL ANTI-AVOIDANCE RULE

Although the Act does not contain a general anti-avoidance measure, the tax authorities may rely on the so-called “Ramsey principle”. This is a special anti-avoidance rule developed by the House of Lords, which provides that, where a preordained series of transactions or a single composite transaction, in which a step has been inserted with no commercial or family (non-tax) purpose, such an inserted step or steps may be ignored for the purposes of United Kingdom tax law.¹⁹⁹ However, commentators such as Hoffman plead that the courts should concentrate on construing statutes to give effect to the intention of parliament rather than develop general anti-avoidance principles.²⁰⁰

8.9 CAPITAL GAINS TAX

8.9.1 Capital Gains Tax Consequences

Since capital gains tax (CGT) was first introduced in the United Kingdom tax system in 1965, the making of a gift has been an occasion of charge.²⁰¹ The legislation currently in force, the Taxation of Chargeable Gains Act²⁰² (which replaced the original legislation in 1992), provides that, where a person disposes of an asset otherwise than by way of a

¹⁹⁹ The principle was established by the House of Lords in 1982 in the case of *Ramsey Ltd v IRC* [1982] AC 300 (HL). See also *Furniss v Dawson* [1984] AC 474.

²⁰⁰ Hoffman (2006) *Br Tax Rev* 197–206.

²⁰¹ Sandford, Willis and Ironside (1973) 96; Venables (1989) *Br Tax Rev* 335.

²⁰² Act 1992 c.12.

bargain made at arm's length, including (but not limited to) the making of a gift, the disposal will be deemed to be for a consideration equal to the market value of the asset.²⁰³

As pointed out in Chapter 3, a stepped-up base cost approach replaced the original deemed-realisation approach in 1971 and this approach was retained by the 1992 CGT legislation (which is still in force today).²⁰⁴ An heir acquires an asset from a deceased testator at a base cost equal to the market value of the asset at the testator's date of death, without any CGT consequences for the deceased estate.²⁰⁵ As pointed out earlier, the Mirrlees Review proposed that the stepped-up approach is unjustifiable and recommended that it should be replaced by a deemed realisation (or even a carry-over approach).²⁰⁶

Although it is beyond the scope of this study to examine the CGT consequences in relation to dispositions and distributions by trusts, a few comments are appropriate in light of the simultaneous operation of the settled property regime and because the 2006 changes in the inheritance tax settled property regime effected some changes to CGT as well.²⁰⁷ It must be stressed that these comments are broadly stated, and do not attempt to provide a detailed discussion. The overriding principle is that a trust is treated for the purposes of the United Kingdom tax system as a separate independent entity.²⁰⁸ A transfer to a trust constitutes a disposal by the transferor for the purposes of CGT.²⁰⁹ Any subsequent disposal of assets by trustees will generally be treated along the same lines as

²⁰³ Taxation of Chargeable Gains Act s 17(1). See in general Wallington (2002) par C6.11.

²⁰⁴ See Ch 3 par 3.2.3 n 38 and accompanying text.

²⁰⁵ Taxation of Chargeable Gains Act 1992 s 62. See in general Wallington (2002) par D5.11.

²⁰⁶ Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 3. See also Ch 3 par 3.2.4.

²⁰⁷ See Mckie (2006) *Br Tax Rev* 212 *et seq* for a brief explanation of the changes effected to the CGT regime applicable to trusts.

²⁰⁸ Taxation of Chargeable Gains Act s 69(1).

²⁰⁹ Taxation of Chargeable Gains Act s 70.

disposals by individuals. Where trustees distribute property to a beneficiary, the trustees are deemed to have disposed of and reacquired the property at the market value thereof.²¹⁰ The trustees will therefore in general be liable for CGT on any capital gain that arises as a result of the deemed disposal.²¹¹

Prior to the amendments in 2006, it was provided that, where a beneficiary became absolutely entitled to property as a result of the death of a person entitled to an interest in possession in the settlement, no chargeable gain accrued on the disposal. Instead, the base cost was stepped up to the market value of the property at the date of the death of the life tenant.²¹² In addition, where the interest in possession terminated on the death of the life tenant and the property in which it subsisted continued to be settled property (and did not accrue to another beneficiary absolutely) then the trustees were deemed to dispose of and reacquire the property at the market value on the date of death of the beneficiary, without any taxable disposition accruing.²¹³ The effect of this was that the base cost was stepped up on the date of death of the life tenant and any unrealised capital gains were left untaxed.²¹⁴ These concessions were included to put a person receiving assets on the death of a life tenant (or the trustees where the property remains settled) in the same position as a person receiving assets on the death of an absolute owner (where the stepped-up approach is followed).²¹⁵ However, the 2006 changes reduced the operation of these concessions to immediate post-death interests, transitional serial interests and bereaved minor interests.²¹⁶ McKie points out that the 2006 changes have nonetheless created a

²¹⁰ Taxation of Chargeable Gains Act s 71.

²¹¹ McKie (2006) *Br Tax Rev* 214.

²¹² Taxation of Chargeable Gains Act s 73. See also McKie (2006) *Br Tax Rev* 214.

²¹³ Taxation of Chargeable Gains Act s 72.

²¹⁴ McKie (2006) *Br Tax Rev* 215.

²¹⁵ McKie (2006) *Br Tax Rev* 214.

²¹⁶ McKie (2006) *Br Tax Rev* 214–215. The writer mentions (at 215–216) that it is deeply anomalous that a disabled person's interest has been left out of these "privileged interests", especially in view of the fact that Footnote continues on the next page

considerable disadvantage of trust ownership compared to absolute ownership.²¹⁷ He mentions that the 2006 changes to inheritance tax and CGT were introduced as part of a project to modernise the income tax, capital gains and inheritance tax treatment of trusts, but concludes that the attempted harmonisation has failed. He argues that “there was absolutely no reason why the changes to inheritance taxation should have resulted in changes to capital gains tax”.²¹⁸

8.9.2 Interaction with Inheritance Tax

Any liability for capital gains tax in respect of a transfer (such as in the case of a gift), will, if borne by the transferor, not be deductible in calculating the value of the transfer. Hold-over relief is, however, usually available in respect of the capital gains tax (for example where property is settled in a discretionary trust during the lifetime of the settlor) or where a distribution is made from a trust (subject to the relevant property regime).²¹⁹ Where the capital gains tax is borne by the transferee, it will constitute an allowable deduction.²²⁰

8.10 CONCLUSIONS

- (a) In the United Kingdom the taxation of wealth transfers is currently accommodated in a single statute under the Inheritance Tax Act.²²¹

a disabled person’s interest remains to be treated under the old IIP regime for the purposes of inheritance tax.

²¹⁷ McKie (2006) *Br Tax Rev* 217.

²¹⁸ McKie (2006) *Br Tax Rev* 213.

²¹⁹ In terms of Taxation of Chargeable Gains Act s 260. See in general Wallington (2002) par G6.13 and McKie (2006) *Br Tax Rev* 213.

²²⁰ S 165.

²²¹ See par 8.1.1 n 5 and accompanying text.



- (b) The Act nonetheless levies a wealth transfer tax (called “inheritance tax”) by virtue of separate charging provisions for “lifetime transfers” and “transfers on death”.²²²
- (c) Despite the separate charging provisions, the rules pertaining to the jurisdictional basis and the ordinary valuation rules (as discussed in paragraph 8.3) apply equally to lifetime transfers and transfers on death.²²³ Because of the fact that the scope of United Kingdom wealth transfer tax regimes (with the exception of the short-lived capital transfer tax regime) has had a limited application to lifetime transfers, a number of the double taxation agreements entered into since the introduction of estate duty cover transfers on death only. The unilateral relief provisions apply, however, to both lifetime transfers and transfers on death, eliminating to a large extent any inequities arising as a result of the limited application of the double taxation agreements to lifetime transfers.²²⁴
- (d) The preferential valuation regimes for business property and agricultural property apply to all transfers, whether they occur during lifetime or on death. There are, however, special rules in place where a transfer on death occurs within a seven-year PET period.²²⁵
- (e) The roll-over relief for non-agricultural woodlands applies exclusively to transfers on death.²²⁶

²²² See pars 8.2.1 and 8.2.2.

²²³ See pars 8.2.3 and 8.3.

²²⁴ See par 8.2.4.

²²⁵ See par 8.5.2.

²²⁶ See par 8.5.4.

- (f) In the area of exemptions, the Act distinguishes between exemptions applicable to both lifetime transfers and transfers on death; exemptions applicable to lifetime transfers only and exemptions applicable to transfers on death only. The majority of the exemptions fall into the first category (where the exemptions apply to both types of transfers). The most prominent difference between lifetime transfers and transfers on death is the PET regime, which applies to lifetime transfers only. The Mirrlees Review has, however, identified the PET regime, where lifetime transfers may escape tax indefinitely, as a major drawback for horizontal equity between transfers that occur during lifetime and transfers that occur on death. Moreover, it was shown that the PET regime has resulted in the relevant property regime (applicable to discretionary trusts) being adopted for IIP trusts as well. For the rest of the exemptions, differentiation is usually justifiable (for example, the annual gift exemption for lifetime transfers).²²⁷
- (g) The different rates for lifetime transfers (taxed at 20 percent) and transfers on death (taxed at 40 percent) as well as the credit system (where inheritance tax paid on lifetime transfers is credited against the tax payable on death) seems complicated and an administrative burden to the system. It also disturbs the horizontal equity between transfers that occur during lifetime and transfers that occur during death.²²⁸
- (h) Although recipient-based duties were levied in the United Kingdom (together with transferor-based duties) prior to 1949, the system levied only transferor-based wealth transfer taxation thereafter in the form of estate duty, which was replaced by capital transfer tax in 1975 and which

²²⁷ See par 8.5.3 and par 8.6.2 n 151 and accompanying text.

²²⁸ See par 8.1.2.

was in turn replaced by inheritance tax in 1986 (which is currently still in force).²²⁹ The inheritance tax regime resembles a typical example of a transferor-based wealth transfer tax. However, the system contains some elements which are characteristic of recipient-based taxation, such as the exemption of a transfer to a spouse.²³⁰ The paragraphs below will highlight some characteristics and problem areas (similar to the areas identified under the South African wealth transfer tax system in Chapter 7).²³¹

- (i) For the purposes of lifetime transfers, the complications surrounding an intention to donate have been circumvented by the elimination of such a requirement. However, *bona fide* commercial transactions are sheltered from the tax base by virtue of a specific exemption. Although the impoverishment of the transferor is implicit, a corresponding enrichment by another person is not required under the primary charging provision for lifetime transfers (although some form of enrichment is required where a loss is experienced under a failure to exercise a right). This position creates some strange results. The focus of a wealth transfer tax, even if levied on the transferor, should be on the *transfer* of the wealth, which presupposes some form of enrichment for a recipient. It seems therefore as if the characteristics statutorily required for a lifetime transfer are not satisfactory.²³²
- (j) The problem experienced in the area of value-shifting arrangements (in that the disposer company is not impoverished) is overcome in the inheritance tax regime by provisions attributing the arrangements to the

²²⁹ See par 8.1.1.

²³⁰ See par 8.5.3.1.

²³¹ See Ch 7 par 7.4.

²³² See par 8.2.1.

participators of the close company. The existing shareholders are therefore regarded as the transferors of the benefits granted to the incoming shareholder.²³³

- (k) Over and above ordinary lifetime transfers, benefits indirectly “transferred” by virtue of a *failure to exercise a right* (an omission) are specifically included in the tax base, thereby extending the scope of the tax to e.g. the failure of a person to claim a performance.²³⁴

- (l) Although the provision that “changes in the value of the estate” as a result of the person’s death should be taken into account ensures that life insurance benefits payable to the deceased estate are subject to inheritance tax, benefits payable to a nominated beneficiary (a recipient) escape taxation, arguably because the tax is levied from the perspective of the transferor (the deceased estate).²³⁵ It is, however, unclear why the Act does not contain any provisions deeming such benefits to be a taxable transfer.

- (m) Although the concepts of a usufruct, *fideicommissum* and bare *dominium* property are foreign to United Kingdom property law, these interests are treated under the settled property regime for the purposes of inheritance tax. Usufructuary interests, fideicommissary interests and annuities charged on property are treated as “fixed (life) interests” and bare *dominium* property and fiduciary interests are treated as “reversionary interests”.²³⁶ Depending on whether the limited interest was first created

²³³ See par 8.2.1.

²³⁴ See par 8.2.1.

²³⁵ See par 8.2.2.

²³⁶ See par 8.6.3.1.

before or after 22 March 2006, the pre-2006 IIP regime or the relevant property regime will be applicable.

- (n) In the case of the pre-2006 regime, the initial granting of a limited interest constitutes a lifetime transfer, but the transfer of bare *dominium* property is (but for a few exceptions) deferred until it materialises into full ownership.²³⁷
- (o) As a consequence, taxpayers are largely prevented from concealing a passive transfer of property through passage of time under the pre-2006 regime.²³⁸
- (p) In the event where the granting of the limited interest is immediately taxable (under the pre-2006 regime), inheritance tax will be levied on the full value of the underlying property and no concession will be granted, because a fixed interest is not valued with reference to actuarial tables.²³⁹ This is understandable if one considers that inheritance tax is levied from the perspective of the transferor, where the focus of the tax is on what is “given away”. The no-concession approach may, however, be justifiable in a United Kingdom context where the holder of a fixed life interest is legally regarded as the “beneficial owner” of the underlying property, especially if one considers that such an interest is usually freely disposable.²⁴⁰

²³⁷ See par 8.7.1.1.

²³⁸ See par 8.7.1.1.

²³⁹ See par 8.7.1.2.

²⁴⁰ See par 8.6.1.

- (q) The death or renunciation of an interest holder does not pose any significant difficulties for the system because such an event merely accelerates another transfer.²⁴¹
- (r) A problem that arises as a result of the fact that the interest holder (under the pre-2006 regime) is regarded as the transferor of the property on the materialisation of the bare *dominium* into full ownership (and not the original owner) is that any consideration received by the original owner for the bare *dominium* property would not have been taken into consideration in the calculation of his or her inheritance tax liability.²⁴²
- (s) Where a limited interest is granted on or after 22 March 2006, the relevant property regime applicable to discretionary trusts (referred to below) will usually be applicable and the usufructuary will be liable for periodic levies and an exit charge.²⁴³
- (t) It is evident from the historical development of wealth transfer taxation in the United Kingdom that discretionary trusts have posed some challenging issues for the system. Although the initial transfer to a discretionary trust would fall within the scope of the inheritance tax base, the problem is that any further tax may indefinitely be deferred where the interests remain contingent. To counter tax-avoidance through discretionary trusts, the legislature introduced a “relevant property regime”, which basically personified trusts by making the trustees liable for periodic charges and exit charges.²⁴⁴

²⁴¹ See par 8.7.1.3.

²⁴² See par 8.7.1.3.

²⁴³ See par 8.7.2.

²⁴⁴ See par 8.6.

- (u) Some of the major complications of the relevant property charges are the harmonisation of the regime (which is operated on a transferor basis) with the capital gains tax system. Although the United Kingdom operates a stepped-up base-cost approach for transfers on death (which eliminates the problem of double taxation in the case of transfers on death), the stepped-up approach does not usually apply to the transfer of interests in trust property (since the amendments effected in 2006). Double taxation is also produced when property is distributed to beneficiaries. It would seem that the United Kingdom has not been successful in harmonising the interaction between the inheritance tax regime and the capital gains tax system in the realm of trusts.²⁴⁵
- (v) The inheritance tax regime presents an example of a wealth transfer tax system where substantial relief is afforded to business property in the form of remittance of the tax liability. Some commentators have questioned the foundational justification of the relief.²⁴⁶
- (w) To overcome the problem common to transferor-based taxation – namely, that the tax liability is usually taken into consideration in the valuation of the property taxable in a deceased estate, whereas gifts are usually not valued taking the tax liabilities into account – the Act provides that the inheritance tax liability of a transferor may be taken into consideration in all transfers (whether they occur during lifetime or on death).²⁴⁷

The next chapter will review wealth transfer taxation in the Netherlands.

²⁴⁵ See par 8.9.

²⁴⁶ See par 8.5.2.

²⁴⁷ See par 8.5.1.



CHAPTER 9

WEALTH TRANSFER TAXATION IN THE NETHERLANDS

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9.1 HISTORICAL ORIENTATION AND INTRODUCTION

9.1.1 Historical Development

Succession duties were first introduced in some of the provinces of the Netherlands at the end of the sixteenth century.¹ Following the proclamation of the Batavian Republic at the end of the eighteenth century, the *Ordonnantie eener Belasting op het Regt van Successie* was introduced in 1805, in terms of which a transferor-based estate duty was levied.² This Act was temporarily replaced with the French *Frimairewet* in 1812,³ whereafter the first *Successiewet* of 1817 was introduced,⁴ which levied inheritance tax (*successierecht*) in a similar way as was provided for by the Ordinance of 1805.⁵ The tax was later extended to the transfer of Dutch property that belonged to foreigners, namely transfer tax (*recht van overgang*).⁶

The *Successiewet* of 1859 reintroduced some key elements of a recipient-based tax.⁷ Van Vijfeijken explains that this occurrence has unfolded parallel to the development of the idea that a person should ideally be taxed in accordance with his or her taxable capacity.⁸ The tax base was extended to the taxation of gifts (*schenkingsrecht*) in 1917.⁹ The need to

¹ See Ch 3 par 3.2.3.

² Adriani (1925) 5–6; Schuttevaer and Zwemmer (1998) v5; Zwemmer (2001) *Mededelingen* 9; Van Vijfeijken (2002) *WPNR* 179; Dijkstra (2008) *WPNR* 445; Sonneveldt and De Kroon (2008) *WFR* 594.

³ From 1810 to 1813 the Netherlands was part of the French Empire.

⁴ Schuttevaer and Zwemmer (1998) v5; Zwemmer (2001) *Mededelingen* 10; Dijkstra (2008) *WPNR* 446.

⁵ Adriani (1925) 28.

⁶ Adriani (1925) 30.

⁷ VanVijfeijken (2002) *WPNR* 179; Sonneveldt and De Kroon (2008) *WFR* 594.

⁸ Van Vijfeijken (2004) *WPNR* 321.

⁹ Adriani (1925) 32; Zwemmer (2001) *Mededelingen* 10.

reform the legislation developed in 1947,¹⁰ which culminated in the introduction of the *Successiewet* of 1956 (Inheritance and Gifts Tax Act, hereafter referred to as “the Act”),¹¹ which is primarily based on the character of the 1859 Act¹² and which is (in its amended form) still in force today.

In view of the fact that the current system is based on early nineteenth-century legislation, various efforts have been made to modernise the Act.¹³ In 2000, a commission appointed by the Minister of Finance under the chairmanship of Moltmaker issued a report on the modernisation of the tax titled *De Warme, De Koude en De Dode Hand* (hereafter “Moltmaker Report”).¹⁴ The report, having accepted the justification and recipient-based structure of the tax,¹⁵ focused mainly on the treatment of family transfers, the acquisition of enterprises and trusts and foundations. Although the government agreed with most of the committee’s recommendations,¹⁶ only a few amendments to the Act were effected, apparently due to budgetary constraints.¹⁷

In 2008 the Minister of Finance announced that the existing legislation, being old, complicated and prone to tax avoidance, was to be replaced by new legislation, namely

¹⁰ Schuttevaer and Zwemmer (1998) v6.

¹¹ Act of 28 June 1956, introduced on 1 August 1956.

¹² Van Vijfeijken (2002) *WPNR* 179.

¹³ E.g. in 1964 a new Act was proposed, but this proposal was never implemented. See Schuttevaer and Zwemmer (1998) v6. See also Martens and Sonneveldt (2007) 1–3 for a short exposition of the changes effected in 1980, 1984, 1997, 2000, 2001, 2002, 2005, 2006 and 2007. See also Auerbach (2008) *WFR* 1080.

¹⁴ The title refers to a Dutch expression for making gifts with the warm hand, the passing of property by the deceased with the cold hand and the transfer of assets to a trust or foundation with the dead hand. See Sonneveldt in Sonneveldt *ed* (2002) 52 n 18.

¹⁵ Moltmaker Report (2000) 7.

¹⁶ See Van Vijfeijken (2001) *WFR* 1381–1390 for a comprehensive discussion on the proposals that were lodged in the second chamber of parliament.

¹⁷ De Waard in Sonneveldt *ed* (2002) 11; Van Vijfeijken (2002) *WPNR* 187 (for a brief summary of the amendments).

De Wet Schenk- en Erfbelasting.¹⁸ As a consequence, numerous scholars published their comments and proposals in anticipation of the new regime.¹⁹ However, in view of the extensive research that a new fiscal regime would have required, the legislature instead opted for the route of introducing comprehensive amendments to the existing Act. On 20 April 2009, the Minister of Finance submitted to the Second Chamber of Parliament the “Legislative Proposal for the Amendment of the Inheritance and Gift Tax Act” (*Wetsvoorstel Wijziging Successiewet*),²⁰ containing proposals for the amendment of the existing Act in respect of various matters. The proposed amendments elicited a tidal wave of criticism by Dutch scholars and tax advisers.²¹ Following a process of parliamentary debates and amendments,²² an amended legislative proposal (hereafter referred to as “31 930 A”)²³ was submitted to the First Chamber of Parliament, which was accepted on 15 December 2009 and became effective on 1 January 2010. The general sentiment in academic circles is nonetheless that the amendments are, overall, disappointing and incomplete.²⁴

¹⁸ The Minister made this announcement on 14 April 2008. See *Gastcollege Staatssecretaris van Financien*, a presentation delivered at Tilburg University, available at <http://www.schenkenerfbelasting.nl> (accessed on 1 March 2009). For a summary of the address, see Van Bommel and De Pagter (2008) *WFR* 501 *et seq* and Boer (2008) *WFR* 518 *et seq*.

¹⁹ See collection of articles that have since been published in e.g. *Weekblad Fiscaal Recht (WFR)* and *Weekblad Privaatrecht, Notariaat en Registratie (WPNR)*, some of which will be referred to in the paragraphs below. See also the information available at www.schenkenerfbelasting.nl.

²⁰ *Kamerstukken* 31930, available at http://www.tweedekamer.nl/kamerstukken/aanhangige_wetgeving/index.jsp (accessed on 22 May 2009). For the Minister’s comments and brief summary of the proposals, see http://www.minfin.nl/Actueel/Kamerstukken/2009/04/Legislative_wijziging_Successiewet (accessed on 22 May 2009).

²¹ Dijkstra (2009) *WFR* 896 *et seq* refers to a congress held by the Dutch Federation of Tax Advisers on the topic in June 2009.

²² See the parliamentary debates, reports and amendments available at <http://parlando.sdu.nl>.

²³ 31 930 A, available at <http://parlando.sdu.nl>.

²⁴ See e.g. Van Vijfeijken (2009) *WPNR* 528; Sonneveldt and De Kroon (2009) *WFR* 737.

9.1.2 Broad Overview of Inheritance Tax and Gift Tax

Inheritance tax (*erfbelasting*)²⁵ is primarily levied on the value of everything acquired by a person by virtue of an inheritance from a person with *woonplaats*²⁶ in the Netherlands.²⁷ In addition, gift tax (*schenkbelasting*)²⁸ is levied on property acquired by a person under a gift from a donor with *woonplaats* in the Netherlands.²⁹ Broadly speaking, these charges are levied on the net amount acquired by a beneficiary. The taxable value is in general determined by deducting from the value of the property the debts and charges incurred by the beneficiaries. The Act provides for a broad spectrum of relief and exemptions, some of which depend on the relationship between the transferor and the beneficiary.

Prior to the amendments affected on 1 January 2010, transfer tax (*recht van overgang*) was also levied on the value of certain properties located in the Netherlands (*binnenlandse situsgoederen*),³⁰ which were acquired by a person by virtue of an

²⁵ The traditional term *successierecht* was replaced with the term *erfbelasting* on 1 January 2010. See 31 930 A. For criticism on the new term, see Van Vijfeijken (2009) *WPNR* 520.

²⁶ Although the Act does not define the concept, it provides that a legal entity will be regarded as having *woonplaats* in the Netherlands if it has been established in the country (s 2.2). This will in general be determined with reference to its place of effective management. See Sonneveldt, Bom and Zuiderwijk (1995) 32 and Van Vijfeijken in Kolkman *et al* (2006) 637–638. However, the General Code on Taxes of 1994 (*Algemene Wet Inzake Rijksbelastingen*) s 4 provides that the fiscal *woonplaats* of a natural person should be determined according to his or her circumstances, which could, for example, be determined with reference to the location of his or her primary residence, the place where his or her children attend school, the period of time spent abroad, his or her nationality and the location of his or her business or labour agreement. See Soares and McCutcheon (1995) 96; Sonneveldt, Bom and Zuiderwijk (1995) 31–32; Martens and Sonneveldt (2007) 6–7. *Woonplaats* is therefore determined with reference to the daily life of the person, which is not identical to the general concept of domicile, which usually depends on the subjective intention of a person, or the Anglo-American concept of residency. See Soares and McCutcheon (1995) 96 and Sonneveldt Doctoral Thesis (2000) 151.

²⁷ S 1.1° (as amended by 31 930 A).

²⁸ The traditional term *recht van schenking* was replaced with the term *schenkbelasting* on 1 January 2010. See 31 930 A.

²⁹ S 1.2° (as amended by 31 930 A).

³⁰ *Binnenlandse situsgoederen* included *inter alia* (a) business assets attributable to a permanent establishment, including property rights to such an enterprise other than the rights of the shareholder, (b) immovable property situated in the Netherlands or rights *in rem* in respect of such property, not forming part of an enterprise and (c) profit-sharing rights with regard to an enterprise with its effective management in the Netherlands, unless the rights originate from employment or are in the form of securities. See ss
Footnote continues on the next page

inheritance or a gift from a testator or donor with *woonplaats* outside the Netherlands.³¹ For the purposes of transfer tax, the allowable deductions were restricted to certain inland debts (*binnenlandse schulden*)³² only.³³ In addition, the exemptions offered in the realm of transfer tax were extremely limited.³⁴ In view of these restrictions, the question was raised at numerous occasions whether or not transfer tax was compatible with European Union law.³⁵ The debate was intensified in view of the European Court's ruling that the restriction on the deductibility of debts was too narrow for the purposes of the free movement of people and capital in the European Union.³⁶ Numerous commentators therefore suggested that transfer tax, being hardly justifiable and easily avoidable, should be repealed or replaced by some or other alternative.³⁷ It is therefore not surprising that transfer tax was totally repealed from the Act by the 2010 amendments. In reaction,

5.3.a, 5.3.b.1°, 5.5 and 5.3.b.2° (prior to the amendments effected by 31 930 A in 2010). See in general Sonneveldt, Bom and Zuiderwijk (1995) 30; Van Vijfeijken in Kolkman *et al* (2006) 643 and Martens and Sonneveldt (2007) 79.

³¹ S 1.1.2° (as it read before the amendments effected in terms of 31 930 A).

³² *Binnenlandse schulden* included (a) debt claims attributable to a Dutch permanent establishment, and (b) debts in respect of immovable property situated in the Netherlands, secured by mortgage and incurred in respect of the acquisition, improvement or maintenance of such immovable property. See s 5.4 (as it read before the amendments effected in terms of 31 930 A in 2010). See in general Sonneveldt, Bom and Zuiderwijk (1995) 30; Van Vijfeijken in Kolkman *et al* (2006) 643–644 and Martens and Sonneveldt (2007) 79–80.

³³ S 5.2 (as it read before the amendments effected in terms of 31 930 A). Also, inland debts incurred within one year prior to the date of death or the date of the gift were disregarded. See in general Van Vijfeijken in Kolkman *et al* (2006) 674 and Martens and Sonneveldt (2007) 147.

³⁴ See s 32a.1–3 (as it read before the amendments introduced by 31 930 A on 1 January 2010).

³⁵ In an attempt to resolve the difficulties, the Moltmaker Report (2000) 64 recommended the return of the pre-1985 regime, levying a proportional transfer tax at a rate of 6% with no provision for the deduction of liabilities and charges. This proposal was never implemented. See De Haan and Idsinga (2002) *WFR* 724–735 and Van Vijfeijken (2002) *WPNR* 186–187 for further reading.

³⁶ See Van Vijfeijken (2004) *WPNR* 631 *et seq* and Martens and Sonneveldt (2007) 81–83 for a discussion of the Barbier case. This decision has influenced the European Court in a number of subsequent cases, such as the cases of Gerritse, Jager, Eckelkamp and Arens-Sikken. See Van Vijfeijken (2009) *WFR* 341–346 for a discussion on the cases of Arens-Sikken and Eckelkamp.

³⁷ See Van Vijfeijken (2004) *WPNR* 328; Van Vijfeijken (2008) *WPNR* 305–306; Zwemmer (2008) *WPNR* 422; Van Vijfeijken (2008) *WPNR* 428–429; Sonneveldt and Monteiro (2008) *WPNR* 430–433; Sonneveldt and De Kroon (2008) *WFR* 596–597; Van Vijfeijken (2009) *WFR* 346.

Sonneveldt and De Kroon concede that this move is understandable, especially considering that transfer tax contributed a mere €6 million to national revenue. However, they question whether the total lack of taxation in respect of non-residents is truly what the legislature had in mind, especially considering that inheritances and gifts are usually exempt from the property transfer tax.³⁸

Since the inception of the Act in 1956, the applicable tax rate has depended on the relationship between the transferor and the beneficiary as well as the size of the acquisition. Prior to the amendments of 2010, provision was made for three different rate categories, namely (a) group 1, applicable to a surviving spouse, registered partner or a qualifying cohabitant,³⁹ children, grandchildren and other descendants of the transferor, (b) group 2, applicable to brothers and sisters, parents, grandparents, great-grandparents and other ascendants of the transferor and (c) group 3, applicable to all other beneficiaries (“strangers”).⁴⁰ The 2010 amendments simplified the categories (as well as the rate structures). In addition, a new concept for a “partner” was introduced, which now includes a spouse, registered partner and, subject to certain conditions, a cohabitant.⁴¹ For the 2010 year of assessment, the rate categories and rate structures are as follows:

- For partners and children: 10 percent on the first €118 000 together with a charge of 20 percent on the amount above the threshold;
- For grandchildren: 18 percent on the first €118 000 together with a charge of 36 percent on the amount above the threshold; and

³⁸ Sonneveldt and De Kroon (2009) *WFR* 737. Note, however, that these authors do not purport to suggest that the property transfer tax should be used as a measure to substitute the lack of taxation in respect of inheritances and gifts made by non-residents. For a critical discussion on the effect of the 2010 amendments to the property transfer tax regime, see Boer, Lubben and Schuver-Bravenboer (2009) *WFR* 745 *et seq.*

³⁹ The Act provided for a contractual cohabitant, a two-party non-contractual cohabitant and a multiple party non-contractual cohabitant. See s 24.2(a)–(c) (as it read before the amendments effected by 31 930 A in 2010). See Van Vijfeijken in Kolkman *et al* (2006) 701–702, 703 and Martens and Sonneveldt (2007) 201 for further reading on the classification of these cohabitants.

⁴⁰ S 24.1 and 24.2 (as it read before the amendments effected in terms of 31 930 A). See in general Van Vijfeijken in Kolkman *et al* (2006) 700.

⁴¹ S 1a (as amended by 31 930 A).

- For all other persons: 30 percent on the first €118 000 together with a charge of 40 percent on the amount above the threshold.⁴²

Because taxpayers may be tempted to “split” acquisitions to attract a more favourable tax position, the Act provides that, where two partners have acquired inheritances or gifts from the same testator or donor, the tax will be calculated as if it had been one aggregated acquisition. In the case where there is a difference in relationship, the closest relationship will be indicative.⁴³ Furthermore, gifts made by the same donor to the same donee are aggregated within one calendar year.⁴⁴ All the gifts by parents to children are also aggregated per calendar year.⁴⁵

9.2 TAX BASE

The Act provides for acquisitions by virtue of gifts and inheritances. In addition, certain arrangements and events are deemed to be a gift or an inheritance, depending on the circumstances. These fictions are referred to as “fictitious acquisitions” and will be discussed in paragraph 9.2.3 below.

9.2.1 Acquisitions by virtue of Gifts

Gift tax is primarily levied on the value of a gift acquired by any person (whether an individual or a legal entity).⁴⁶ The tax is levied on the donee⁴⁷ upon the conclusion of the

⁴² S 24 (as amended by 31 930 A).

⁴³ S 25 (for inheritances) and s 26 (for gifts).

⁴⁴ S 27. See in general Van Vijfeijken in Kolkman *et al* (2006) 707 and Martens and Sonneveldt (2007) 195.

⁴⁵ S 28. See Van Vijfeijken in Kolkman *et al* (2006) 707 and Martens and Sonneveldt (2007) 195.

⁴⁶ S 1.2° (as amended by 31 930 A).

⁴⁷ S 36.

gift, after the fulfillment of any suspensive conditions.⁴⁸ A gift includes a formal gift (*schenking*) as well as a material gift (*gift*).⁴⁹ A formal gift is an agreement in terms of which the donee is enriched at the expense of the donor. The four essential elements are (a) an agreement; (b) an intention of generosity on the part of the donor (*oogmerk van liberaliteit*); (c) the impoverishment of the donor and (d) the enrichment of the donee.⁵⁰ A formal gift, for example, includes an agreement in terms of which property is donated without the obligation to reward the donor and the waiver of a debt.⁵¹ A material gift (which is a wider concept) includes *any act*, except for a formal gift, whereby one person enriches another at his or her own expense, provided that the act will only constitute a gift once the beneficiary has received the right to claim the donated property.⁵² Although the concept of a material gift is wider than a formal gift, the elements of enrichment, impoverishment and the intention of generosity (hereafter the “gift characteristics”) are still required.⁵³ Examples of material gifts are remuneratory gifts⁵⁴ and the sale of property for a price less than market value (with the corresponding intention of generosity).⁵⁵ However, an ordinary *bona fide* commercial transaction below market value will not constitute a material gift.⁵⁶ To counter the difficulties involved in the burden of proof that relates to the intention of generosity, Van Rijn has proposed that a

⁴⁸ S 1.9 (as amended by 31 930A).

⁴⁹ S 1.7 (as amended by 31 930 A).

⁵⁰ See Van Vijfeijken in Kolkman *et al* (2006) 629–630 and Martens and Sonneveldt (2007) 53–60 for a detailed discussion on the elements of a formal gift (*schenking*), as required in terms of the Civil Code 7:175.

⁵¹ See Van Vijfeijken in Kolkman *et al* (2006) 630–636 and Martens and Sonneveldt (2007) 55–72 for various examples and scenarios.

⁵² Martens and Sonneveldt (2007) 59 refers to Civil Code 7:187.

⁵³ Van Vijfeijken in Kolkman *et al* (2006) 629.

⁵⁴ Van Vijfeijken in Kolkman *et al* (2006) 630.

⁵⁵ Martens and Sonneveldt (2007) 59.

⁵⁶ Van Vijfeijken in Kolkman *et al* (2006) 629.

provision should be included in the Act whereby the intention of generosity is deemed to be present in gifts from family members, unless proven otherwise.⁵⁷

An omission (*een niet handelen*) may also in principle constitute a gift.⁵⁸ However, the gift requirements must still be complied with. The mere failure to exercise a right will therefore not constitute a gift where the person (who failed to exercise the right) has not in actual fact been impoverished by the omission. According to Van Vijfeijken, it will not always be simple to establish whether the requirements are complied with in the event of an omission.⁵⁹

The Act specifically provides that any benefit accruing as a result of a repudiation of an inheritance will not constitute a benefit accruing under a gift.⁶⁰ The amount of tax levied on the substituted heir will, however, not be less than it would have been had the original heir not repudiated.⁶¹ In the case where a surviving spouse parts with the *wettelijke verdeling* as provided for in section 18 of book 4 of the Civil Code, the inheritance tax liability will be established as if the *wettelijke verdeling* was cancelled retrospectively.⁶²

9.2.2 Acquisitions by virtue of Inheritance

Inheritance tax is primarily levied on the value of property acquired by a person (an individual or a legal entity) by virtue of an inheritance.⁶³ An acquisition by virtue of an

⁵⁷ Van Rijn (2008) *WPNR* 437.

⁵⁸ Van Vijfeijken in Kolkman *et al* (2006) 630.

⁵⁹ Van Vijfeijken in Kolkman *et al* (2006) 630.

⁶⁰ S 1.8 (as amended by 31 930 A). In the case where a surviving spouse parts with the *wettelijke verdeling* as provided for in section 18 of book 4 of the Civil Code, the inheritance tax liability will be established as if the *wettelijke verdeling* was cancelled retrospectively. See in general Martens and Sonneveldt (2007) 60.

⁶¹ S 30.

⁶² S 1.8.

⁶³ S 1.1° (as amended by 31 930 A).

inheritance includes acquisitions through testamentary dispositions as well as statutory regulations.⁶⁴

The tax is imposed on the heir at the moment of the death of the testator.⁶⁵ Where an inheritance is subject to a suspensive condition, the remaining heirs would have to pay inheritance tax on the value of the property comprised in the inheritance subject to the condition. The heirs would basically keep the inheritance in pledge for the conditional heir. On the fulfilment of the condition, the heirs may claim the inheritance tax previously paid by them from the tax authorities.⁶⁶

9.2.3 Fictitious Acquisitions

The Act deems certain acquisitions or third party arrangements to be either a gift or an inheritance. In view of the fact that the fictions have developed over many years into a complicated set of rules, some of which are even based on the principles of historic transferor-based (estate) taxation,⁶⁷ the Moltmaker Report and commentators from academic circles have over the years called for the modernisation of these provisions.⁶⁸ Furthermore, some scholars have pleaded that the fictions approach is archaic and too narrow and have proposed that the chargeable events should be redefined to link up instead with a broader concept of an economic acquisition.⁶⁹ In spite of these proposals, the basic character of all the existing fictions have remained intact following the 2010 amendments, although various changes have been effected to the provisions to counter

⁶⁴ As provided for in the Civil Code Book 4. See Van Vijfeijken in Kolkman *et al* (2006) 626 and Martens and Sonneveldt (2007) 19.

⁶⁵ S 36.

⁶⁶ S 53(1).

⁶⁷ Van Vijfeijken (2002) *WPNR* 179–180 and 183–185 refers to the fictions provided for ss 10 and 15 (prior to its amendment in 2003).

⁶⁸ Moltmaker Report (2000) 51–60 (the provisions were never implemented); Verstraeten (2000) *WPNR* 614; Van Vijfeijken (2002) *WPNR* 179–180; Zwemmer (2008) *WPNR* 423.

⁶⁹ See e.g. Van Rijn (2008) *WPNR* 438–439 and Schols (2009) *WPNR* 485.

some anti-*fiscus* judgments, eliminate some avoidance loopholes and re-structure the existing fictions. The amendments also introduced some additional fictions (mentioned in paragraphs (d), (i)(b) and (l) below). However, Van Vijfeijken mentions that the amendments have also created some new issues, and expresses regret over the fact that the legislature did not use the window of opportunity to modernise and simplify the fictions regime.⁷⁰

For the acquisitions listed in paragraphs (b), (c), (e), (f), (g), (i)(b) and (j) below, the value of the acquisition may be reduced by any amount that was paid by the beneficiary for the respective benefit acquired by him or her, together with simple interest calculated at a statutory rate (currently six percent) from the date of the payment to the date of the deemed acquisition.⁷¹ Also, any gift tax (relating to the event under the fiction) that was payable at an earlier stage together with simple interest calculated at a statutory rate (currently six percent) from the date of the payment to the date of the deemed acquisition will in general be deductible from the amount inheritance tax payable.⁷²

The Act currently provides for the following fictions:

- (a) Where the deceased's heirs renounce their share in the communal estate, the surviving spouse (who was married in community of property with the deceased) will be regarded as having acquired the renounced matrimonial rights by virtue of an inheritance.⁷³

⁷⁰ Van Vijfeijken (2009) *WFR* 722. See also Schols (2009) *WPNR* 484.

⁷¹ S 7.1 and 7.3 (as amended by 31 930 A). Prior to the 2010 amendments, this concession was limited to the s 10 fiction only. See s 10.3 (as it read prior to the amendments effected by 31 930 A).

⁷² S 7.2 and 7.3 (as amended by 31 930 A) read with s 12.2 (as amended). Prior to the 2010 amendments, this concession was limited to the s 10 fiction only. See s 10.4 (as it read prior to the amendments effected by 31 930 A).

⁷³ S 6. See in general Van Vijfeijken in Kolkman *et al* (2006) 645 and Martens and Sonneveldt (2007) 89–90. S 30 provides that the amount inheritance tax payable will not be lessened by any renunciation of rights. The amount payable by the surviving spouse will therefore not be less than the amount that would have been payable should the community of property not have been renounced.

- (b) Where the deceased labelled goods in his or her possession, excluding registered goods, as belonging to another person, the beneficiary will, subject to certain exceptions,⁷⁴ be regarded as having acquired the goods by virtue of an inheritance from the deceased.⁷⁵
- (c) Where someone has admitted to an obligation in his or her will, the value of such an obligation will be regarded as having been acquired by the beneficiary by virtue of an inheritance on the death of the first-mentioned person.⁷⁶
- (d) With effect from 1 January 2010, where a monetary claim which was acquired under an inheritance (*onderbedelingsvorderingen*) becomes claimable or is settled and such a claim includes interest at a higher rate than the prescribed statutory rate (currently six percent), then the amount of interest in excess of the statutorily calculated interest will be deemed to be an inheritance by the creditor from the debtor.⁷⁷
- (e) Subject to certain exceptions and conditions, the so-called “section 10 fiction” provides that where a deceased had (during his or her life) transferred an asset by virtue of a legal act (*rechtshandeling*) or any associated acts (*samenstel van rechtshandelingen*)⁷⁸ of which he or she or his or her partner had been a party, to a

⁷⁴ Exceptions are provided for (a) where the deceased was in possession of such goods in the course of his enterprise or profession (excluding goods “belonging” to close relatives and their partners), (b) where the deceased was in possession of the goods by reason of an official position such as an executor, curator, guardian or similar position, (c) goods in the possession of one of the co-owners, (d) goods belonging to the surviving partner and (e) where the claim for the goods already existed during the lifetime of the deceased. See s 8.4 (as amended by 31 930 A).

⁷⁵ S 8.1.

⁷⁶ S 8.3 (as amended by 31 930 A). Prior to the amendments, this fiction was provided for in s 9. See in general Van Vijfeijken in Kolkman *et al* (2006) 649–652 and Martens and Sonneveldt (2007) 101–105 for the position prior to the 2010 amendments.

⁷⁷ S 9.2 (as amended by 31 930 A).

⁷⁸ The meaning of *rechtshandeling* has been the subject of debate. Some are of the opinion that it is restricted to an agreement, while others argue for a wide interpretation, namely any act with legal

Footnote continues on the next page



partner or close relative at the expense of such transferor's estate and subject to the reservation of a lifelong enjoyment of the asset (such as a usufruct or periodic payment) in favour of himself or herself, then the acquisition by the beneficiary of the *full ownership* upon the death of the deceased transferor (or within 180 days prior to the death) will be deemed to have been acquired by such beneficiary by virtue of an inheritance.⁷⁹ The value of the deemed inheritance will be the full value of the property on the death of the transferor less any consideration paid for the *bare dominium* property (sacrificed by the *bare dominium* owner) plus interest at six percent.⁸⁰ Where B did not provide any consideration, but was liable for gift tax on the initial acquisition of the *bare dominium* property, the gift tax will be credited against any inheritance tax due.

The fiction in its current form (as described above) had been broadened by the 2010 amendments. Prior to 1 January 2010, the section did not refer to associated acts (*samenstel van rechtshandelingen*) and was restricted to cases where only the testator was a party to the *rechtshandeling*. The application of section 10 (prior to the 2010 amendments) created a number of uncertainties and interpretation problems, for example in the area of *onderbedelingsvorderingen*. The section was also relatively easy to circumvent. For example, the fiction did not extend to the so-called *gesplitste aankoop*, where, for instance, A purchases a usufruct and B (A's son) purchases the *bare dominium* from C. It was also common for a wealth holder to sell the *bare dominium* in property to a close relative and to stay on

consequences. Apparently the judiciary favours the latter approach. See Van Vijfeijken in Kolkman *et al* (2006) 654 and Van Vijfeijken (2009) *WFR* 713–714. See also Schols (2009) *WPNR* 487–488. With effect from 1 January 2010, certain acts have been expressly excluded from the ambit of *rechtshandeling*. See s 10.7 (as amended by 31 930 A).

⁷⁹ S 10.1 read with 10.4 (as amended by 31 930 A).

⁸⁰ S 7.

residing in the property at a nominal lease payment.⁸¹ However, the 2010 amendments introduced some measures countering these tax avoidance techniques.⁸² Provisions were also introduced to exclude the operation of the fiction to *onderbedelingsvorderingen* and certain other scenarios.⁸³ Because this fiction is especially relevant in the realm of limited interests for comparative purposes, it will more fully be explained (with the assistance of examples) in paragraph 9.7 below.

- (f) Where a partner or close relative (or his or her partner) acquires more than his or her rightful share in partnership property during the life of a former partner or as a result of the death of such partner, any excess share shall be regarded as having been acquired by virtue of a gift or an inheritance respectively.⁸⁴ Also, where a person acquires, on the death of a spouse, more than his or her rightful share in communal property by virtue of the provisions of an ante-nuptial contract or a distribution agreement, the award in excess of his or her rightful share will be deemed to have been acquired by him or her by virtue of an inheritance.⁸⁵
- (g) Where someone renounces a debt in favour of another person, provided that such person survives him or her, then the value of such a renounced debt shall be

⁸¹ For further reading on the tax avoidance opportunities prior to the 2010 amendments, see Van Vijfeijken (1997) *WFR* 11–21; Blokland, Klinkert-Cino and Schutte (1998) Ch 5 67–80; Vegter (2003) *WPNR* 421 *et seq*; Van Vijfeijken in Kolkman *et al* (2006) 653–658 and Martens and Sonneveldt (2007) 105–125.

⁸² S 10.1 and 10.3.

⁸³ S 10.5–10.7.

⁸⁴ S 11.1 and 11.2 (as amended by 31 930 A). Prior to the amendments, the Act referred only to the acquisition of partnership property (in excess of a rightful share) on the *death* of a former partner. The fiction has therefore been extended to lifetime transfers. For the position prior to the amendments, see in general Van Vijfeijken (2002) *WPNR* 185–186; Van Vijfeijken in Kolkman *et al* (2006) 658–662 and Martens and Sonneveldt (2007) 92–98.

⁸⁵ S 11.4 (as amended by 31 930 A). Prior to the amendments, this fiction was separately provided for in s 7. For further reading on the pre-2010 text, see Van Vijfeijken in Kolkman *et al* (2006) 646–647 and Martens and Sonneveldt (2007) 92. For further reading on the amendments to the fiction, see Van Vijfeijken (2009) *WFR* 719–720 and Schols (2009) *WPNR* 486–487.

- regarded as having been acquired by the beneficiary by virtue of an inheritance on the death of the first-mentioned person.⁸⁶
- (h) Any gift made within a period of 180 days prior to the death of a donor with *woonplaats* in the Netherlands will be regarded as having been acquired by the donee by virtue of an inheritance.⁸⁷ With effect from 1 January 2010, property acquired under a gift, which is only completed after the death of the donor, will also be regarded as having been acquired by virtue of an inheritance.⁸⁸
- (i)(a) The benefits acquired through a life insurance agreement⁸⁹ are regarded as having been acquired by the beneficiary thereof by virtue of an inheritance from the deceased estate of the life insured, “to the extent that” the deceased contributed to the acquisition of the policy benefits, provided that such beneficiary was not already liable for gift tax or inheritance tax in respect of the surrender value of the policy at an earlier stage.⁹⁰ Where a deceased insured, for example, paid 80 percent of the premiums in respect of a life policy and the beneficiary paid 20 percent, then only 80 percent of the benefits payable on the insured’s death will be taxable in the hands of the beneficiary. A life policy that was affected by a company or partnership on the life of one of the members will typically not fall within the ambit of the Act in view of the fact that the company or partnership

⁸⁶ S 11.3 (as amended by 31 930 A). Prior to the amendments, this fiction was provided for in s 9.

⁸⁷ S 12.1 (first full sentence). The content of this section was not affected by the 2010 amendments. For further reading, see Van Vijfeijken in Kolkman *et al* (2006) 662–663; Martens and Sonneveldt (2007) 125–127 and Van Vijfeijken (2009) *WFR* 722.

⁸⁸ S 12.1(second full sentence). This sentence was added by 31 930 A and is effective from 1 January 2010.

⁸⁹ According to Dutch law, the benefits acquired by a beneficiary in terms of a life insurance policy upon the death of the insured life are enforceable in their own right and not through the estate or the deceased estate of the policy owner, who is in many instances also the insured life. See Van Vijfeijken in Kolkman *et al* (2006) 664.

⁹⁰ S 13.1 (as amended by 31 930 A).

will normally have been responsible for the payment of the premiums.⁹¹ Prior to the 2010 amendments, the fiction applied to all cases where the insured contributed “something” to the acquisition of the benefits and the full value of the benefits was in principle subject to inheritance tax. However, the Act included a provision (which was repealed by the 2010 amendments) stating that anything sacrificed by the beneficiary in respect of the acquisition of the policy benefits, such as premiums, were deductible from the value of the benefits.⁹² The amendments effected in 2010, which have limited the scope of the fiction, have generally been welcomed by scholars as more equitable.⁹³

- (i)(b) With effect from 1 January 2010 an additional provision was included stating that, where the insurer (*verzekeraar*) of a life policy is a partner or close relative (or his or her partner) of the deceased insured (*verzekerde*), then the full value of the policy benefits are deemed to have been acquired by virtue of an inheritance from the insured.⁹⁴

- (j) Where a partner or a close relative (or his or her partner) of a person is the holder of a substantial share in an enterprise, as defined in the Income Tax Act of 2001, in respect of which the value has been increased as a consequence of the last-mentioned person’s death, then the value of the shareholding, less any related

⁹¹ See in general Van Vijfeijken in Kolkman *et al* (2006) 664–669 and Martens and Sonneveldt (2007) 128–142.

⁹² S 23.1 (as it read before the amendments effected by 31 930 A). See in general Van Vijfeijken in Kolkman *et al* (2006) 695–697.

⁹³ See e.g. Van Vijfeijken (2009) *WFR* 717–718.

⁹⁴ S 13(2) (as introduced in terms of 31 930 A). For further reading, see Van Vijfeijken (2009) *WFR* 718–719.

- debts or deferred income tax liabilities,⁹⁵ will be deemed to have been acquired by virtue of an inheritance.⁹⁶
- (k) Where a person unilaterally renounces a limited interest, the expansion of another person's beneficial interest in the property will be regarded as a fictitious acquisition by the last-mentioned person from the first-mentioned person.⁹⁷
- (l) With effect from 1 January 2010, the absence of market-related interest on a demand loan is regarded as a gift to the debtor by the creditor of a usufruct over the money on a daily basis chargeable on an annual basis, provided that the loan had been awarded to an individual by another individual not in the ordinary course of his or her profession or trade.⁹⁸ This method was earlier proposed by the Moltmaker Report.⁹⁹ The fiction need not have been extended to term loans, because the nominal value of a term loan is less than the market value of the claim for repayment (in the absence of market-related interest). The difference in these values constitutes the gift of a usufruct over the money in terms of the ordinary rules.¹⁰⁰

⁹⁵ See par 9.9 for description of deferred income tax liabilities.

⁹⁶ S 13a (as amended by 31 930 A) for the pre-2010 text, see Van Vijfeijken in Kolkman *et al* (2006) 670–673 and Martens and Sonneveldt (2007) 142–143. For further reading on issues related to the 2010 amendments, see Van Vijfeijken (2009) *WFR* 723.

⁹⁷ S 14.

⁹⁸ S 15 (as amended by 31 930 A). The amount of the interest foregone could not qualify as a gift in terms of the ordinary rules. The impoverishment of the donor seems to be the problematic issue, in view of the fact that no proprietary rights have indeed been abandoned by the lender. See Van Vijfeijken in Kolkman *et al* (2006) 631 and Martens and Sonneveldt (2007) 61. For further reading on the 2010 amendments, see Van Vijfeijken (2009) *WFR* 721 and Schols (2009) *WPNR* 494–495.

⁹⁹ Moltmaker Report (2000) 65. See also Zwemmer (2008) *WPNR* 423.

¹⁰⁰ The definition of a usufruct includes the free use of property. See par 9.3.4. If there is no date determined for the repayment of the money, the usufruct will be valued over the life expectancy of the debtor. See Van Vijfeijken in Kolkman *et al* (2006) 631–632 and Martens and Sonneveldt (2007) 60–64.

9.2.4 Jurisdictional Basis

The jurisdictional basis of the respective taxes is determined with reference to either *woonplaats* or the location of assets.

9.2.4.1 Residency (*Woonplaats*)

Inheritance tax and gift tax is in principle chargeable where the transferor has his or her *woonplaats* in the Netherlands at the date of his or her death or on the conclusion of the gift.¹⁰¹ Although the legal structure of the Act is based on a recipient-based tax, the *woonplaats* of the beneficiary is actually irrelevant.¹⁰² This position has been evaluated and questioned by some commentators. The Moltmaker Report supported the connection with the *woonplaats* of the transferor, in view of the fact that a connection with the recipient ranks under a connection with the transferor for the awarding of the primary right to tax under the OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts (1982). Also, a connection with the transferor is globally speaking much more popular.¹⁰³ Some scholars argue, however, that the beneficiary's

¹⁰¹ S 1.1° and 1.2°. Since the enactment of the Ordinance of 1805, the charge for Dutch wealth transfer taxes (charged in various forms under various fiscal regimes) have been based on the principle of *woonplaats*. This tendency is in line with the general trend that has been followed in most other European jurisdictions. See Adriani (1925) 10; Van Vijfeijken (2002) *WPNR* 179; Sonneveldt (2004) *WPNR* 315; Sonneveldt and De Kroon (2008) *WFR* 594. In view of the fact that the *woonplaats* of a person can be changed at an instant, the Act provides for a few fictions (*woonplaatsficties*), which deem the *woonplaats* of the transferor to be within the Netherlands in certain circumstances. The “ten-year rule” (provided for in s 3.1) creates the fiction that any person with Dutch nationality who had a *woonplaats* in the Netherlands and who has died or donated property within ten years from the date on which the person obtained a *woonplaats* outside the Netherlands, will be regarded as having *woonplaats* within the Netherlands at the date of his or her death or upon the making of a gift. The “one-year rule” (as provided for in s 3.2) deems a person who has had a *woonplaats* within the Netherlands and who donated property within one year after having obtained a *woonplaats* outside the Netherlands to have a *woonplaats* within the Netherlands upon the making of a gift. S 2 (as amended by 31 930 A) also provides that a Dutch citizen, residing outside the Netherlands and who is in the employment of the government as a diplomatic representative, together with his or her partner and children younger than 27 years, are regarded as having their *woonplaats* in the Netherlands. For further reading on the fictions, see Soares and McCutcheon (1995) 98; Sonneveldt, Bom and Zuiderwijk (1995) 32–33; Sonneveldt (2004) *WPNR* 318–319; Van Vijfeijken (2004) *WPNR* 327; Meussen (2004) *WPNR* 639 *et seq*; Van Vijfeijken in Kolkman *et al* (2006) 638–639 and Martens and Sonneveldt (2007) 7–13.

¹⁰² Sonneveldt, Bom and Zuiderwijk (1995) 31; Van Vijfeijken in Kolkman *et al* (2006) 626.

¹⁰³ Moltmaker Report (2000) 7. For support of this proposal, see Zwemmer (2001) *Mededelingen* 26.

woonplaats should ideally be the connecting factor, in view of the fact that the legal structure has evolved from a transferor-based tax to a recipient-based tax.¹⁰⁴ Van Vijfeijken explains that the two main objections against such an approach are (a) the administrative difficulties that would be created for the tax authorities (to deal with foreign assets) and (b) the fact that the connection with the transferor is, globally speaking, the most popular approach. A regime where the connection is restricted to the recipient would therefore either contribute to double taxation or a lack of taxation.¹⁰⁵ She nevertheless points out that many European jurisdictions, such as Germany, Finland, France and Austria, have initiated “double connecting factors” by levying wealth transfer taxation with reference to the *woonplaats* of both the transferor and the recipient. Although she concedes that this approach is objectionable, she submits that it could serve as a transitional measure towards the eventual connection to the *woonplaats* of the recipient.¹⁰⁶ Sonneveldt and Monteiro call for the connection to be directed at the *woonplaats* of the recipient only. They argue that the international preference is not such a great obstacle, especially in view of the fact that the Netherlands has only entered into a few tax treaties with other countries. They mention that an adjustment to the jurisdictional basis would in actual fact encourage negotiations in respect of treaties with countries such as Belgium, France and Germany.¹⁰⁷ Another scholar, Van der Weerd-Van Joolingen, also concluded that the international difficulties related to a recipient-connection are not insurmountable.¹⁰⁸ Although the Minister of Finance has indicated that

¹⁰⁴ Van Vijfeijken (2002) *WPNR* 180; Van Vijfeijken (2004) *WPNR* 320; Van Vijfeijken (2008) *WPNR* 425; Sonneveldt and Monteiro (2008) *WPNR* 434; Van Rijn (2008) *WPNR* 437; Juch (2008) *WFR* 656; Sonneveldt and De Kroon (2008) *WFR* 596.

¹⁰⁵ Van Vijfeijken (2008) *WPNR* 425. This author also refers to the fact that the *woonplaats* of the transferor takes preference to the *woonplaats* of the recipient in terms of the OECD model convention on estate and inheritance taxation.

¹⁰⁶ Van Vijfeijken (2002) *WPNR* 180 and Van Vijfeijken (2004) *WPNR* 327.

¹⁰⁷ Sonneveldt and Monteiro (2008) *WPNR* 434–435. See also Sonneveldt and De Kroon (2008) *WFR* 596.

¹⁰⁸ Van der Weerd-Van Joolingen (2009) *WFR* 833.

the extension of the connection to the *woonplaats* of the recipient should be considered,¹⁰⁹ the jurisdictional basis has not been altered by the 2010 amendments.

9.2.4.2 Location of Assets

As explained above, the location of certain assets in the Netherlands acquired under an inheritance or a gift from a person with *woonplaats* outside the Netherlands had previously been included in the jurisdictional basis of the Act through the levying of transfer tax (*recht van overgang*) on such acquisitions.¹¹⁰ However, transfer tax was abolished with effect from 1 January 2010.¹¹¹

9.2.5 Double Taxation

Relief for double taxation can be afforded through double taxation agreements or through the granting of a unilateral tax credit.¹¹²

Double taxation agreements have been entered into with Switzerland, Sweden, Finland, the United States of America, Israel, Great Britain and Northern Ireland, and Austria (although the agreements with Sweden, Israel and Austria are of limited effect because wealth transfer taxes have been abolished in those countries). With the exception of the agreements concluded with Great Britain and Northern Ireland and Austria (which covers inheritance tax and gift tax), the agreements apply to inheritance tax only. The multilateral ruling (*Belastingregeling voor het Koninkrijk* or “BRK”) with the other

¹⁰⁹ JK de Jager, address of 14 April 2008 at the University of Tilburg, available at www.schenkenerbelasting.nl (accessed on 15 May 2009).

¹¹⁰ See par 9.1.2.

¹¹¹ See 31 930 A.

¹¹² See in general Martens and Sonneveldt (2007) Ch 9.

member countries of the Kingdom of the Netherlands applies to both inheritance tax and gift tax.¹¹³

The Order for the Prevention of Double Taxation (*Besluit Voorkoming Dubbele Belasting*)¹¹⁴ provides that, where a person with *woonplaats* in the Netherlands is liable for inheritance tax or gift tax in respect of property situated in a foreign jurisdiction, then that person would be entitled to unilateral relief under the order in the absence of relief granted by a double taxation agreement.¹¹⁵ In terms of the relief, a credit is granted for the foreign inheritance tax (or gift tax) or the proportionate part of the Dutch inheritance tax (or gift tax), whichever is the lower, attributable to assets which form part of a permanent establishment in that foreign country, or in respect of immovable property situated in that country.¹¹⁶ In respect of all other assets situated in the foreign jurisdiction (e.g cash), the taxpayer would be entitled to claim the foreign tax as a liability in the valuation of the asset for the purposes of Dutch inheritance tax.¹¹⁷ These reliefs also operate in respect of gift tax.¹¹⁸

9.2.6 Object of Taxation: Property

The object of taxation is the value of all that is acquired (*die waarde van al wat wordt verkregen*),¹¹⁹ which includes tangible as well as intangible property.¹²⁰

¹¹³ See in general Martens and Sonneveldt (2007) 233–234.

¹¹⁴ This order (“BVDB”) was issued in 2001 under s 38 of the General Tax Code.

¹¹⁵ BVDB ss 1–2.

¹¹⁶ BVDB s 47. See Martens and Sonneveldt (2007) 235–236 for some examples.

¹¹⁷ BVDB s 49.

¹¹⁸ BVDB s 51.

¹¹⁹ S 1.1° and 1.2°.

¹²⁰ Martens and Sonneveldt (2007) 20 refer to Civil Code 3:1.

9.3 VALUATION

Except for a general rule, the Act provides special provisions for the valuation of residential property, usufructs and annuities, bare *dominium*, listed shares and businesses. Provision is also made for favourable valuation rules in respect of business property and qualified country estates, rules that are more fully discussed in paragraph 9.5.2 below.

Property should be valued on the moment of its acquisition,¹²¹ which is, in the case of an inheritance, generally the date of death of the testator, and in the case of a gift, the date that the agreement has been concluded.¹²²

9.3.1 General Rule

If no special rule applies, property is assessed at its fair market value.¹²³

9.3.2 Residential Property

With effect from 1 January 2010, the so-called WOZ value has been made applicable for the valuation of residential property for the purposes of both inheritance tax and gift tax.¹²⁴ The WOZ value of residential properties is periodically assessed by the relevant municipalities pursuant to the Valuation of Immovable Property Act (*Wet Waardering Onroerende Zaken*). The values are stored in a central administration system, which is accessible for the purposes of the valuation of property for tax or insurance purposes. In terms of the new provisions introduced in the Act, the WOZ values for the year preceding the relevant tax year would, subject to certain exceptions, be used for valuation

¹²¹ S 21.1.

¹²² Van Vijfeijken in Kolkman *et al* (2006) 686.

¹²³ S 21.1. See Van Vijfeijken in Kolkman *et al* (2006) 687 and Martens and Sonneveldt (2007) 153 for further reading.

¹²⁴ S 21.5 – 21.9 (as amended by 31 930 A).

purposes.¹²⁵ Because WOZ values do not account for the depreciatory effect caused by lease agreements, special regulations were issued to provide for a discount in these instances.¹²⁶ A special rule is also provided for properties subject to hereditary tenures.¹²⁷

9.3.3 Periodic Payments (Annuities)

A “periodic payment”, meaning not only a payment in money, but any recurrent or fixed performance,¹²⁸ is valued by multiplying the annual value¹²⁹ of the payments with a predetermined factor (published under an implementation decree (*uitvoeringsbesluit*) as an annexure to the Act) that relates either to the age and life expectancy of the beneficiary, or to a fixed period of time.¹³⁰ Special rules apply where the payments relate to more than one person’s life expectancy. Where the payments expire at the death of the survivor of these persons, then the factor will be determined according to the age of a

¹²⁵ S 21.5 and 21.7.

¹²⁶ S 21.8 read with UB Ch 1 s 10a.

¹²⁷ S 21.9.

¹²⁸ S 18.2. See in general Van Vijfeijken in Kolkman *et al* (2006) 677.

¹²⁹ If the amount of the periodic payment is uncertain, for instance where a person becomes entitled to an annual profit share, the annual value must be estimated (Implementation Decree (*Uitvoeringsbesluit* or “UB”) Ch 1 s 8.1). If the payment is not in money, then the value of the performance should be used (UB Ch 1 s 8.2).

¹³⁰ S 21.13 (as amended by 31 930 A) and UB Ch 1 ss 5–7. Where the payments are payable for the duration of a single person’s life, the factor varies between 16 (for a person younger than 20 years) to 2 (for a person older than 90 years)(UB 7A s 5). Where the payments are payable for a fixed period of time, the relevant factor depends on whether or not the period is restricted to the beneficiary’s life expectancy. Where the period is restricted as such, a specific factor is determined for (1) the first 5 years, (2) the period 5–10 years, (3) the period 10–15 years (4) the period 15–20 years (5) the period 20–25 years and (6) any further period exceeding 25 years. For each of these periods, the factor depends on whether the beneficiary is (a) younger than 40 years, (b) between 40 and 60 years or (c) older than 60 years. The factor varies between 0.84 (for a person younger than 40 years), 0.83 (for a person 40–60 years) and 0.75 (for a person older than 60 years) in respect of the first 5 years to 0.12 (for a person younger than 40 years), 0.06 (for a person 40–60 years) and zero (for a person older than 60 years) in respect of the period that exceeds 25 years. Where the payments are payable for a fixed period of time (unrestricted by a person’s life expectancy), the factor varies between 0.85 for the first 5 years to 0.15 for the period that exceeds 25 years (UB 7A s 6.1). If the beneficiary of the periodic payments passes away prior to the expiration of the period, the payments in respect of the unexpired period devolve upon such person’s heirs, who will once again be liable for the payment of inheritance tax in respect of the remaining period. See in general Martens and Sonneveldt (2007) 161–164.

person five years younger than the youngest of them.¹³¹ Where the payments expire at the death of the first of them to die, then the factor will be determined according to the age of a person five years older than the oldest of them.¹³² Special provision is also made for the enjoyment of payments for an undetermined period of time.¹³³

Where a periodic payment is subject to a resolutive condition, for instance the remarriage of a person, the calculation is made irrespective of the condition. Upon the condition being fulfilled, the periodic payment may be re-valued and any excess inheritance tax may be reclaimed on application to the tax authorities.¹³⁴

9.3.4 Usufructs

For the purposes of the Act a usufruct¹³⁵ includes the use of an asset without adequate consideration, a right of habitation (*habitatio*) and distributions in the form of income, fruit or allowances charged against property.¹³⁶ A usufructuary interest is valued by multiplying its annual value, calculated at six percent¹³⁷ of the fair market value of the underlying property, with the relevant factor, which is determined in the same manner as

¹³¹ UB 7A s 7.1.

¹³² UB Ch 1 s 7.2.

¹³³ UB Ch 1 s 6.3 (the factor would be set at 17). This would for instance be the case where a periodic payment is bequeathed to a foundation (*stichting*) for the period of its existence. See Martens and Sonneveldt (2007) 163.

¹³⁴ S 53. See in general Van Vijfeijken in Kolkman *et al* (2006) 763; Martens and Sonneveldt (2007) 162.

¹³⁵ The Dutch civil code describes a usufruct as a “limited right which gives a right to use [of] property belonging to another and to enjoy the fruits thereof”. See Sonneveldt, Bom and Zuiderwijk (1995) 45.

¹³⁶ S 18.1. See in general Van Vijfeijken in Kolkman *et al* (2006) 677 and Martens and Sonneveldt (2007) 165.

¹³⁷ Zwemmer argues that the six percent rule is old-fashioned and in need of reform. The fixed percentage can either be exploited where the actual yield is higher than six percent, or it can function unfairly where the yield is lower than six percent. See Zwemmer (2008) *WPNR* 423.

provided for in respect of the valuation of periodic payments.¹³⁸ The usufruct must be valued at the moment that the usufructuary becomes entitled to the enjoyment thereof.¹³⁹ See paragraph 9.7 below for example calculations.

9.3.5 Bare *Dominium*

The value of bare *dominium* property is calculated as the difference between the fair market value of the underlying property and the value of the usufruct.¹⁴⁰ In the case of successive usufructs, the value of the bare *dominium* is calculated as if a usufruct was granted for the duration of a joint continuance of lives (until the death of the survivor), which means that the usufruct would be calculated in accordance with the factor established with reference to the age of a person five years younger than the youngest of the usufructuaries.¹⁴¹ See paragraph 9.7 below for example calculations.

9.3.6 Fideicommissum (*Tweetrapsmaking*)

The legal construction of a *fideicommissum* is that the first beneficiary (in Latin the *fiduciarius*, in Dutch the *bezwaarde erfgenaam*) inherits the property subject to a resolutive condition, whereas the second beneficiary (in Latin the *fideicommissarius*, in Dutch the *verwachter*) acquires the property subject to a suspensive condition.¹⁴² For the purposes of the valuation of the property in the hands of the first beneficiary, the Act

¹³⁸ S 21.13 read with UB Ch 1 s 10. See Blokland, Klinkert-Cino and Schutte (1998) 81–81, 86–93 for a discussion and examples. The health of the usufructuary and market interest are irrelevant factors. See Van Vijfeijken in Kolkman *et al* (2006) 766. See also Martens and Sonneveldt (2007) 165–166 (for an example).

¹³⁹ Van Vijfeijken in Kolkman *et al* (2006) 691.

¹⁴⁰ S 21.10.

¹⁴¹ See par 9.3.3.

¹⁴² Van Vijfeijken in Kolkman *et al* (2006) 690; Martens and Sonneveldt (2007) 155. For the construction of a *fideicommissum* under South African law, see Ch 5 par 5.2.4 n 45.

provides that the resolutive and suspensive conditions should be disregarded.¹⁴³ The market value of the asset will therefore be assessed as if no condition to preserve the property had been imposed. The second beneficiary will be deemed to have acquired the property from the testator (*insteller*) on the death of the first beneficiary,¹⁴⁴ which means that the blood relationship between the testator and the second beneficiary will be relevant for the determination of the applicable tax rate.¹⁴⁵

9.3.7 Businesses

A business (sole proprietorship) or partnership interest is valued with reference to the price a third party with the intention of continuing the enterprise would be willing to pay for it (referred to as the “going concern value”).¹⁴⁶ It is also provided that the going concern value (for the purposes of the Act) should at least be the liquidation value (which may be lower or higher than the going concern value).¹⁴⁷

The acquisition of business property may, however, be subject to business relief (as will be discussed more fully below), which is determined with reference to the going concern value. However, where the liquidation value is higher than the true going concern value, the tax attributable to the difference in the values may also be subject to business relief (subject to the business being continued for a period of five years after the acquisition).¹⁴⁸

¹⁴³ S 21.2. See in general Van Vijfeijken in Kolkman *et al* (2006) 690.

¹⁴⁴ S 21.4 (as amended by 31 930 A).

¹⁴⁵ Sonneveldt, Bom and Zuiderwijk (1995) 42.

¹⁴⁶ S 21.12 (as amended by 31 930 A). For further reading on the different valuation methods, see Van Vijfeijken in Kolkman *et al* (2006) 688–689; Martens and Sonneveldt (2007) 173–176 (also for example calculations); Sonneveldt in Sonneveldt *ed* (2002) 52.

¹⁴⁷ S 21.12.

¹⁴⁸ See par 9.5.2.1.

9.3.8 Listed Shares

Listed shares are valued according to their published closing price on the date preceding the day of acquisition.¹⁴⁹

9.4 TAXPAYER AND FILING OF RETURN

Inheritance tax and gift tax are primarily levied on the beneficiary of an inheritance or gift.¹⁵⁰ The taxes are collected in terms of an assessment system.¹⁵¹ In the case of inheritance tax, a taxpayer must file a tax return within a period of eight months from the death of the wealth holder.¹⁵² In the case of gift tax, the return must be submitted within two months from the end of the calendar year in which the liability for the tax had been incurred.¹⁵³ Subsequent to the filing of the tax return(s), the revenue authorities will then issue assessments. Where there are a number of heirs benefiting from the same estate, they are entitled to submit a joint return.¹⁵⁴ An executor may also complete returns on behalf of the heirs, unless all the heirs reside outside the Netherlands, in which case the executor is obliged to submit the returns on their behalf.¹⁵⁵

9.5 RELIEF MECHANISMS

The Act provides for various forms of relief, which include (a) the deduction of certain liabilities and any consideration paid from the value of a gift or inheritance, (b) the

¹⁴⁹ S 21.3. Unlisted shares are valued according to the general rule. See Van Vijfeijken in Kolkman *et al* (2006) 690.

¹⁵⁰ S 36.

¹⁵¹ S 37. For further reading, see Martens and Sonneveldt (2007) 241–247.

¹⁵² S 45.

¹⁵³ S 46.

¹⁵⁴ S 39.

¹⁵⁵ S 72.

provision of preferential valuation rules in respect of business property and qualified country estates and (c) the provision of certain exemptions.

9.5.1 Allowable Deductions: Liabilities and Consideration

For the purposes of inheritance tax, the charge is levied on the value of all that is acquired by the beneficiary, less the beneficiary's share in any debts, legacies and charges deductible in terms of the Act.¹⁵⁶ The debts must be due and payable at the moment of death.¹⁵⁷ An heir burdened with the obligation to adhere to a legacy or a personal charge would therefore be able to deduct the value of such a charge from his or her inheritance.¹⁵⁸

Specific provision is made for the deductibility of reasonable funeral costs¹⁵⁹ as well as certain deferred income tax liabilities.¹⁶⁰ Administration costs, executor's fees, valuation costs and inheritance tax are not deductible, in view of the fact that they were not due and payable upon the death of the testator and in the absence of any specific provision in this regard.¹⁶¹

For the purposes of gift tax, all debts and obligations relating to the gift, in terms of which either the donor or a third party would have benefited, are deductible from the value of the property comprised in the gift.¹⁶²

¹⁵⁶ S 5.1 read with s 20. See in general Van Vijfeijken in Kolkman *et al* (2006) 642 and Martens and Sonneveldt (2007) 21–24.

¹⁵⁷ S 20.3.

¹⁵⁸ Van Vijfeijken in Kolkman *et al* (2006) 642; Martens and Sonneveldt (2007) 24–25.

¹⁵⁹ S 20.1–20.2. See in general Van Vijfeijken in Kolkman *et al* (2006) 681.

¹⁶⁰ S 20.5 and 20.6. See par 9.9 for a discussion on deferred income tax liabilities. See in general Blokland, Klinkert-Cino and Schutte (1998) Ch 6; Van Vijfeijken in Kolkman *et al* (2006) 682–685 and Martens and Sonneveldt (2007) 22–23.

¹⁶¹ Martens and Sonneveldt (2007) 21.

¹⁶² S 5.2 (as amended by 31 930 A). See in general Van Vijfeijken in Kolkman *et al* (2006) 644–645.

9.5.2 Preferential Valuations

9.5.2.1 Business Property

The first form of business relief under the Act dates back to 1983, with the introduction of a deferred payment system for the inheritance or gift tax liability in respect of business assets.¹⁶³ The motivation behind its implementation was to counter instances where the continuation of businesses was endangered as a result of the tax liabilities.¹⁶⁴ In 1990, a comprehensive relief facility was incorporated into the Collection of Taxes Act.¹⁶⁵ In 2002, following the Moltmaker Report's recommendation,¹⁶⁶ a revised business relief facility (*bedrijfsopvolgingsfaciliteit*) was reintroduced in the Inheritance and Gift Tax Act. The provisions and requirements of the facility were revised with the 2010 tax reform process.

For the purposes of inheritances and gifts, an exemption of 100 percent is (on application of the acquirer) available in respect of the going concern value of "business property"¹⁶⁷ (*ondernemingsvermogen*) where the value of the business does not exceed €1 million.¹⁶⁸

¹⁶³ See Zwemmer (2000) *WPNR* 143 and Zwemmer (2004) *WPNR* 346 for further reading on the first form of business relief.

¹⁶⁴ Zwemmer (2000) *WPNR* 143; Zwemmer (2004) *WPNR* 345; Van Uunen (2000) *WFR* 811; Hoogveen (2002) *WPNR* 303; Van Vijfeijken and Van Joolingen (2007) *WPNR* 1059.

¹⁶⁵ Martens and Sonneveldt (2007) 211.

¹⁶⁶ Moltmaker Report (2000) 23. However, most of the Moltmaker Report's recommendations in respect of business relief (at 23–36) were never implemented. See Van Rijn *WFR* (2000) 768–776 and Van Uunen (2000) *WFR* 810–820 for discussions on the recommendations.

¹⁶⁷ "Business property" as defined basically includes a business operated through a sole proprietorship or a partnership interest. In addition, it includes a substantial share-interest in a limited liability corporate entity operating a business (s 35c.1(a)–(c)). A substantial interest exists, generally speaking, where a shareholder owns by himself or herself together with his or her partner, directly or indirectly, an interest of at least five percent in the shareholding of the entity (Income Tax Act s 4.6). However, the value of the substantial interest which may qualify for the relief may only include investments the value of which does not exceed five percent of the value of the business (S 35c.1(c).2°). See in general Van Vijfeijken in Kolkman *et al* (2006) 733.

¹⁶⁸ S 35b.1(a).

Where the value of the business property exceeds €1 million, any difference between the liquidation value and the going concern value (where the first value is higher than the second value) as well as the first €1 million of the going concern value will be fully exempt from inheritance or gift tax. In respect of the value exceeding €1 million, an exemption of 83 percent of the going concern value will be available.¹⁶⁹ Prior to 1 January 2010, the relief percentage was set at 75 percent (irrespective of the value of the business property).¹⁷⁰ The exemptions offered are conditional on certain requirements being adhered to in the period following the acquisition of the business property, which will be touched on below. The payment of the tax attributable to the 17 percent of the going concern value may in certain instances be postponed for 10 years, at an interest rate as provided for in the Collection of State Taxes Act 1990.¹⁷¹

To counter the abuse of the facility, it is provided that, in the event of a gift, the donor should have operated the business or held the substantial interest for at least five years prior to the making of the gift.¹⁷² Prior to 1 January 2010 the facility did not contain a similar provision for inheritances. However, the 2010 amendments introduced a

¹⁶⁹ S 35b.1(b).

¹⁷⁰ The percentage was 75% in respect of acquisitions after 1 January 2007. For the period 1 January 2005 – 31 December 2006 the percentage was 60%, and for the period 1 January 2002 – 31 December 2004 the percentage was 30%. Prior to 1 January 2002, when the facility as provided for in the Collection of Taxes Act was applicable, the percentage was set at 25%. At first, the new proposal (31 930 as originally issued) proposed a concession of 90%. For further reading on the initial proposal (for business relief), see Janssen (2009) *WFR* 723 *et seq.*

¹⁷¹ Collection of State Taxes Act 1990 (*Invorderingswet*) s 25.12. See in general Van Vijfeijken in Kolkman *et al* (2006) 736. Prior to 1 January 2002, payment could be made in 10 annual interest-free installments. This provision was replaced with the interest-bearing postponement provision, following a recommendation of the Moltmaker Report (2000) 33. See Sonneveldt in Sonneveldt *ed* (2002) 53–55; Van Rijn *WFR* (2000) 773 (who agrees with the charging of interest) and Bindels (2002) *WFR* 1191.

¹⁷² S 35d. Prior to 1 January 2010, in the event of a gift, the relief would in addition only have been applicable where the donor was at least 55 years of age or was declared disable for occupational purposes (at least 45 percent). S 35c.4 (as it read before the amendments effected by 31 930 A in 2010). See in general Van Vijfeijken in Kolkman *et al* (2006) 734 and Martens and Sonneveldt (2007) 212.

requirement that the deceased business property owner should have operated the business or held the substantial interest for at least one year prior to his or her death.¹⁷³

The relief offered is also conditional upon the acquirer of the inheritance or gift continuing to receive profits from the business or dividends through the shares for a period of at least five years. In addition, the exemption will be withdrawn where a shareholder disposes of the shares or converts the shares to preference shares within the five-year period.¹⁷⁴

Critics argue that business relief in the form of the remittance of a high percentage of the tax liability creates severe horizontal inequity towards the acquisition of non-business property and is therefore unjustified, especially in view of the fact that the beneficiary of the business property (in most cases) acquires it without any consideration. Various alternative relief measures have been proposed.¹⁷⁵ It has also been suggested that the relief (in its contemporary form) should rather be restricted to cases where the continuation of the business operations are endangered.¹⁷⁶ In response to the extension of the relief with effect from 1 January 2010, critics mention that it is strange that the legislature did not use the window of opportunity to evaluate the foundational justification for the relief.¹⁷⁷

9.5.2.2 *Qualified Country Estates (Landgoederen)*

Property that complies with the definition of “qualified country estates” (*landgoederen*) as provided for in the Estates Act 1928 (*Natuurschoonwet*), which has been declared as

¹⁷³ S 35d.

¹⁷⁴ S 35e.

¹⁷⁵ For further reading, see Van Rijn (2000) *WFR* 768 *et seq*; Zwemmer (2000) *WPNR* 144–145; Hoogeveen (2002) *WPNR* 303; Zwemmer (2004) *WPNR* 345; Zwemmer (2008) *WPNR* 423 and De Wijkerslooth-Lhoëst (2008) *WPNR* 1114 *et seq*.

¹⁷⁶ Van Rijn (2000) *WFR* 768–769; Zwemmer (2000) *WPNR* 144; Bindels (2002) *WFR* 1190; Hoogeveen (2002) *WPNR* 303.

¹⁷⁷ De Wijkerslooth-Lhoëst (2009) *WPNR* 512.

such by the Minister of Agriculture, Nature Management and Fishery and the Minister of Finance on request by the owner of the property, may be valued in accordance to certain preferential rules prescribed in section 7 of that Act.¹⁷⁸

9.5.3 Exemptions

In view of the fact that the value of the exemptions are, where applicable, revised and adapted on an annual basis, the amounts referred to below apply (unless otherwise stated) to inheritances or gifts acquired during the 2010 tax year.

9.5.3.1 Exemptions Applicable to Gift Tax

The following gifts are exempt from gift tax:

- gifts acquired from the Queen or members of the Royal Family;¹⁷⁹
- gifts made by or acquired by the state; as well as gifts made by a province or municipality.¹⁸⁰ Gifts acquired by a province or municipality in the Netherlands are also exempt, but provided that the gifts are not subject to directions which would alter their cause to something other than the general interest of the society;¹⁸¹
- gifts acquired by *algemeen nut beogende instellingen* (commonly referred to as ANBIs).¹⁸² Gifts made by these institutions are also exempt, but provided that they are

¹⁷⁸ Estates Act s 7.

¹⁷⁹ S 33.1.1°. See in general Van Vijfeijken in Kolkman *et al* (2006) 723 and Martens and Sonneveldt (2007) 208.

¹⁸⁰ S 33.1.2°.

¹⁸¹ S 33.1.3°.

¹⁸² S 33.1.4°. An ANBI is an institution, established in any member country of the European Union, the Netherlands Antilles or Aruba or in any other country with which the Netherlands had entered into an information exchange agreement, and which serves a religious, philosophical, ideological, charitable, cultural, scientific or general interest in favour of the society. See Income Tax Act s 6.33.1(b). The general interest of the society should be served, and not the interests of a particular group of persons, such as a local club. See Van Vijfeijken in Kolkman *et al* (2006) 714–715 and Martens and Sonneveldt (2007) 189.

made for the general interest of the society;¹⁸³

- gifts acquired by *sociaal belang behartigende instellingen* (commonly referred to as SBBI),¹⁸⁴ but provided that they are not subject to directions which would alter their cause to something other than social interest;¹⁸⁵
- gift acquired by someone, who is not able to pay his or her debts, provided that the gifts are used to pay such person's creditors;¹⁸⁶
- gifts acquired by an entity, which had been established for the purposes of the promotion of the financial and social interests of the employees or their relatives in the enterprise of the donor;¹⁸⁷
- gifts which are subject to income tax;¹⁸⁸ and
- gifts acquired by virtue of certain natural obligations.¹⁸⁹

An annual exemption (€5 000 for the 2010 tax year) is allowed in respect of gifts by a parent or parents to a child. For a child between 18 and 35 years the Act specifies that the value of the exemption may be increased for one calendar year only (for the purposes of this paragraph referred to as the secondary exemption). For the 2010 tax year the value of the secondary exemption is set at €24 000. The 2010 amendments introduced a provision that the secondary exemption may be increased to €50 000 where the money is to be used

¹⁸³ S 33.1.10°. See in general Van Vijfeijken in Kolkman *et al* (2006) 725 and Martens and Sonneveldt (2007) 208.

¹⁸⁴ An SBBI is an institution established in any member country of the European Union, the Netherlands Antilles or Aruba or in any other country with which the Netherlands had entered into an information exchange agreement and which serves a social interest such as sports clubs and *dorpshuizen*. See s 32.1.8°.

¹⁸⁵ S 33.1.13°.

¹⁸⁶ S 33.1.8°. See in general Van Vijfeijken in Kolkman *et al* (2006) 724–725 and Martens and Sonneveldt (2007) 208.

¹⁸⁷ S 33.1.11°. See in general Van Vijfeijken in Kolkman *et al* (2006) 726 and Martens and Sonneveldt (2007) 209.

¹⁸⁸ S 33.1.9°. See in general Van Vijfeijken in Kolkman *et al* (2006) 725 and Martens and Sonneveldt (2007) 209.

¹⁸⁹ S 33.1.12°. See in general Van Vijfeijken in Kolkman *et al* (2006) 726–727 and Martens and Sonneveldt (2007) 209.

for the acquisition of a primary residence or for the purposes of studies.¹⁹⁰ To provide a concession where a child between the ages of 18 and 35 years had already used the secondary exemption in a previous tax year, it is provided that such a child would for one calendar year (between the age of 18 and 35 years) be entitled to an additional exemption of €26 000 where the money is to be used for the acquisition of a primary residence.¹⁹¹

For all other gifts, a general exemption is available in the amount of €2 000.¹⁹²

9.5.3.2 Exemptions Applicable to Inheritance Tax

The Act provides for the exemption of the following inheritances:¹⁹³

- inheritances acquired by the state;¹⁹⁴
- inheritances acquired by a province or a municipality in the Netherlands, but provided that they are not subject to directions which would alter their cause to something other than the general interest of the society;¹⁹⁵
- inheritances acquired by ANBIs, but provided that they are not subject to directions which would alter their cause to something other than the general interest of the society;¹⁹⁶
- inheritances acquired by SBBIs, but provided that they are not subject to directions which would alter their cause to something other than social interest;¹⁹⁷

¹⁹⁰ S 33.1.5°.

¹⁹¹ S 33.1.6°.

¹⁹² S 33.1.7°.

¹⁹³ For further reading on the historic development of these exemptions, see Hemels (2004) *WPNR* 330–332.

¹⁹⁴ S 32.1.1°.

¹⁹⁵ S 32.1.2°.

¹⁹⁶ S 32.1.3°. See in general Van Vijfeijken in Kolkman *et al* (2006) 714 and Martens and Sonneveldt (2007) 189, 205–206.

¹⁹⁷ S 32. 1.8°.

- the acquisition of pension benefits under a pension plan, in terms of an annuity or by virtue of periodic payments;¹⁹⁸
- an acquisition from an employer or his or her spouse in respect of services supplied in terms of a natural obligation as provided for in civil code 6:3;¹⁹⁹ and
- interest and other income which accrues after the death of the testator (apparently because of the fact that these accruals have been subjected to income tax).²⁰⁰

With effect from 1 January 2010, the Act provides for the following part-exemptions (*voet vrijstellingen*) in respect of inheritances acquired by the following relatives:²⁰¹

Relative	Exempt threshold
Partner	€600 000, reduced by half of the partner's pension entitlements, but provided that the exemption will not be less than €155 000 ²⁰²
Handicapped/sick child	€57 000
Child	€19 000
Grandchild	€19 000
Parent	€45 000

In respect of all other inheritances, an amount of €2 000 is exempt from inheritance tax.²⁰³

¹⁹⁸ S 32.1.5° read with ss 32.3–32.5. See in general Van Vijfeijken in Kolkman *et al* (2006) 718 and Martens and Sonneveldt (2007) 206 (although this was also the position prior to 1 January 2010, the numbering of the section was restructured by 31 930 A).

¹⁹⁹ S 32.1.9°. See in general Van Vijfeijken in Kolkman *et al* (2006) 719 and Martens and Sonneveldt (2007) 206.

²⁰⁰ S 32.1.10°. See in general Van Vijfeijken in Kolkman *et al* (2006) 719–720 and Martens and Sonneveldt (2007) 207.

²⁰¹ S 32.1.4°(a)–(e).

²⁰² S 32.2.

²⁰³ S 32.1.4°(f).



9.6 TREATMENT OF COMMON-LAW TRUSTS

9.6.1 The Trust: An Unknown Phenomenon in the Dutch Law

The common-law trust is in principle an unknown phenomenon in Roman law-based civil law systems. The Dutch law does therefore not recognise a legal institution directly equivalent to such a concept.²⁰⁴ However, the law acknowledges some similar trust-like relationships, such as a *fideicommissum*,²⁰⁵ a nominee account,²⁰⁶ a *bewind*,²⁰⁷ a mandate²⁰⁸ and a foundation,²⁰⁹ where the fiduciary relationship among the persons involved can in various ways be compared with the relationship among the parties to a common-law trust.²¹⁰

²⁰⁴ Hayton, Kortmann and Verhagen (1999) 195–215; Koppenol-Laforce and Sonneveldt (2001) *WPNR* 173 *et seq.* See also Moltmaker Report (2000) 37–39, where the need to provide for a trust-like institution under Dutch law has been acknowledged. However, the proposal for the introduction of a family foundation (*familiestichting*) was not taken any further by the government.

²⁰⁵ See par 9.3.6.

²⁰⁶ A nominee account is a bank account which is maintained by a person (such as an advocate or notary) in his or her capacity as an agent for the benefit of another person (usually a client). See Hayton, Kortmann and Verhagen (1999) 198.

²⁰⁷ In the case of a *bewind*, the beneficiary is the legal owner of assets to be managed by an administrator (*bewindvoerder*). The administrator acts as an agent for the beneficiary. See Hayton, Kortmann and Verhagen (1999) 199–200.

²⁰⁸ In the case of a mandate, a principal may authorise his or her agent to execute acts of management or acts of disposition in respect of assets. For the duration of the mandate, the principal does not have the authority to manage the assets himself or herself. See Hayton, Kortmann and Verhagen (1999) 200–201.

²⁰⁹ A foundation is an entity with legal capacity which is established for an ideal or social purpose and which are managed by administrators. The institution has a function under Dutch law similar to that of the charitable trust in common-law jurisdictions. Under Dutch law, a foundation is created by virtue of a notarial deed (or will). See Hayton, Kortmann and Verhagen (1999) 202. Although the Act contained some specific provisions dealing with foundations (see ss 16 and 17 of the Act as it read prior to the amendments effected by 31 930 A in 2010), these provisions were repealed from the Act by 31 930 A with effect from 1 January 2010, because acquisitions can be taxed in terms of the normal charging provisions.

²¹⁰ See Hayton, Kortmann and Verhagen (1999) 196–203 for a comparative analysis of these and other Dutch trust-like institutions.

As a consequence of the fact that the Netherlands was a signatory to the 1985 Hague Trust Convention (which came into operation in the Netherlands in 1996), a foreign trust must be recognised under Dutch law.²¹¹ It is therefore of paramount importance to understand the applicability of the Inheritance and Gift Tax Act to transfers involving these foreign institutions, for example where a Dutch resident donates property to a foreign trust, or where the object of the transfer to or by the trust involves Dutch *situs* property.

In view of the fact that the Hague Convention does not cover the fiscal position of trusts,²¹² the Minister of Finance announced some policy guidelines in respect of the position of trusts, namely (a) a trust is not a legal entity for the purposes of fiscal legislation; (b) the fiscal consequences of a trust have to be ascertained by applying the analogical legal positions that exist in the Netherlands, and these consequences have to be reconcilable with the Dutch tax legislation; and (c) the trust capital always belongs to either an individual or a legal entity, and can never “float around”.²¹³

Although the common law trust can be classified in various ways, the Dutch literature usually refers to a “fixed trust”, which resembles a trust similar to an interest in possession trust (IIP trust) in the United Kingdom,²¹⁴ and a discretionary trust (where there are no fixed interests in possession). Prior to 1 January 2010, the Act did not contain any specific provisions in respect of trusts. The inheritance tax and gift tax consequences were therefore derived by applying the existing principles. However, a special regime aimed to counter *inter alia* the problematic nature of common-law discretionary trusts and foreign foundations was introduced on 1 January 2010 (the

²¹¹ Hayton, Kortmann and Verhagen (1999) 9; Sonneveldt and De Kroon (2009) *WFR* 734. For further reading on the Hague Convention, see Lupoi (2000) Ch 6.

²¹² Sonneveldt, Bom and Zuiderwijk (1995) 102; Martens and Sonneveldt (2007) 149; Sonneveldt and De Kroon (2009) *WFR* 734.

²¹³ Soares and McCutcheon (1995) 108.

²¹⁴ See Ch 8 par 8.6.1.

afgezonderd particulier vermogen (APV) regime), which will be discussed more fully in paragraph 9.6.3.3 below.

9.6.2 Fixed Trusts

Because the APV regime introduced in 2010 (referred to below) does not apply to fixed trusts, these trusts have remained unaffected by the amendments.

Because the donative intent is directed at the beneficiaries, and not the trustees,²¹⁵ a beneficiary is either liable for inheritance tax or gift tax in respect of the acquisition of a fixed interest through the construction of a benefit on behalf of a third party.²¹⁶ For example, where A (a Dutch resident) donates property to a fixed trust where B holds the life interest and C the remainder interest in the trust absolutely (i.e. a typical life interest trust), both B and C are liable for gift tax in respect of the life interest and remainder interest respectively. The life interest will apparently be valued in accordance with the method provided for the valuation of usufructs.²¹⁷

9.6.3 Discretionary Trusts

9.6.3.1 *The Position Prior to the APV Regime*

A discretionary trust posed some more challenging issues for the application of the Act prior to the introduction of the APV regime in 2010. Where, for example, a (Dutch resident) settlor transferred property into a discretionary trust (where the trustees had the discretion to distribute the income and the capital), a question arose whether a gift

²¹⁵ See Leemreis in Sonneveldt and Van Mens *eds* (1992) 62 and Sonneveldt (2000) *WFR* 776.

²¹⁶ See Leemreis in Sonneveldt and Van Mens *eds* (1992) 62; Sonneveldt Doctoral Thesis (2000) Ch 6; Van Vijfeijken in Kolkman *et al* (2006) 632 and Martens and Sonneveldt (2007) 150.

²¹⁷ Sonneveldt Doctoral Thesis (2000) 76; Martens and Sonneveldt (2007) 150.

occurred for the purposes of the Act. Although the settlor was definitely impoverished, the transfer did not yet result in the complete enrichment of a beneficiary, because of the trustees' intervening discretionary powers. In 1998, the high court had an opportunity to address the tax consequences of such a scenario. It was held that an *inter vivos* transfer of property to a discretionary trust constituted a gift for the purposes of the Act and the trustees were liable for gift tax in accordance with the rates applicable to group 3 (strangers).²¹⁸ Because most trusts are resident outside the Netherlands, the subsequent distribution of assets by the trustees would have fallen outside the scope of the Act (in most instances). As a consequence, it became relatively easy for a person to channel property to a beneficiary in the Netherlands tax-free. Another thorn in the flesh for the tax authorities was that income from trust property escaped income taxation in the absence of specific provisions contained in the income tax legislation.

9.6.3.2 *Proposals for a Solution*

Scholars generally agreed that the position of discretionary trusts was highly unsatisfactory and that some form of legislative intervention was required. Various proposals were put on the table. Sonneveldt suggested two alternative solutions. In terms of his first proposal the chargeable event would be deferred until the eventual distribution of the property to the beneficiary, and this transfer would be assumed to originate from the settlor. However, this approach had a number of disadvantages.²¹⁹ In terms of his second proposal, the disposal to the trust would be treated as a transfer to a separate fund, which is more in line with the approach taken by the judiciary. This proposal called for the implementation of a new fiscal regime applicable to trusts. There would in principle be three charges levied in terms of the proposed regime (at moderate rates), namely (a) an initial charge on the transfer of the property to the trust, (b) a periodic tax levied during

²¹⁸ HR 18 November 1998, *BNB* 1999/35, 36 and 37. See Sonneveldt Doctoral Thesis (2000) 102–114 for a discussion of the case. See also Martens and Sonneveldt (2007) 150–151.

²¹⁹ Sonneveldt Doctoral Thesis (2000) 247–248 (see also summary in English at 279).

the existence of the separate fund and (c) the final (main) charge levied upon the distributions to the beneficiaries.²²⁰

The Moltmaker Report proposed a uniform fiscal regime for trusts and foundations, whereby any disposal to such an entity, except for disposals to a public benefit organisation or a family foundation (as more fully discussed below), would be taxed in terms of the rates applicable to tariff group 3 (the highest).²²¹ Koppenol-Laforce and Sonneveldt criticised this non-transparent approach because it did not differentiate between fixed and discretionary interests.²²² According to Koele this proposal would also have been extremely detrimental to Dutch legal constructions such as certification and the benefit-for-a-third-party arrangements.²²³ The report furthermore proposed the implementation of a new concept, namely the family foundation (*familie-stichting*), an entity (with legal capacity) with characteristics similar to the common-law discretionary trust.²²⁴ This entity would be subject to a special fiscal regime, according to which (a) the initial transfer of property would be taxable at a flat rate of 10 percent, (b) any subsequent distribution to a beneficiary would be treated as a gift, taxable in accordance with the relationship between the settlor and the beneficiary and (c) the foundation would be subject to income tax in respect of any undistributed property.²²⁵

In principle Koele welcomed the planned implementation of a Dutch institution similar to the common-law discretionary trust (although she had some alternative suggestions), but pleaded that the legislature should introduce a uniform regime for all trusts, foundations

²²⁰ Sonneveldt Doctoral Thesis (2000) 248–254 (see also summary in English at 279–280).

²²¹ Moltmaker Report (2000) 37.

²²² Koppenol-Laforce and Sonneveldt (2001) *WPNR* 180.

²²³ Koele (2004) *WPNR* 339–342.

²²⁴ Moltmaker Report (2000) 37–39.

²²⁵ Moltmaker Report (2000) 38. See also Sonneveldt (2000) *WFR* 776, 778–779; Koppenol-Laforce and Sonneveldt (2001) *WPNR* 180–181 and Koele (2004) *WPNR* 336–337 for a summary of the proposal.

and other similar constructions. In respect of transfers to a discretionary trust (or foundation), she suggested that the regime should link up with the idea that the trust is only a conduit-pipe to the eventual beneficiaries. In terms of her proposal (a) the initial transfer of property would be taxable at a flat rate of seven percent, (b) any subsequent distribution to a beneficiary would be taxed as an inheritance or a gift from the settlor (the initial charge of seven percent would, however, be deductible against any inheritance tax or gift tax payable) and (c) any income accrued in the period between the initial transfer and the eventual distribution would be attributed to either the settlor or his heirs (in proportion to their shares under the deceased estate).²²⁶

9.6.3.3 The Introduction of a Regime for Afgezonderd Particulier Vermogen in 2010

On 1 January 2010 the legislature introduced a regime for *afgezonderd particulier vermogen* (APV). The new regime followed neither the proposition of the Moltmaker Report nor those of the other commentators referred to above. Its theoretical underpinning is instead based on the idea of transparency. The APV regime, which involved amendments to the Income Tax Act as well as the Inheritance and Gift Tax Act, basically looks through an APV and attributes the capital, income, debts and expenses to certain persons, as will be described more fully below.

An APV is basically defined as capital which has been secluded by a person for the intended benefit of other persons, other than for the issuing or creation of shares, membership rights, profit shares or any other similar vested rights in respect of the capital.²²⁷ Although this definition is clearly formulated to include (pure) discretionary trusts, Boer and Freudenthal point out that the regime does not apply to mixed trusts, meaning trusts with discretionary interests as well as fixed interests.²²⁸

²²⁶ Koele (2004) *WPNR* 342–344.

²²⁷ The concept is defined in Income Tax Act s 2.14(a).2. For further reading on the meaning and complexities of the definition, see Auerbach (2009) *WPNR* 497–499.

²²⁸ Boer and Freudenthal (2009) *WPNR* 509–510.



The regime operates as follows: where a person (hereafter “settlor”) transfers assets to an APV, the initial transfer will not be taxable under the Inheritance and Gift Tax Act. For income tax purposes, the property and its accompanying liabilities, accruals and losses will be attributed to the settlor (during his or her lifetime), unless a beneficiary acquires a vested life interest (to for example an annuity), in which case the income attributable to such an interest will be attributable to the beneficiary. On the death of the settlor, the trust property, accompanying liabilities, accruals and losses will be attributed to the settlor’s heirs (in proportion to their respective inheritances). Where an heir (or his or her partner or close relative) cannot, directly or indirectly, receive a benefit from such an entity (because he or she is, for example, not included in the list of beneficiaries under the APV), the assets and income will be attributed to the remaining heirs as if the first-mentioned heir was not inheriting from the settlor’s estate. Where the settlor, his or her partner or the heirs could not be ascertained, the assets will be attributed to the beneficiaries of the entity (in proportion to their interests). The income tax consequences as described above will, however, not be applicable in the case where the income is subject to business taxation of at least ten percent.²²⁹

For the purposes of the Inheritance and Gift Tax Act, the attribution of the property to the settlor’s heirs (or the trust beneficiaries) upon his or her death will be deemed to constitute an inheritance from the settlor for the purposes of the Act. An heir (or beneficiary) will therefore become liable for inheritance tax attributable to his or her pro-rata share in the property. Any other distributions from the entity will be deemed to be a gift from the person to whom the property (or a share therein) has been attributed according to the rules described above.²³⁰ For example, where an entity distributes property to a beneficiary during the lifetime of the settlor, the acquisition of the property will be taxed as a gift from the settlor to such beneficiary. Where an entity distributes

²²⁹ Income Tax Act of 2001 s 214a.

²³⁰ Ss 16, 17 and 26a (as amended by 31 930 A).

property to a beneficiary subsequent to the death of the settlor, the acquisition of the property will be taxed as a gift from the heirs (or trust beneficiaries) to such beneficiary.

9.6.3.4 A Storm of Criticism

The APV regime has evoked a storm of criticism. The main objection is directed at the transparency approach chosen by the legislature, instead of treating trusts as individual institutions in accordance with their special characteristics.²³¹ Critics point out that the approach may produce double taxation by taxing the property as an inheritance on the death of the settlor and again as a gift when the property is distributed.²³² They argue that it is simply unfair and unjust to attribute property to heirs of the settlor (on his or her death) irrespective of whether the heirs would indeed benefit from the trust, especially considering that a beneficiary (although provided for as a beneficiary) may not necessarily receive a benefit in future because of the discretion of the trustees.²³³ They also point out that the regime could be avoided by merely appointing institutions as heirs which are normally exempt from inheritance tax (such as ANBIs or even the State of the Netherlands).²³⁴ Another objection is that the Act does not provide principles for the way in which attribution should be accomplished.²³⁵

Over and above these difficulties, the question is posed why the Netherlands has chosen to implement a “transparency” regime which is totally different from the regimes operative in other international jurisdictions.²³⁶ Boer and Freudenthal conclude as follows:

²³¹ Auerbach (2009) *WPNR* 500; Boer and Freudenthal (2009) *WPNR* 511.

²³² Sonneveldt and De Kroon (2009) *WFR* 734–735; Auerbach (2009) *WPNR* 504.

²³³ Sonneveldt and De Kroon (2009) *WFR* 735; Auerbach (2009) *WPNR* 500–502.

²³⁴ Sonneveldt and De Kroon (2009) *WFR* 736; Auerbach (2009) *WPNR* 502.

²³⁵ Auerbach (2009) *WPNR* 502.

²³⁶ Auerbach (2009) *WPNR* 502.

“Waarom denkt de Nederlandse wetgever nu dat het beter is die oorspronkelijke kennis en ervaring weg te gooien, en daarvoor een fictieve transparantie in de plaats te stellen? Natuurlijk moet een heffing op entiteitsniveau worden ingepast in het (inter)nasionale belastingrecht, en natuurlijk is het heffingssysteem op entiteitsniveau niets zonder aanvullende (vestigingsplaats)ficties, maar de oplossing is altijd nog beter dan het thans voorgestelde systeem. Deze staat mijlenver af van de civielrechtelijke belevingswereld, en plaats Nederland op een eiland.”²³⁷

9.7 TREATMENT OF LIMITED INTERESTS AND BARE *DOMINIUM*

The discussion below explains and illustrates the treatment of limited interests and bare *dominium* under the current regime.

9.7.1 The Position of Bare *Dominium*

The transfer of bare *dominium* (whether *inter vivos* or on death) is immediately chargeable and not deferred until it materialises into full ownership. This position may sometimes conceal a passive transfer of wealth through passage of time, as will appear more fully from the example below:

Example 1

A bequeaths a lifelong usufruct in favour of his wife B over property worth €1 million and donates the bare *dominium* in the property to his son C. The value of the bare *dominium* in C's hands will be valued as the difference between the market value of the property and the value of the usufruct calculated with reference to B's life expectancy at that point in time (say, a value of €800 000). Assuming that the 2010 exemptions apply and that B is entitled to an exemption of €600 000, then B will be liable for gift tax on €200 000. C will only be liable for gift tax on €181 000 (€200 000 - €19 000). If B dies 10 years later at a time when the market value of the property is €1.5 million, then the accrual of the enjoyment of the property to C will not attract any inheritance tax.

²³⁷ Boer and Freudenthal (2009) *WPNR* 511.

From a theoretical point of view, the above position is justifiable, because the bare *dominium* owner paid either gift tax or consideration for the acquisition of the bare *dominium*. Such a person was deprived of the use and enjoyment of the property for the duration of the usufruct. However, it should be obvious that an owner may transfer property to another using the passage of time and exemption thresholds to complete the transfer at a minimal tax cost.

9.7.2 The Creation of Limited Interests

The transfer of a limited interest to another person constitutes a taxable transfer in the hands of such person, calculated over his or her the life expectancy (in the case of a lifelong interest) or a fixed period of time (where the interest is granted for a certain period only).²³⁸ What is significant to observe is that the tax consequences for the interest holder is exactly the same whether the interest is granted to him or her during the life of the owner of the property, or upon such person's death, as will more fully appear from the example below:

Example 2

- 2.1 A (male, age 74) bequeaths property worth €1 million to his grandson C subject to a lifelong usufruct in favour of his son B (male, age 45). Ignoring any exemptions and rebates, B will be liable for inheritance tax on the usufruct valued at €780 000 and C will be liable for inheritance tax on the value of the bare *dominium* (€220 000).
- 2.2 A (male, age 74) donates property worth €1 million to his grandson C subject to a lifelong usufruct in favour of his son B (male, age 45). Ignoring any exemptions and rebates, B will be liable for inheritance tax on the usufruct valued at €780 000 and C will be liable for inheritance tax on the value of the bare *dominium* (€220 000).

It is evident from examples 2.1 and 2.2 above that the “aged-donor” phenomenon (pointed out under the South African law)²³⁹ is not mirrored in the Dutch system, because

²³⁸ See pars 9.3.3 and 9.3.4.

²³⁹ See Ch 7 par 7.4.4.3.



the circumstances of the beneficiary determine the value of the usufruct as well as the value of the bare *dominium* (whether the transfer occurs *inter vivos* or on death).

Limited interests may also be granted successively. The example below illustrates the tax consequences:

Example 3:

A bequeaths property valued at €200 000 to his grandson D, subject to A's son B (age 53) having a lifelong usufruct over the property and A's daughter C (age 40), on B's death, being entitled to a successive usufruct on the property for the duration of her life. D will only become the full owner of the property on C's death (provided that C survives B). D will only once be liable for inheritance tax on the value of the bare *dominium* on A's death, which will be calculated in accordance with the appropriate factor established with reference to a person aged 35. The (joint life) usufruct will be valued at €168 000. D will therefore be liable for inheritance tax on €32 000 (less any exemptions). B will, however, only be liable for inheritance tax on the value of his usufruct calculated with reference to his own age, namely €144 000 (less any exemptions). When C becomes entitled to the enjoyment of the property on B's death, C will be liable for inheritance tax in respect of that (successive) usufruct calculated on the market value at that point in time with reference to her age at that date (less any exemptions).²⁴⁰

9.7.3 The Termination of Limited Interests

The lapse of a limited interest through expiration of time does not constitute a taxable event.

Where an interest holder renounces (even unilaterally) an interest, any gain “transferred” to the successor to the enjoyment of the property is specifically captured in the tax base. Where the enjoyment/fruits of the property accrues to the bare *dominium* owner, then he or she is liable for gift tax on the value of his or her “gain”, calculated with reference to the “unexpired” period of the interest, namely with reference to the life expectancy of the interest holder (at the moment of renunciation) or the unexpired period of time (in the case of a fixed period interest).

²⁴⁰ See Martens and Sonneveldt (2007) 166–167.

On the other hand, an interest that ceases as a result of death is not captured under the tax base, except in cases where the section 10 fiction applies, the operation of which is illustrated in example 5 below. The absence of tax consequences on death is theoretically acceptable if one considers that death, like termination through passage of time, is a natural cause of cessation of interests (unlike renunciation, which requires at least wilful conduct by the interest holder). However, any “benefit” acquired by the bare *dominium* owner on the unexpected death of the usufructuary falls outside the scope of the Act. Consider the following example:

Example 4

A bequeaths property worth €1 million to his grandson D subject to a lifelong usufruct in favour of A’s son B. B will be liable for inheritance tax on the value of the usufruct (calculated with reference to his or her life expectancy at that point in time), say €800 000 (less any exemptions). D will be liable for inheritance tax on the bare *dominium* of €200 000 (less any exemptions).

- 4.1 Where B renounces the usufruct after one year, D will be liable for gift tax on the value of the “unexpired period” of the interest, calculated over the life expectancy of B (on the moment of renunciation), say €750 000 (less any exemptions).
- 4.2 However, in the event where B dies after one year, D will not be responsible for any tax on the accrual of the right of enjoyment.

Example 4 illustrates that there is no neutrality between the case where D receives earlier possession under a renunciation and the case where D receives earlier possession because of death. This happens because it is virtually impossible to value a usufruct accurately upon the acquisition thereof because of the uncertainty of its natural period (even in the case of a fixed period usufruct which can also be terminated by an earlier death). In the absence of any specific provisions (other than the section 10 fiction explained below), a bare *dominium* owner may therefore passively “acquire” a benefit as a result of the death of the usufructuary, a benefit that will be greater the sooner the usufructuary dies.

9.7.4 The Section 10 Fiction – Usufruct & Bare *Dominium*

The example below illustrates a classic scenario for which the section 10 fiction was designed:

**Example 5**

A is the owner of land valued at €1 million. During his life, A transfers the bare *dominium* in the property to his son B for €50 000, retaining a lifelong usufruct in favour of himself. A dies two years later (when the property is valued at €1.2 million). In the absence of any special provisions, B will not be liable for any inheritance tax on the accrual to him of the right to enjoyment of the property on A's death.

The section 10 fiction deems the accrual of the right of enjoyment to B (in the example above) to be an inheritance by B from A of the *full* value of the property on A's death. A concession is granted by the provision that the value of the deemed inheritance may be reduced by any consideration paid by B for the initial acquisition of the bare *dominium* (plus interest at six percent).²⁴¹ Applied to the facts in example 5 above, the operation of section 10 will cause B to take an inheritance from A on A's death of €1 144 000 (€1.2 million - €50 000 - €6 000 (two years' interest at six percent)), less any exemptions.

Although section 10 is clearly designed to counter the exploitation of the legal position between related parties (note that the fiction is only applicable where the bare *dominium* owner is a partner or close relative of the deceased), its foundational justification seems questionable. Van Vijfeijken argues that the fiction is strictly speaking not in harmony with the underlying approach of a recipient-based tax, because the bare *dominium* owner either paid for the bare ownership or was liable for gift tax in respect of the acquisition thereof.²⁴² However, it was suggested in paragraph 9.7.1 above that, although this viewpoint is commendable from a theoretical point of view, it seems as if a transferor may, in the absence of some countering provisions such as provided for in section 10, be tempted to "transfer" property through passage of time, especially because the taxation of the bare *dominium* is not deferred until it materialises into full ownership and because the death of an interest holder is not otherwise accommodated under the ordinary rules.

²⁴¹ See par 9.2.3 par (e).

²⁴² Van Vijfeijken (2002) *WPNR* 179–180 and 185; Van Vijfeijken (2009) *WFR* 716–717.

Nevertheless, the question is whether the section 10 fiction (whether justifiable in theory or not) represents an appropriate and fair way to deal with the passive “transfer” of benefits to the bare *dominium* owner. It is herewith suggested that the fiction contains a number of inequities, a few of which are pointed out below:

- The fiction relates only to the partner or close relative of the deceased. This disturbs the horizontal equity between a case involving these relatives and all other cases, especially where a relative paid an arm’s length consideration for the bare *dominium*;
- The fiction is applicable only where the deceased retains for himself a *lifelong* limited interest. Where, for example, A retains for himself a (say) 40-year usufruct and donates the bare *dominium* to his son, and A survives the 40-year period, the lapse of the usufruct will not constitute a taxable event and section 10 will not be applicable on A’s death. Although one can in principle understand that, theoretically, the son paid adequate consideration for the bare *dominium*, the point is this: why should a lifelong interest be disadvantaged if compared to a fixed period interest (where it is possible to escape the claws of section 10)?
- The fiction is only applicable where the deceased retains for himself an interest during his lifetime, and not where the deceased “splits” the interests by granting an interest to another person (during his lifetime) and by transferring the bare *dominium* to his partner or close relative. The facts set out in example 1 will therefore not fall within the scope of section 10.

9.8 GENERAL ANTI-AVOIDANCE RULE

Apart from some specific anti-avoidance provisions, the Act does not provide for a general anti-avoidance measure.



9.9 INCOME TAX (CAPITAL GAINS TAX)

9.9.1 Income Tax (Capital Gains Tax) Consequences

Although the Dutch tax system does not provide for the levying of a capital gains tax as such, the Dutch Income Tax Act of 2001 provides for the levying of charges on three different categories of income (referred to as “boxes”), each with their own tariff. Box 1 is a progressive tax on wages, profits, social security benefits, owner occupied dwellings and pension benefits; Box 2 is a flat tax of 25 percent on income from a substantial business interest (in general a shareholding of at least five percent in a private company or partnership), such as dividends and (capital) gains realised on the realisation of such interest, and Box 3 is a flat tax of 30 percent on a fixed assumed yield of four percent on the total value of the taxpayer’s savings and investments (effectively taxed at 1.2 percent per year).

For income tax purposes an interest in a personal enterprise (a sole proprietorship or a partnership) is deemed to be transferred upon the death of the owner at its fair market value to the person who acquires such enterprise.²⁴³ The tax liability in respect of any taxable reserves will constitute a liability in the hands of the deceased taxpayer, which will form part of his or her deceased estate. In view of the fact that the heir of the business interest will in fact be burdened with the payment of the (Box 1) tax, the Income Tax Act provides that such person may take over the book value of the taxable reserves and thereby account for tax in respect thereof in the future.²⁴⁴

The transfer of a substantial business interest by virtue of an inheritance is also deemed to be a realisation event in the hands of the deceased for the purposes of (Box 2) income

²⁴³ Income Tax Act s 3.58; Martens and Sonneveldt (2007) 171.

²⁴⁴ Income Tax Act s 3.62; Martens and Sonneveldt (2007) 171.



tax.²⁴⁵ However, where the heir of the business interest is an individual resident of the Netherlands, the acquisition of the interest (if it occurred in a period of two years from the death of the transferor) will not be deemed to be a realisation event where the business constitutes an active enterprise.²⁴⁶ In that case the cost base of the deceased will be carried over to the heir.²⁴⁷

9.9.2 Interaction with Inheritance Tax

Although the liabilities for the (Boxes 1 and 2) income tax on death may be deferred (as explained above), the Inheritance and Gift Tax Act accounts for these future liabilities.²⁴⁸

In the case of a Box 1 deferred income tax liability, the Inheritance and Gift Tax Act (for the purposes of inheritance tax) allows the acquirer a deduction of 20 percent of the taxable reserves (30 percent of any pension reserves) and 20 percent of the goodwill against the value of the business interest comprised in the inheritance.²⁴⁹

In the case of a Box 2 deferred income tax liability (where the base cost is actually carried over to the heir) the Inheritance and Gift Tax Act (for the purposes of inheritance tax) allows the heir a deduction of 6,25 percent of the (capital) gain against the substantial business interest comprised in the inheritance.²⁵⁰

²⁴⁵ Income Tax Act s 4.16 (e). See in general Sonneveldt in Sonneveldt *ed* (2002) 43.

²⁴⁶ Income Tax Act s 4.17. See in general Sonneveldt in Sonneveldt *ed* (2002) 43.

²⁴⁷ Sonneveldt in Sonneveldt *ed* (2002) 43.

²⁴⁸ See Dijkstra (2008) *WPNR* 447–449 for a comprehensive summary.

²⁴⁹ S 20.5 and 20.6; Martens and Sonneveldt (2007) 171.

²⁵⁰ S 20.5 and 20.6. See in general Sonneveldt in Sonneveldt *ed* (2002) 43.



9.10 CONCLUSIONS

- (a) In the Netherlands the taxation of wealth transfers is currently accommodated in a single statute under the Inheritance and Gift Tax Act.²⁵¹
- (b) The Act nonetheless levies separate taxes on “gifts” and “inheritances” (respectively referred to as “gift tax” and “inheritance tax”) in terms of separate charging provisions,²⁵² because the Act is based on nineteenth-century legislation where these taxes developed as two separate taxes at different points in time.²⁵³ To broaden the tax base for the purposes of both taxes, the Act contains a number of fictitious acquisitions.²⁵⁴
- (c) Despite the separate charging provisions, the rules pertaining to the jurisdictional basis, rate structures and the ordinary valuation rules (as discussed in paragraph 9.3) apply equally to *inter vivos* transfers and transfers on death.²⁵⁵ What seems to disturb horizontal equity, however, is that a number of double taxation agreements cover transfers on death only. This position appears to be unwarranted if one considers that the unilateral relief provisions (which are applicable only in the absence of a double taxation agreement with a particular country) apply to both *inter vivos* transfers and transfers on death.²⁵⁶

²⁵¹ See par 9.1.1 n 10 and accompanying text.

²⁵² See pars 9.2.1 and 9.2.2.

²⁵³ See par 9.1.1.

²⁵⁴ See par 9.2.3.

²⁵⁵ See pars 9.2.4, 9.1.2 and 9.3.

²⁵⁶ See par 9.2.5.

- (d) The preferential valuation regimes for qualified country estates and business property apply to both gifts and inheritances, except that the minimum-ownership requirement for the purposes of the business relief differs depending on whether the business is transferred by way of a gift (in which case a period of five years is required) or by way of an inheritance (in which case a period of only one year is required), arguably because death is usually an unplanned event, whereas a gift requires an intentional act.²⁵⁷
- (e) In the area of exemptions, the legislature distinguishes between exemptions applicable to gifts (in section 32) and exemptions applicable to inheritances (in section 33). In some cases, an exemption offered for a gift is also correspondingly offered for an inheritance. For example, an exemption is offered for a gift or inheritance acquired (or, in the event of a gift, sometimes made by) the state, a province, a municipality, an ANBI and an SBBI. In other cases, the exemptions differ. Although the differences are usually justifiable or at least explainable because of the difference in circumstances between a transfer that occurs during life and a transfer that occurs on death, there seem to be a few minor instances where the differentiation seems incomprehensible. For example, a gift acquired from the Queen or members of the Royal Family is exempt from gift tax, but an inheritance acquired from one of these persons is not correspondingly exempt from inheritance tax.²⁵⁸
- (f) Although the Act stems from early nineteenth-century transferor-based legislation,²⁵⁹ it resembles a typical example of a classical recipient-based

²⁵⁷ See par 9.5.2.

²⁵⁸ See par 9.5.3.

²⁵⁹ See par 9.1.1.

tax, where the relationship between the transferor and the recipient is significant in the calculation of the tax and where acquisitions are generally taxed on an individual basis as and when they accrue. However, the system contains some transferor-based elements, such as the section 10 fiction²⁶⁰ and the connection with the transferor in establishing the jurisdictional basis of the tax.²⁶¹ The paragraphs below will highlight some characteristics and problem areas (similar to the areas identified under the South African wealth transfer tax system in Chapter 7).²⁶²

- (g) It is evident that the Dutch system experiences difficulties in demarcating the jurisdictional basis. As a consequence of the repeal of transfer tax (which embodied *situs*-based taxation in respect of non-residents), the Dutch wealth transfer tax base is now restricted to a worldwide basis for residents only.²⁶³ It remains to be seen whether Dutch property owned by non-residents is going to escape Dutch wealth transfer taxation indefinitely, especially if one considers that *situs*-based taxation for non-residents is commonly followed in international wealth transfer tax systems and that double taxation agreements often allocate the primary taxing rights to the contracting state in which the taxable property is located.
- (h) Scholars have pointed out that, from a theoretical perspective, the jurisdictional basis should actually be established with reference to the status of the beneficiary, being the taxpayer. It was, however, explained that most jurisdictions (globally speaking) levy wealth transfer taxation

²⁶⁰ See par 9.2.3(e).

²⁶¹ See par 9.2.4.1.

²⁶² See Ch 7 par 7.4.

²⁶³ See pars 9.1.1 and 9.2.4.

with reference to the status of the transferor. In addition, the 1982 OECD model convention allocates higher preference to a contracting state levying taxation linked to the status of the transferor (than a state levying taxation with reference to the status of the beneficiary).²⁶⁴

- (i) The Dutch system provides an example of a system where the characteristics required for a taxable gift include (a) an intention of generosity on the part of the donor (*oogmerk van liberaliteit*), (b) the impoverishment of the donor and (c) the enrichment of the donee. This approach ensures that ordinary expenditures and *bona fide* business transactions fall outside the scope of the Act, although it would appear that the requirement of intention (which is sometimes difficult to establish) may create difficulties for the taxing authorities.²⁶⁵
- (j) Because life insurance benefits payable to third parties do not pass through the deceased estate of the insured, the Act includes the acquisition of life insurance benefits by a third party in the tax base through a fictitious acquisition. Prior to 1 January 2010, the benefits were taxed in full where the deceased contributed “something” to the policy. A deduction was, however, offered for all the premiums paid by the beneficiary. Since 1 January 2010, benefits are only taxable “to the extent” that the deceased contributed to the policy, which means that policy benefits are only taxable to the extent that they were funded by the deceased. This approach ensures that key-man policies, policies affected in terms of buy and sell arrangements and the half-share of a person who was married with the deceased are sheltered from the tax base.²⁶⁶

²⁶⁴ See par 9.2.4.1.

²⁶⁵ See par 9.2.1.

²⁶⁶ See par 9.2.3(i)(a).



- (k) Taxable acquisitions are not restricted to benefits which can be immediately enjoyed. The transfer of bare *dominium* property is therefore not deferred until it materialises into full ownership.²⁶⁷
- (l) It was shown that this position may be exploited to conceal a passive transfer through passage of time, especially because the system does not include (except for the section 10 fiction) a passive “transfer” of benefits on the death of an interest holder.²⁶⁸
- (m) Because the Act operates on a recipient basis, the “aged donor” phenomenon, illustrated under the South African system, does not pose a tax avoidance opportunity under the Dutch regime.²⁶⁹
- (n) The termination of a limited interest on the death of an interest holder resembles a problem area under the Act. An indirect “transfer” of wealth on the death of an interest holder is not captured in the tax base. As a result, there is no neutrality between a “transfer” of the unexpired period of enjoyment on a renunciation (which is included in the tax base) and a “transfer” of the unexpired period of enjoyment on the death of the interest holder (which is not included in the tax base).²⁷⁰ Although the inclusion of a “transfer” on the death of an interest holder is debatable, the nub of the problem is that it is virtually impossible to accurately value a limited interest upon acquisition because its period of enjoyment is uncertain. Even a fixed period interest may be terminated before natural expiration as a consequence of renunciation or death. Nevertheless, and leaving aside

²⁶⁷ See par 9.7.1.

²⁶⁸ See par 9.7.1.

²⁶⁹ See par 9.7.2.

²⁷⁰ See par 9.7.3.



the issue of whether a passive “transfer” occurs on death, it was shown that the absence of tax consequences on death creates some opportunities for tax avoidance through the use of artificial actuarial values, in the absence of any special provisions. The inclusion of the section 10 fiction was an attempt by the legislature to counter the most obvious avoidance scheme where the owner of property would be tempted to transfer the bare *dominium* in the property to a future heir during the owner’s life, retaining a usufruct in favour of him- or herself. In the absence of any special provisions, the death of the owner would carry no inheritance tax consequences. For years this fiction was relatively easy to circumvent. Although some of these avoidance schemes were closed down with the amendments effected in 2010, it seems as though the scope of the fiction (as amended) may still be by-passed. In addition, it is arguable that the limited scope of the fiction raises equity concerns. The fiction could therefore, in theory, operate quite unfairly.²⁷¹ It seems as if the Dutch system is struggling to find a balance between, on the one hand, acknowledging that death (being a natural cause for the cessation of a limited interest) does not truly reflect an event where benefits are transferred to another, and on the other hand, recognising the possibility of exploitation.

- (o) The use of an interest-free demand loan has also created a tax avoidance loophole in the Dutch system. It is submitted that the provision introduced in the Act with effect from 1 January 2010 by deeming the absence of market-related interest to be a gift to the debtor by the creditor of a usufruct over the money on a daily basis, seems to present a relatively easy and simple method to counter this estate-freezing technique.²⁷²

²⁷¹ See par 9.7.4.

²⁷² See par 9.2.3(1).



- (p) The treatment of transfers to and from a common-law trust has posed some of the most challenging issues for the Dutch system, especially in the realm of discretionary trusts. Moreover, the income derived from trust property escaped the Dutch income tax net (prior to the amendments introduced on 1 January 2010). As a consequence, a number of scholars and the Moltmaker Commission called for legislative intervention and a few proposals were put on the table. The central idea was that a trust should be personified for the purposes of inheritance/gift tax and income tax. However, the legislature introduced a regime for *afgezonderd particulier vermogen* (APV) on 1 January 2010, which was a far cry from the proposals put forward. The basic theoretical underpinning of the regime is that the existence of a discretionary trust is totally disregarded (for the purposes of inheritance and gift tax as well as income tax). The trust property, income, accruals and expenses of the trust are in general attributed to either the settlor (during his or her life) or the settlor's heirs (after his or her death). Any distribution from the trust is treated as a transfer from the settlor (or his or her heirs) to the beneficiary. It was pointed out that the APV regime has elicited a storm of criticism among Dutch scholars, the main point of criticism being that the regime is foreign to the international trend of personifying trusts for the purposes of taxation.²⁷³
- (q) The Act provides relief for business property (the definition of which may include agricultural property) in the form of a substantial remittance of the tax liability. Some commentators have expressed their concern that the relief increases horizontal inequity towards non-business assets and should

²⁷³ See par 9.6.



rather be limited to businesses where the tax liability endangers the continuation of the operations.²⁷⁴

- (r) Although the main apparent disadvantage of a recipient-based tax is administrative difficulties (because of the larger number of taxpayers), it would seem that the Dutch system does not experience any particular problems in this area, arguably because taxpayers are themselves obliged to disclose the acquisition of all inheritances and gifts to the taxing authorities. Also, heirs (or the executor on behalf of the heirs) may submit a joint tax return, which simplifies the system to a certain extent.²⁷⁵

The next chapter will review wealth transfer taxation in Ireland.

²⁷⁴ See par 9.5.2.1.

²⁷⁵ See par 9.4.



CHAPTER 10

WEALTH TRANSFER TAXATION IN IRELAND

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10.1 HISTORICAL ORIENTATION AND INTRODUCTION

10.1.1 Historical Development

The British estate duty, which was adopted in Ireland upon its foundation as a state in 1922, was replaced by a recipient-based capital acquisition tax (hereafter “CAT”) in 1975. When CAT was enacted, Ireland became the first common-law legal system to



impose a recipient-based wealth transfer tax.¹ As already pointed out earlier, when the O’Brien Committee reviewed the direct tax system of Ireland in 1982, the existing framework for CAT was endorsed.²

The provisions of the Capital Acquisitions Tax Act of 1976 and the amending provisions of the subsequent annual Finance Acts were consolidated with the enactment of the Capital Acquisitions Consolidation Act of 2003 (hereafter “CATCA” or “the Act”),³ which is (as amended by the annual Finance Acts) currently still in force. A short-lived probate tax, which levied a duty of 2 percent on a deceased estate and which was introduced in 1993, was abolished in respect of deaths occurring on or after 6 December 2000.⁴

10.1.2 Broad Overview of CAT

CAT comprises three taxes, namely an inheritance tax, a gift tax and a discretionary trust tax. The two principal taxes, namely inheritance tax and gift tax, are imposed on the taxable value of all taxable gifts and taxable inheritances acquired by individuals. In general, the taxable value is determined by deducting from the “incumbrance-free value”⁵ costs and expenses allowable by the Act and any *bona fide* consideration (in money or money’s worth) paid for the benefit by the beneficiary.

The Act provides for a broad spectrum of relief and exemptions, some of which depend on the relationship between the transferor and the beneficiary. To calculate the amount of CAT due on a taxable acquisition (an inheritance or a gift), one also needs to take the

¹ See Ch 3 par 3.2.3. See also Bohan and McCarthy (2008) par 1.05.

² See Ch 3 par 3.2.3.

³ Act 1 of 2003.

⁴ Doyle (2008) par 1.2.4.

⁵ The “incumbrance-free value” of property is the market value of property less relevant liabilities.

relevant group threshold into account. Each beneficiary is entitled to three exempt lifetime thresholds, depending on the relationship between the disponent⁶ and the beneficiary.⁷ All lifetime gifts and inheritances taken by a beneficiary, which fall within the same group threshold, are aggregated for the purposes of ascertaining whether or not a tax-free threshold has been exceeded. The thresholds are indexed every year on 1 January by an indexation factor calculated by reference to the Consumer Price Index.⁸ Inheritance tax and gift tax are then charged at a current flat rate of 25 percent⁹ on the amount of the taxable gift or taxable inheritance that exceeds the relevant tax-free group threshold. Other Irish taxes, which arise in respect of the same property on the same event, such as capital gains tax or stamp duty, as well as foreign inheritance taxes, may in certain instances be allowed as a credit against any CAT payable.¹⁰

The three group (lifetime) thresholds are:

- (a) Group A (currently determined at €434 000), which applies:
- in respect of a gift or an inheritance, where the beneficiary is the child of the disponent;
 - in respect of a gift or an inheritance, where the beneficiary is a nephew or niece of the disponent and has worked substantially on a full-time basis for a period of five years, in general, in the business or profession of the disponent and the gift or inheritance consists of property which was used in connection with such business or profession;¹¹

⁶ A “disponent” is a term used in Irish law to describe the transferor.

⁷ Where a beneficiary is, at the date of the gift or inheritance, the surviving spouse of a deceased person who was, at the time of his or her death, of nearer relationship to the disponent than the beneficiary, then the beneficiary is deemed to bear the same relationship to the disponent that his or her deceased spouse had. See sch 2 prt 1 par 6. See in general Bohan and McCarthy (2008) par 8.13 and Doyle (2008) 837 example 34.6.

⁸ Bohan and McCarthy (2008) par 12.36.

⁹ The rate has been increased from 22% with effect from 8 April 2009.

¹⁰ Ss 104–107. See in general Bohan and McCarthy (2008) par 5.26.

¹¹ Sch 2 prt 1 par 7 (the nephew or niece will be regarded as a child of the disponent). See in general Bohan and McCarthy (2008) pars 8.02–8.12 and Doyle (2008) 837 example 34.5.



- in respect of a gift or an inheritance, where the beneficiary is a minor child¹² of a predeceased child of the donor;¹³
 - in respect of an inheritance, where the successor is the parent of the donor and the interest taken does not constitute a limited interest;¹⁴
 - in respect of a gift or an inheritance, where the beneficiary is a foster-child of the donor, subject to certain conditions;¹⁵
- (b) Group B (currently determined at €43 400), which applies:
- In respect of a gift or an inheritance, where the beneficiary is a lineal ancestor, lineal descendant (other than a child), brother, sister or brother's or sister's child of the donor; and
- (c) Group C (currently determined at €21 700), which applies to all other cases.¹⁶

In view of the different exemptions applicable to the various group thresholds, a donor may arrange for a gift to reach a person through the use of two or more connected gifts, by taking advantage of the other higher group thresholds.¹⁷ This avoidance technique (the so-called “gift-splitting”) is countered by the Act, which provides that where a donee takes a gift under a disposition made by a donor (the “original donor”) and, within the period commencing three years before and ending three years after the date of that gift, the donee makes a disposition under which a second donee takes a gift and whether or not the second donee makes a disposition within the same period under which a third

¹² In terms of the Age of Majority Act 1985, a minor child is a child who is under 18 years of age. See Bohan and McCarthy (2008) par 8.14.

¹³ Sch 2 prt par 1. See in general Bohan and McCarthy (2008) par 8.14.

¹⁴ Sch 2 prt 1 par 1(a)(ii). See in general Bohan and McCarthy (2008) par 8.16.

¹⁵ Sch 2 prt 1 par 9. See in general Bohan and McCarthy (2008) par 8.17.

¹⁶ Sch 2. See Bohan and McCarthy (2008) Ch 12 and Doyle (2008) 836–837 for a comprehensive discussion on the computation of CAT.

¹⁷ For example, if a father (A) intends to donate an amount of €200 000 to his daughter-in-law (C), the gift would be subject to the exemption applicable to Group C (for strangers). However, if A donates the amount to his son (B), whereafter B donates the sum to his wife (the daughter-in-law of A), then the gift between the father (A) and his son (B) would be subject to the Group A threshold, and the subsequent gift between the son (B) and his wife (C), would be exempt from CAT. See Bohan and McCarthy (2008) par 20.1.

donee takes a gift, and so on, each donee is deemed to have taken a gift from the original donor.¹⁸ However, this provision will not apply if the first gift was not made with a view to enabling or facilitating the second gift.¹⁹

Because a beneficiary is not deemed to become beneficially entitled to assets held in trust by the trustees of a discretionary trust until a disposal is made from the trust, a discretionary trust tax, which was introduced in 1984, is imposed on certain discretionary trusts. Discretionary trust tax, which will be discussed more fully in paragraph 10.6 below, comprises an initial charge on the transfer of property to a discretionary trust, as well as an annual levy until all the property has been appointed to the beneficiaries. The DTT regime was therefore introduced to discourage persons from transferring assets to a discretionary trust to postpone CAT.²⁰

10.2 TAX BASE

10.2.1 Taxable Transfers

A beneficiary (the “successor”²¹ or “donee”²²) is deemed to take an inheritance or a gift where, under or in consequence of any disposition, he or she becomes beneficially entitled in possession to any benefit, otherwise than for full consideration in money or money’s worth.^{23 24} An inheritance is taken “on a death”, namely where benefits are taken

¹⁸ S 8(1). See Bohan and McCarthy (2008) pars 20.01–20.02 for some examples.

¹⁹ S 8(2); Bohan and McCarthy (2008) par 20.03.

²⁰ Bohan and McCarthy (2008) par 10.03.

²¹ The person taking the inheritance is referred to as the successor (s 2(1) “successor”).

²² The person taking the gift is referred to as the donee (s 2(1) “donee”).

²³ See in general Bohan and McCarthy (2008) pars 4.07–4.11 for a discussion on the meaning of “full consideration in money or money’s worth”.

²⁴ Ss 5 (gift) and 10 (inheritance).

under dispositions ascertainable by reference to the death of a person, for example a benefit taken under a testamentary disposition or a *donatio mortis causa*.²⁵ The term does not involve only the death of the disponent. For example, where A donates property to B, subject to the proviso that the property should devolve upon C on the death of B (a *fideicommissum*), then C takes an inheritance from A on the death of B. This is the case even where A may still be living when C becomes entitled to the property on the death of B.²⁶ A gift, on the other hand, is taken “otherwise than on a death”,²⁷ except where the gift was made within two years prior to the death of the disponent, in which case the benefit taken would be regarded as an inheritance.²⁸ Although it was quite relevant to distinguish between an inheritance and a gift prior to December 1999, when gifts were taxed at 75 percent of the primary tax rate, the distinction has become less significant. However, it is still relevant for the purposes of the application of certain exemptions, the jurisdictional basis and the determination of the date of liability and date of valuation, as will appear more fully from the discussion below.

A beneficiary becomes beneficially “entitled in possession” to property only on acquiring a present right to the enjoyment of the property, as opposed to acquiring a future right in respect thereof.²⁹ If A, for example, bequeaths his property to his son C, subject to a life interest in favour of his spouse B, then B will take an inheritance from A on his death (valued as a limited interest),³⁰ whereas C will take an inheritance (of the full value of the property) from A only on the death of the life tenant B. C’s interest is referred to as a “reversionary interest”.

²⁵ S 10. See ss 3(1)(a)–(d) and 3(2)(a)–(d) for the meaning of the term “on a death”. See in general Bohan and McCarthy (2008) pars 2.71–2.73 for a comprehensive discussion.

²⁶ Doyle (2008) 833 example 34.1.

²⁷ S 5.

²⁸ S 3(1)(c). Accordingly, where an individual dies within two years of making a gift, the property transferred constitutes an inheritance. See Bohan and McCarthy (2008) par 2.72 for a general discussion.

²⁹ S 2(1) “entitled in possession”. See in general Bohan and McCarthy (2008) par 4.01.

³⁰ See par 10.3.5.



The term “disposition” includes a long list of specific matters listed from paragraph (a) to (n).³¹ Paragraph (a) includes any act or omission by a person as a result of which the value of that person’s estate immediately after the act or omission is less than would be but for the act or omission. Although this paragraph requires only a loss to the disponent,³² it should be noted that it is the value of the increase in the recipient’s estate that is subject to CAT. A disposition in terms of this paragraph therefore presupposes the impoverishment of the disponent as well as the enrichment of the recipient. It is, however, not necessary that the decrease in the disponent’s estate be equal to the increase in the recipient’s estate.³³ For the purposes of this paragraph, an example of an “omission” would be the failure to defend an action.³⁴ Although the failure to take up a valuable right would not be included in this paragraph (because it does not diminish an estate, but merely prevents an increase), paragraph (h) specifically deems the failure to exercise a right, as well as the release, forfeiture, surrender or abandonment of any debt or benefit, to be a disposition (without requiring impoverishment).³⁵ A typical example of a failure taxable within the ambit of this paragraph is the failure to demand payment of an outstanding debt or the failure to exercise an option.³⁶ According to Bohan and McCarthy, the failure to sue for damages could apparently also be covered by this paragraph.³⁷ In addition, the following events are included as dispositions for the purposes of the Act, namely:

³¹ S 2(1) “disposition”.

³² Bohan and McCarthy (2008) par 2.32.

³³ Bohan and McCarthy (2008) par 2.32.

³⁴ Bohan and McCarthy (2008) par 2.32.

³⁵ Apparently, the failure to exercise a right would be a disposition even if it arises inadvertently. An example of this would be the failure to take up a rights issue in a company (which would confer a benefit on the other shareholders). See Bohan and McCarthy (2008) par 2.44.

³⁶ Bohan and McCarthy (2008) par 2.44.

³⁷ Bohan and McCarthy (2008) par 2.44.



- any trust, covenant,³⁸ agreement³⁹ or arrangement,⁴⁰ whether made by a single operation⁴¹ or by associated operations⁴² (paragraph b);⁴³
- the creation of a debt or other right enforceable against the disponent personally or against any estate or interest that the disponent may have in property (paragraph c);⁴⁴
- the payment of money (paragraph d);⁴⁵
- the allotment of shares in a company (paragraph e);⁴⁶
- the grant or creation of any benefit (paragraph f);⁴⁷

³⁸ A covenant is an undertaking to transfer money or money's worth in terms of a deed of covenant. See Bohan and McCarthy (2008) par 2.33.

³⁹ An agreement is simply the coming together of two or more minds. See Bohan and McCarthy (2008) par 2.34.

⁴⁰ An arrangement is apparently something less than an agreement and can be the result of one person's unilateral actions. It is a form of an unenforceable right, which is unenforceable due to a technical or legal deficiency, e.g. a lack of compliance to formalities. See Bohan and McCarthy (2008) par 2.34.

⁴¹ An operation includes virtually any act that an individual can carry out. However, it does not include (a) an omission, (b) a death, (c) a birth, (d) the vesting of an interest and (e) the happening of a contingency, unless the contingency is dependent on a positive action by the beneficiary, e.g. a marriage. See Bohan and McCarthy (2008) par 2.35.

⁴² The reference to "associated operations" was adopted from the UK wealth transfer tax legislation to act as a mechanism to counter tax avoidance schemes. See Ch 8 par 8.2.1 and Bohan and McCarthy (2008) 2.36–2.38 for further discussion on the position in the UK law. Unlike the position in the UK, the term is not defined in the Act.

⁴³ See in general Bohan and McCarthy (2008) pars 2.33–2.38.

⁴⁴ This includes any agreement to pay a sum of money. See in general Bohan and McCarthy (2008) par 2.39.

⁴⁵ See in general Bohan and McCarthy (2008) par 2.40.

⁴⁶ The existing shareholders would be the disponents and the new shareholders would be the donees or successors. The formal issue of the shares (subsequent to the allotment thereof) would not qualify as a disposition. See in general Bohan and McCarthy (2008) par 2.41.

⁴⁷ This description is very wide and would cover almost all other matters in relation to property which have not been covered by the definition of a disposition. See in general Bohan and McCarthy (2008) par 2.42.



- the grant or the creation of any lease, mortgage, charge, licence, option, power, partnership or joint tenancy or other estate or interest in or over any property (paragraph g);⁴⁸
- the exercise of a “general power of appointment”⁴⁹ in favour of any person other than the holder of the power (paragraph i);⁵⁰
- a *donatio mortis causa* (paragraph j);⁵¹
- a will or other testamentary disposition (paragraph k);⁵²
- an intestacy, whether total or partial (paragraph i);⁵³
- the payment of a share as a legal right under pt IX of the Succession Act 1965 (paragraph m);⁵⁴ and
- a resolution passed by a company (paragraph n).⁵⁵

⁴⁸ See in general Bohan and McCarthy (2008) par 2.43.

⁴⁹ A “general power of appointment includes every power, right, or authority whether exercisable only by will or otherwise which would enable the holder of such power, right, or authority to appoint or dispose of property to whoever the holder thinks fit or to obtain such power, right or authority, but exclusive of any power exercisable solely in a fiduciary capacity under a disposition made by the holder, or exercisable by a tenant for life under the Settled Land Act 1882, or as mortgagee” (s 2(1) “general power of appointment”).

⁵⁰ See in general Bohan and McCarthy (2008) pars 4.46–4.52.

⁵¹ A *donatio mortis causa* is a gift made in contemplation of death. The gift is reversible and cannot be taken until death. It is therefore an inheritance under the Act (not a gift). The following conditions must be satisfied: (a) the gift must be made in expectation of death, (b) the property must comprise personal movable property (it must be capable of passing by delivery), (c) there must be a delivery (either actual or constructive) of the property to the donee and possession must be transferred at the time of the gift. If the property is too difficult to deliver, a symbol of dominion may be an effective delivery (for example a key to a box), (d) the gift must be conditional on the donor’s death and must be returned if the donor recovers. See in general Bohan and McCarthy (2008) par 2.50.

⁵² See in general Bohan and McCarthy (2008) par 2.51.

⁵³ See in general Bohan and McCarthy (2008) par 2.52.

⁵⁴ See in general Bohan and McCarthy (2008) par 2.53.

⁵⁵ Bohan and McCarthy (2008) par 2.54 point out that this is an anti-avoidance provision. If a resolution is passed by a company whereby the value of one shareholder’s shares is increased at the expense of another shareholder, the resolution will qualify as a disposition if the last-mentioned shareholder could have prevented it by voting against it or exercising any right to block the resolution.



It is specifically provided that a disclaimer (a repudiation) of a benefit under a will or intestacy is not a disposition for the purposes of the Act.⁵⁶ The exclusion does, however, not extend to a post-death redistribution agreement and there could therefore be a charge to CAT.⁵⁷

In the case of a disposition by virtue of a gift, the intention to donate need not be present.⁵⁸ A bad bargain in a commercial context could therefore be subject to CAT. Bohan and McCarthy mention that it is unfortunate that CATCA does not contain a provision exempting transactions entered into at arm's length from the scope of the tax, such as is provided for under the United Kingdom inheritance tax legislation.⁵⁹

Where a person is allowed to have the use, occupation or enjoyment of any property (to which that person is not beneficially entitled in possession) otherwise than for full consideration in money or money's worth, then that person is deemed to take an annual gift or inheritance of such free use in the property.⁶⁰ The annual value that will be subject to CAT is "the best price obtainable in the open market for such [annual] use, occupation or enjoyment".⁶¹ This provision would apply to, for example, interest-free loans and the use of a dwelling free of rent (or at a rent less than the market value).⁶²

⁵⁶ S 12(2). See Hourican (2002) *Conv Prop Law J 17 et seq*; Bohan and McCarthy (2008) pars 4.19–4.34 and Gallagher (2007) *Irish Tax Rev 78 et seq* for a discussion of the various disclaimers and their legal and tax effects.

⁵⁷ See O'Hanlon (2004) *Irish Tax Rev 311 et seq*.

⁵⁸ Bohan and McCarthy (2008) pars 4.01 and 4.10.

⁵⁹ Bohan and McCarthy (2008) par 4.10. See Ch 8 par 8.2.1 for a reference to the exclusion of commercial transactions from the UK inheritance tax.

⁶⁰ S 40(2).

⁶¹ S 40(3).

⁶² Bohan and McCarthy (2008) par 7.03.



Life insurance policies⁶³ payable to a deceased estate will devolve upon an heir under a testamentary (or intestate) disposition (because it will form part of the “free estate”).⁶⁴ If, however, a beneficiary was nominated under an insurance policy, the proceeds will not form part of the free estate, but the beneficiary will be liable for CAT under the nomination, which also constitutes a disposition.⁶⁵ If the benefits were acquired for inadequate consideration, the policy benefits will be subject to CAT in the hands of the beneficiary.⁶⁶ The Act contains a special provision that an interest in a policy of assurance on human life is only deemed to become an interest in possession when the policy either matures or is surrendered to the insurer for consideration in money or money’s worth.⁶⁷ If, during the currency of the policy, the insurer makes a payment of money or money’s worth, in full or partial discharge of the policy, the interest is deemed to have come into possession to the extent of such payment.⁶⁸ The purpose of the section is to postpone a charge to CAT, which could otherwise arise, until such time as a value is derived from the policy.⁶⁹ However, Bohan and McCarthy point out that the Act does not deal with the instance where value is derived prior to maturity or where a policy has been sold to a third party, which can give rise to anomalies. Suppose, for example, that A gives a lump sum life insurance product valued at €1 million to his son B, who immediately sells his right to C for €900 000. B has therefore become entitled to a benefit of €900 000 provided to him by his father without having an immediate liability to CAT.⁷⁰

⁶³ See Bohan and McCarthy (2008) pars 18.70–18.74 for a discussion on the various contracts of assurance. The section refers to both Irish and foreign contracts of assurance (par 18.72).

⁶⁴ See par 10.2.4 for the meaning of “free estate”.

⁶⁵ Bohan and McCarthy (2008) par 4.35.

⁶⁶ See par 10.5.2 for an explanation on the effect of any consideration paid in respect of life policy benefits.

⁶⁷ S 41(a) and (b).

⁶⁸ S 41(b).

⁶⁹ Bohan and McCarthy (2008) par 18.56.

⁷⁰ Bohan and McCarthy (2008) par 18.57.

In view of the fact that the application of inheritance tax and gift tax is restricted to individuals only, the Act provides that any consideration paid by, or disposition made by, a private company is deemed to be consideration, or a disposition, paid or made by the beneficial owners of the shares in the company and the beneficial owners of the entitlements under any liability incurred by the company (hereafter referred to as the “beneficial owners”), otherwise than wholly and exclusively for the business of the company,⁷¹ in the same proportions that the value of their beneficial interests in the shares and entitlements bear to each other.⁷² It is furthermore provided that any consideration, or a gift, or an inheritance taken by a private company is deemed to be consideration, or a gift, or an inheritance taken by the beneficial owners of the company, proportionally in relation to the value of their interests or entitlements in the company.⁷³

To cater for value-shifting arrangements, it is provided that where a person (the disponer) has an absolute interest in possession in shares in a private company and any arrangement results in a decrease in the market value of those shares, the beneficial owners of the “related shares”, namely the shares the market value of which had been increased as a result of the arrangement,⁷⁴ would be taking a gift or inheritance from the disponer in proportion to their shareholdings.⁷⁵ A charge to CAT arises in respect of the difference between the market value of the disponer’s shares immediately before and after the arrangement was made.⁷⁶

⁷¹ Bohan and McCarthy (2008) par 20.11 mention that business creditors would therefore in general fall outside the scope of this provision.

⁷² S 43(2)(a).

⁷³ S 43(2)(b).

⁷⁴ S 44(1) “related shares”.

⁷⁵ S 44(3). See in general Bohan and McCarthy (2008) pars 20.18–20.19 for examples. It is furthermore provided that, if the related shares are held in a discretionary trust (with no beneficial owners in possession), the disponer of that trust (settlor) would be regarded as having taken a benefit (s 44(3)(ii)).

⁷⁶ S 44(1) “specified amount”.



10.2.2 Jurisdictional Basis

10.2.2.1 Residency

When originally enacted, a charge to CAT was primarily based on the domicile of the donor (only).⁷⁷ This corresponded with the position of the United Kingdom inheritance tax.⁷⁸ However, in 1999 the basis of charge was changed to provide that an inheritance or gift (other than a gift taken under a discretionary trust⁷⁹) will in principle be taxable where either the donor, the donee or the successor (not being a successor in relation to the discretionary trust tax charges) is resident⁸⁰ or ordinarily resident⁸¹ in the state at the date of the disposition (in the case of a donor) or date of gift (in the case of a donee) or date of inheritance (in the case of a successor).⁸² The extension of the connection to the status of the beneficiaries (i.e. successors and donees) was not received without criticism. Some

⁷⁷ Bohan and McCarthy (2008) pars 1.02 and 3.02. See also pars 3.23–3.45 for a comprehensive discussion on the meaning of domicile.

⁷⁸ See Ch 8 par 8.2.3.1.

⁷⁹ See par 10.6.3.3 n 203.

⁸⁰ In general, a person will be regarded as an Irish resident if he or she was present in the state (a) at any one time or several times in a year of assessment for a period in the whole year amounting to 183 days or more, or (b) at any one or several times in a year of assessment and in the preceding year of assessment for an aggregate period during the two years amounting to 280 days or more (Taxes Consolidation Act 39 of 1997 ss 818–825). See in general Bohan and McCarthy (2008) par 3.20 and Doyle (2008) 266–267 for further discussion.

⁸¹ In general, a person will be regarded as ordinarily resident in Ireland if he or she has been resident in the state for the previous three years of assessment. Such a person will continue to be ordinarily resident in Ireland until he or she is not resident for three continuous years of assessment. See in general Bohan and McCarthy (2008) par 3.21 and Doyle (2008) 267–268 for further discussion.

⁸² Ss 6(2)(a) and (c), 11(2)(a) and (b). See in general Doyle (2008) 835–836 and Bohan and McCarthy (2008) par 3.05. The new dispensation has been applicable to gifts and inheritances taken on or after 1 December 1999 (Bohan and McCarthy (2008) par 3.03). For the rules pertaining to gifts and inheritances taken before 1 December 1999, see s 6(1) for gifts and s 11(1) for inheritances and Bohan and McCarthy (2008) pars 3.14–3.18. An exception to the new residence-based rules has been retained for non-domiciled residents. See Doyle (2008) 835 and Bohan and McCarthy (2008) pars 1.02, 3.03 and 3.12 for more detail on these rules. See also Williams (2004) *Irish Tax Rev* 405 *et seq* for a discussion on the effect of the change in the territorial scope of CAT for non-Irish domiciled persons.

commentators were of the opinion that the tax base was broadened to an extraordinary width.⁸³

The “date of disposition” (from the perspective of the disponent) means, (a) in the case of a bequest, the death of the testator or the relevant deceased, (b) in the case of a disposition which consists of the failure to exercise a right or a power, the date of the latest time when the disponent could have exercised the right or the power if that disponent were *sui iuris* and not under any physical disability and (c) in any other case, the date on which the last act of the disponent was executed by which the disponent provided or bound himself in respect of the disposition.⁸⁴ The “date of the gift” (from the perspective of the donee) means the date of the happening of the event on which the donee becomes beneficially entitled in possession to the benefit.⁸⁵ The “date of the inheritance” (from the perspective of the successor) means the date when the successor becomes beneficially entitled to the inherited property, right or interest.⁸⁶ The date of inheritance of the vast majority of inheritances is therefore the death of the disponent, which corresponds in most cases with the date of the disposition.⁸⁷

10.2.2.2 Location of Assets

In the case where neither the disponent, donee nor successor is resident or ordinarily resident in the state at the date of the disposition, gift or inheritance (respectively), a

⁸³ See e.g. Madigan (2000) *Acc Ireland* 20.

⁸⁴ S 2(1) “date of disposition”. See in general Bohan and McCarthy (2008) pars 3.05 and 3.07.

⁸⁵ S 2(1) “date of gift”.

⁸⁶ S 2(1) “date of inheritance”. In the case of a gift made within two years prior to the death of the disponent, the date of the inheritance would be the date of the original gift.

⁸⁷ However, there may be a time lapse between the date of the disposition and the date of the inheritance where e.g. the testator bequeaths property subject to a life interest (usufruct). The date of inheritance for the holder of the bare *dominium* (“remainder successor”) would be the date of death of the life tenant (i.e. the usufructuary). See Bohan and McCarthy (2008) par 3.08.

charge to CAT arises only in the instance where the asset subject to the gift or inheritance is situated in the state at the date of the gift or the date of the inheritance.⁸⁸

10.2.3 Double Taxation

Double taxation relief is offered through double taxation agreements negotiated with other countries,⁸⁹ or through unilateral relief.⁹⁰ The two double taxation agreements currently in force, namely a treaty concluded with the United Kingdom (under CATCA) and a treaty concluded with the United States (under previous CAT legislation), apply to both inheritances and gifts.⁹¹

Unilateral relief operates by virtue of the granting of a tax credit. Where a person is liable for CAT as well as a foreign tax in respect of property situated in that foreign jurisdiction at the time of the gift or inheritance, then a credit is given for the foreign tax against CAT, unless the foreign tax exceeds the CAT payable, in which event the credit would be limited to the amount of CAT.⁹² The credit can only be relied on where a double taxation agreement does not apply.⁹³

10.2.4 Object of Taxation: Property

A charge to CAT arises where a beneficiary becomes entitled to a benefit in property. A gift or inheritance consists of the whole or “appropriate part”⁹⁴ of the property in which

⁸⁸ Ss 6(2)(d), 11(2)(c)(i). See in general Bohan and McCarthy (2008) pars 3.05 and 3.10.

⁸⁹ As provided for in s 106. See Bohan and McCarthy (2008) par 13.01.

⁹⁰ As provided for by s 107.

⁹¹ See Bohan and McCarthy (2008) Ch 13.

⁹² S 107(1) read with 107(2). See Bohan and McCarthy (2008) par 13.34 for examples.

⁹³ S 107(3).

⁹⁴ S 5(5) defines an appropriate part as “that part of the entire property in which the benefit subsists, or on which the benefit is charged or secured, or on which the donee [or beneficiary, see s 10(2)] is entitled to

Footnote continues on the next page

the beneficiary takes a benefit, or in which the benefit is charged or secured or on which the beneficiary is entitled to have it charged or secured.⁹⁵ A benefit is described as any “estate, interest, income or right [in property]”.⁹⁶ Property furthermore includes “rights and interests of any description”.⁹⁷ A person’s “free estate” is the estate which will pass on death under will or intestacy and includes property which comes into existence only by reason of his or her death, for example a pension fund payment or insurance benefit which is payable to the personal representative (executor) of the deceased.⁹⁸

10.3 VALUATION

The Act provides general rules for the determination of the market value of property generally and special rules for the determination of the market value of annuities and shares in private companies. In the case where the subject matter of the gift or inheritance is a limited interest, the Act provides for a method whereby the incumbrance-free value of the underlying property is adjusted to determine the value of the limited interest. Provision is also made for some favourable valuation rules in respect of business property and agricultural property, which will be more fully discussed in paragraph 10.5.3 below.

have it so charged or secured, which bears the same proportion to the entire property as the gross annual value of the entire property, and the gift [or inheritance, see s 10(2)] shall be deemed to consist of the appropriate part of each and every item of property comprised in the entire property”. The basic calculation for the appropriate part is therefore: value of property transferred = annual value of benefit/total annual value of property. See Bohan and McCarthy (2008) pars 4.12–4.14, 5.12 and 6.17 for the determination of the value of the appropriate part of property.

⁹⁵ Ss 5(2)(a) and 10(2). Bohan and McCarthy (2008) par 5.12 explains that, if a liability deprives the beneficiary of the present use of the property or part thereof, then the liability is treated as a deduction of the appropriate part of the property, e.g. where a testator bequeaths a fund to his son subject to an annuity payable to his surviving spouse. See also pars 5.14 and 5.31–5.39.

⁹⁶ S 2(1) “benefit”. Bohan and McCarthy (2008) par 2.04 state that the four terms are merely indicative of the type of category that falls within the term “benefit” and that it would appear not to be exhaustive. They submit that it would also include any advantage, profit or gain given to the recipient.

⁹⁷ S 2(1) “property”.

⁹⁸ Bohan and McCarthy (2008) par 4.35.



10.3.1 Valuation Date

The Act contains some special rules in respect of a “valuation date”. This date is important, because the property must be valued on such date, and, more importantly, because the charge to CAT arises only on such date. In the case of a gift, the valuation date is usually the date of the gift. In the case of an inheritance, the valuation date is usually the date of the finalisation of the deceased estate or the actual delivery of the benefit (whichever is the earlier).⁹⁹

10.3.2 General Rule

The market value of property is estimated to be the price which, in the opinion of the taxing authorities, such property would fetch if sold in the open market on the date on which the property is to be valued, in such a manner and subject to such conditions as might reasonably be calculated to obtain for the vendor the best price for the property.¹⁰⁰ No reduction can be obtained on the assumption that the whole property is to be placed on the market at one and the same time.¹⁰¹ The value of a gift or inheritance is ascertained ignoring any contingencies.¹⁰² If a contingency happens, then the taxable value will be recalculated on the basis of the actual period for which the benefit was indeed enjoyed.¹⁰³ In such a case, the beneficiary can claim a refund of any excess CAT that has been paid.¹⁰⁴

⁹⁹ S 30. See also Doyle (2008) 844–845 and Bohan and McCarthy (2008) Ch 7 for a comprehensive discussion of the valuation date provisions.

¹⁰⁰ S 26(2). See Bohan and McCarthy (2008) pars 6.02–6.17 for a comprehensive discussion of the general valuation rule, especially in regard to blocked assets (par 6.09), businesses (par 6.10), goodwill (pars 6.11–6.12), property held in co-ownership (pars 6.13–6.16) and an appropriate part in property (par 6.17).

¹⁰¹ S 26(3).

¹⁰² S 29.

¹⁰³ S 29.

¹⁰⁴ Bohan and McCarthy (2008) par 16.24.



The value of an unincorporated business or an interest in an unincorporated business should be taken to be its net value,¹⁰⁵ which would be the market value of the assets used in the business, including the goodwill, reduced by the market value of the liabilities incurred for the purposes of the business.¹⁰⁶ Unquoted shares in public companies and minority holdings in private companies (that are not controlled by the beneficiary) are also valued at market value according to the general rules,¹⁰⁷ which is in practice ascertained according to the specific rules contained in the Taxes Consolidation Act.¹⁰⁸ In valuing private company shares, any specific restrictions or conditions on the disposal or the transfer of the shares are to be ignored in so far as they prevent the sale of those shares. However, the restrictions will be taken into account in establishing the market value thereof.¹⁰⁹ The Act contains a specific rule for unquoted shares in private controlled companies, which will be discussed below.

¹⁰⁵ S 98.

¹⁰⁶ Bohan and McCarthy (2008) pars 10.63–10.64. See Brennan and Hennessee (2001) *Comm Law Prac* 270 *et seq* for a discussion on the various methodologies applicable to the valuation of businesses.

¹⁰⁷ See Bohan and McCarthy (2008) pars 6.22–6.30 for a comprehensive discussion on the guidelines used, depending on the percentage of shareholding being valued, as well as the various bases of valuing shares in a private company, namely valuation based on earnings, asset valuation and dividend yield valuation. See also Cremins (2006) *Irish Tax Rev* 60 *et seq* for a discussion on the valuation processes and general valuation principles applicable to shares.

¹⁰⁸ Taxes Consolidation Act s 548. The market value of Irish quoted shares is the lower of (i) the last price recorded on the Stock exchange Official List, or (ii) the price recorded on the relevant date (if more than one, halfway between the lowest and the highest). The market value of UK quoted shares is the lower of (i) the lower of the two prices shown in the quotations on the relevant date, plus one quarter of the difference between those two figures, or (ii) the price recorded on the relevant date (if more than one, halfway between the lowest and the highest). The value of foreign securities is converted at the exchange rate applicable at the valuation date. See Bohan and McCarthy (2008) par 6.21 for a comprehensive discussion.

¹⁰⁹ Bohan and McCarthy (2008) pars 6.18–6.20.

10.3.3 Unquoted Shares in Private Controlled Companies

The market value of a share in a private company that is controlled¹¹⁰ by the beneficiary after taking a gift or inheritance is determined as if the share formed part of a group of shares¹¹¹ (the “family group”) sufficient to give the owner of the group control of the company.¹¹² No discount for a minority holding will be allowed.¹¹³ Instead, the value will be ascertained as a proportionate part of the total family group of shares.¹¹⁴ If there are various classes of shares, the rights of each of the different classes will be taken into account in the apportionment.¹¹⁵

10.3.4 Annuities

For the purposes of the valuation of an annuity, the Act distinguishes between annuities charged on property and other annuities.

¹¹⁰ A person is generally deemed to control a company where he or she (together with, for example, his or her relatives and nominees) is the registered owner of the majority of the shares (Bohan and McCarthy (2008) par 6.36). However, a person is also deemed to have control of a company (a) if he (together with, for example, his relatives and nominees), in general, can control over 50% of the votes of the company, or (b) if he (together with, for example, his relatives and nominees) has control of the board of directors, or the powers of the managing director, or the nomination of a majority of the directors or a managing director, or the power to veto the appointment of a director or any powers of a like nature to the foregoing (s 27(4)). A company that is controlled by a beneficiary is regarded as a relative of such beneficiary (s 27(3)), as a consequence of which control cannot be evaded through the use of a number of companies (Bohan and McCarthy (2008) par 6.35).

¹¹¹ A “group of shares means the aggregate of the shares in the company of the donee or successor, the relatives of the donee or successor, nominees of the donee or successor, nominees of the relatives of the donee or successor, and the trustees of a settlement whose objects include the donee or successor or relatives of the donee or successor” (s 27(1)).

¹¹² S 27. See in general Bohan and McCarthy (2008) par 6.31.

¹¹³ Bohan and McCarthy (2008) par 6.31.

¹¹⁴ Bohan and McCarthy (2008) par 6.31.

¹¹⁵ See in general Bohan and McCarthy (2008) pars 6.38–6.47 for a discussion on the various classes of shares and classes of rights attaching thereto.



10.3.4.1 Annuities Charged on Property

Where the benefit consists of an annuity charged or secured on any property, it is valued using the following formula: market value of property x (annual value of benefit/annual income of the property).¹¹⁶ For example, where an annuity of €10 000, secured by a rental property (valued at €600 000) with an annual rental income of €30 000, is donated, the value of the annuity would be calculated at €200 000 (€600 000 x €10 000/€30 000).¹¹⁷

Where an annuity is taken for a period less than 50 years, or alternatively, where an annuity is granted for the duration of a life or lives, an adjustment is necessary to reflect the fact that the beneficiary does not have an absolute interest in the property according to the rules dealing with the determination of the value of limited interests.¹¹⁸

10.3.4.2 Annuities Not Charged on Property

The Act provides that, if the benefit is an annuity or other periodic payment which is not charged or secured by any property, the gift or inheritance is deemed to consist of such sum as would, if invested on the date of the gift or inheritance in a security of the government which was issued last before that date for subscription in the state and is redeemable not less than 10 years after the date of issue, yield an annual income equal to the annual value of the annuity or other periodic payment receivable by the beneficiary.¹¹⁹ If the annuity was granted for a fixed period or for the duration of a life or lives, the value should furthermore be adjusted in accordance with the rules pertaining to limited interests.¹²⁰

¹¹⁶ S 5(2)(a). See in general Doyle (2008) 846 and example 34.15.

¹¹⁷ See Doyle (2008) 846 example 34.15.

¹¹⁸ See par 10.3.5 for the determination of the value of a limited interest. See also Doyle (2008) 848 example 34.19.

¹¹⁹ Ss 5(2)(b) and 10(2). See Doyle (2008) 846 for an example.

¹²⁰ See par 10.3.5 for the determination of the value of a limited interest. See also Doyle (2008) 847 example 34.18.

10.3.5 Adjustment for Limited Interests

A limited interest is an interest for the duration of a life or lives or for a certain period or any interest which is not an absolute interest.¹²¹ An interest in possession in a fixed trust, a usufructuary interest and a fideicommissary interest would therefore all be examples of limited interests for the purposes of CATCA. Where a gift or inheritance comprises a limited interest, the incumbrance-free value is reduced by the appropriate limiting factor in accordance with the tables contained in the First Schedule to the Act (which has remained unchanged since the initial passing of the original CAT Act in 1976).¹²² The schedule contains two tables, namely Table A, which is based on life expectancy and which is used in the case where an interest is taken for a duration of life or lives, and Table B, which is based on a fixed period and which is used in the case where the interest is taken for a fixed period of time.¹²³ The value of the property is multiplied with the appropriate factor, which is, in the case of an interest taken for life or lives, dependent on the age¹²⁴ and sex of the person for the duration of whose life the interest is to be so valued.¹²⁵ Table A also contains a column of joint factors, which are used where an interest is taken for a joint continuance of two lives, for a joint continuance of three or more lives, for the longer of two lives or for the longest of more than two lives.¹²⁶ The value of an interest for the joint continuance of two lives is, for example, determined by multiplying the joint factor that is appropriate to the younger life.¹²⁷ When a person takes

¹²¹ S 2(1) “limited interest”. See also Doyle (2008) 846.

¹²² See Bohan and McCarthy (2008) par 5.45 and Doyle (2008) 847–848 examples 34.17–34.18.

¹²³ The factors (in Table A) vary from 0.9519 (for a male under 1 year of age) to 0.0458 (for a male older than 100 years of age) and 0.9624 (for a female under 1 year of age) to 0.0698 (for a female older than 100 years of age). The factors in Table B vary from 0.0654 (for 1 year) to 0.9945 (for 50 years and over).

¹²⁴ The age is determined by the previous birthday.

¹²⁵ Sch 1 prt 1 rule 1 (for the duration of a single life). See Bohan and McCarthy (2008) par 5.48 for an example.

¹²⁶ The factors vary from 0.99 (for a person under 1 year of age) to 0.45 (for a person older than 100 years of age).

¹²⁷ Sch 1 prt 1 rule 2. See Bohan and McCarthy (2008) par 5.49 for an example. See also rules 3–5 (for the other special rules) and Bohan and McCarthy (2008) pars 5.50–5.52. For the calculation of an interest taken for a fixed period of time, see Sch 1 prt 1 rule 6 and Bohan and McCarthy (2008) par 5.53 for an example.

an absolute interest on the cessation of an intervening life interest, the taxable value will be the full open market value of the property on the death of the life tenant.¹²⁸ See paragraph 10.7 below for some example calculations.

10.4 TAXPAYER AND RETURN FILING

The donee or successor is primarily liable for gift tax or inheritance tax.¹²⁹ However, the donor, personal representative, agent, guardian or trustee may also be held accountable for the payment of the tax.¹³⁰ The trustees of a discretionary trust (for the time being at the date of the inheritance) are primarily accountable for the payment of the DTT charges.¹³¹

CAT is a self-assessment tax with provision made for the delivery of the return together with the payment of the tax within four months of the valuation date.¹³²

10.5 RELIEF MECHANISMS

The Act provides for various forms of relief, which include (a) the deduction of certain liabilities and any consideration paid from the market value of a taxable gift or a taxable inheritance, (b) the provision of favourable valuation rules in respect of agricultural property and business assets and (c) the provision of certain exemptions.

10.5.1 Deductible Liabilities

A deduction is allowed for all liabilities, costs and expenses that are properly payable out

¹²⁸ Doyle (2008) 847.

¹²⁹ S 45(1).

¹³⁰ S 32.

¹³¹ S 16(c).

¹³² S 46.

of the taxable gift or inheritance.¹³³ Allowable expenses include, for example, deductions legally enforceable against the disponent or his or her personal representative such as funeral expenses, outstanding income tax or capital gains tax, hospital expenses, outstanding accounts (e.g. heating, light, food), bank overdrafts, outstanding mortgages and other testamentary expenses.¹³⁴ If a gift or inheritance consists of agricultural property or business property that qualifies for relief,¹³⁵ any liabilities, expenses or consideration should be proportionally reduced.¹³⁶ Certain liabilities are, however, prohibited,¹³⁷ for example certain foreign liabilities in respect of property situated in Ireland, where neither the disponent nor the beneficiary has been resident in Ireland, which are due to non-residents (except where the liability is contractually required to be paid in Ireland or where the liability is charged in respect of the Irish property which is the subject of the inheritance or gift), unless the foreign assets are insufficient to meet all the foreign liabilities, in which case the surplus expenses can be deducted against the Irish property.¹³⁸ Any tax, interest or penalties chargeable under the Act, or the costs, expenses or interest incurred in raising or paying such liabilities, are also not allowed.¹³⁹ It is provided that, where a liability is a burden on specific property, it should as far as possible be allowed as a deduction against that property.¹⁴⁰

¹³³ S 28(1).

¹³⁴ Bohan and McCarthy (2008) pars 5.04, 5.07. These expenses are usually paid from the residuary estate, although there may be a testamentary direction that an expense should be charged against a specific asset (par 5.04). See also Doyle (2008) 844.

¹³⁵ See par 10.5.3.

¹³⁶ S 89(2)(ii) and (iii).

¹³⁷ Such as contingent liabilities. See s 28(5)(a).

¹³⁸ S 28(5)(f). See in general Bohan and McCarthy (2008) pars 5.25 and 5.26, where the authors question whether this position would still be applicable within the EU in the light of the Mutual Assistance Directive. For other prohibited liabilities, see s 28(5) and Bohan and McCarthy (2008) pars 5.19–5.24.

¹³⁹ S 28(5)(d). See in general Bohan and McCarthy (2008) par 5.22; Doyle (2008) 844.

¹⁴⁰ S 28(11).



10.5.2 Consideration

Any consideration which a beneficiary gives to the disponer, or any person at the direction of the disponer, may be deducted from the incumbrance-free value.¹⁴¹ Such a deduction includes any liability of the disponer which the beneficiary undertakes to discharge and any other liability to which the gift or inheritance is subject under the terms of the disposition under which it was created.¹⁴² If a beneficiary paid all the premiums in respect of a life assurance policy, then he or she would have given full consideration for the policy and the proceeds would not be regarded as a taxable gift or inheritance. However, if the beneficiary only paid a proportion of the premiums, he or she would only be liable for CAT in respect of a proportion of the proceeds.¹⁴³ In the event of business partner's insurance, the premiums should therefore strictly speaking be equalised among all the persons involved (according to their different ages). However, Bohan and McCarthy mention that it is apparently the practice of the revenue authorities not to levy inheritance merely because the premiums were not equalised (subject to certain conditions).¹⁴⁴ A key-man policy would usually not give rise to a CAT liability, in view of the fact that it is normally effected and paid for by an employer.¹⁴⁵

¹⁴¹ S 28(2); Bohan and McCarthy (2008) par 5.09. If the consideration is paid by someone else, then the beneficiary takes two benefits. E.g. where A sells an asset worth €500 000 to B for €100 000, but the consideration is paid by C, then B takes two benefits, namely one from A at a value of €400 000 and one from C at a value of €100 000.

¹⁴² Subject to the proviso that no double deduction is allowed (s 28(2)). See in general Bohan and McCarthy (2008) par 5.09 and Doyle (2008) 845 example 34.14.

¹⁴³ Bohan and McCarthy (2008) pars 4.35, 18.59. See also *Barclays Bank v AG* [1994] AC 372 and s 83.

¹⁴⁴ Bohan and McCarthy (2008) par 18.77.

¹⁴⁵ Bohan and McCarthy (2008) par 18.78.

10.5.3 Preferential Valuations

10.5.3.1 *Agricultural Property*

Favourable treatment has been afforded to agricultural property since the introduction of CAT legislation in 1975.¹⁴⁶ Currently, the Act provides that, where any gift or inheritance consists of “agricultural property”¹⁴⁷ at the date of the gift or inheritance and at the valuation date, and where such property is taken by a beneficiary who is, on the valuation date and after taking the gift or inheritance, a “farmer”¹⁴⁸ for the purposes of the Act, then the market value of the agricultural property (the “agricultural value”) may be reduced by 90 percent.¹⁴⁹ Any liabilities, costs, expenses and consideration attaching to the property must be proportionally reduced.¹⁵⁰ Shares which derive their value from agricultural property do not qualify for the relief.¹⁵¹ However, such shares may qualify for business relief.¹⁵² In 2005, the Act introduced certain claw-back provisions to counter the possible misuse of the section. Agricultural relief may now be withdrawn where the agricultural property (other than crops, trees or underwood) is disposed of or compulsorily acquired

¹⁴⁶ Bohan and McCarthy (2008) par 9.01.

¹⁴⁷ “Agricultural property” includes agricultural land, pasture and woodlands situated in the state and crops, trees and underwood growing on such land. It also includes the farm buildings, farm house and mansion house. The description furthermore includes any farm machinery, livestock and bloodstock on such property (s 89(1) “agricultural property”). See Bohan and McCarthy (2008) pars 9.02–9.16 for a comprehensive discussion.

¹⁴⁸ A “farmer” refers to an individual whose assets are mainly represented by agricultural property. For the purposes of this test, at least 80% of the gross market value of all the property to which such individual is beneficially entitled (after taking the gift or inheritance) must consist of agricultural property as defined (s 89(1)). See Bohan and McCarthy (2008) pars 9.17–9.23 for a comprehensive discussion. See also Doyle (2008) 849–850 examples 34.20–34.21.

¹⁴⁹ Ss 89(1) (the reduced value is referred as the “agricultural value”) and 89(2). See Doyle (2008) 850–852 examples 34.21–34.24 and Bohan and McCarthy (2008) Ch 9 for a more comprehensive discussion.

¹⁵⁰ S 89(2). See example in Bohan and McCarthy (2008) par 9.28.

¹⁵¹ Doyle (2008) 849.

¹⁵² See par 10.5.3.2.



within six years of the date of the gift or the inheritance, without being replaced by other agricultural property within one year of the disposal or within six years of the compulsory acquisition.¹⁵³ The relief may also be withdrawn where the beneficiary is not a resident in the state for any of the three years of assessment immediately following the year of assessment in which the valuation date falls.¹⁵⁴

10.5.3.2 Business Property

Business property relief was in essence copied from the United Kingdom legislation upon its incorporation into the CAT legislation in 1994.¹⁵⁵ Three reasons were advanced by the government for the introduction of this form of relief. Firstly, the business community regarded the absence of business relief as an unfair bias towards the agricultural sector (because agricultural relief had been provided for since the initial introduction of CAT in 1975). Secondly, it was thought that some relief would encourage entrepreneurial activity in the country. The third reason provided was that business relief could assist in the prevention of the forced break-up or liquidation of businesses.¹⁵⁶

The Act currently provides that, where the whole or part of the taxable value of any taxable gift or taxable inheritance is attributable to the value of any “relevant business

¹⁵³ S 89(4)(a). See in general Bohan and McCarthy (2008) par 9.42 and Doyle (2008) 853.

¹⁵⁴ S 89(4)(c). See in general Doyle (2008) 853.

¹⁵⁵ Carr (2001) *Irish Tax Rev* 135.

¹⁵⁶ Bohan and McCarthy (2008) par 10.01.

property”,¹⁵⁷ the whole or that part of the taxable value¹⁵⁸ may be reduced by 90 percent,¹⁵⁹ provided that the property was held by the disponent for a minimum period of five years (in the case of a gift) or two years (in the case of an inheritance) prior to the date of the gift or the inheritance.¹⁶⁰ To neutralise any hardship caused by the minimum ownership requirements, the Act contains special provisions for circumstances where business property had been replaced by other business property or where the beneficiary had died within the prescribed period.¹⁶¹ The relief may also be withdrawn or partially clawed back if the relevant business assets are disposed of or cease to qualify as business property within six years of the gift or inheritance, unless the property is replaced by other qualifying business property or again qualifies as relevant business property within one year. However, there will be no claw-back if the business ceases as a result of insolvency.¹⁶²

¹⁵⁷ “Relevant Business property” is defined in s 93(1) and includes any one of the following: (a) property consisting of a business or an interest in a business; (b) unquoted shares in or securities of a company, whether incorporated in the state or otherwise, where the beneficiary will (after the taking of the gift or inheritance) have control of more than 25 percent of the voting rights capable of being exercised in respect of the company; (c) unquoted shares in or securities of a private controlled company; (d) unquoted shares in or securities of a company, whether incorporated in the state or otherwise, where the beneficiary will (after the taking of the gift or inheritance) own an aggregate nominal value which represents 10 percent or more of the aggregate nominal value of the entire share capital and securities of the company, provided that the beneficiary has been a full-time working officer or employee of the company, or if that company is the member of a group, of one or more companies which are members of the group, throughout a period of five years prior to the date of the gift or inheritance; (e) any land or building, plant or machinery owned by the disponent, which was used for the business carried on by a company of which the disponent then had control or by a partnership of which the disponent then was a partner; (f) certain quoted shares in family controlled companies, subject to certain conditions. See Bohan and McCarthy (2008) pars 10.06–10.27 for a comprehensive discussion. The relief does not apply to businesses which are involved in dealing with currencies, securities, stocks or shares, land or buildings, or the making or the holding of investments. See s 93(3) and Bohan and McCarthy (2008) pars 10.28–10.10.53 for a comprehensive discussion.

¹⁵⁸ It should be noted that the relief operates towards the “taxable value”, where any deductible liabilities and consideration have already been taken into account.

¹⁵⁹ S 92.

¹⁶⁰ S 94. See in general Bohan and McCarthy (2008) pars 10.54–10.57; Doyle (2008) 853 and McQuillan (2003) *Acc Ireland 20 et seq* (for a brief summary of the tax consequences (CAT, CGT and stamp duty) on the transfer of a business).

¹⁶¹ Ss 95, 96, 97. See in general Bohan and McCarthy (2008) pars 10.58–10.62.

¹⁶² S 101. See in general Doyle (2008) 854.

10.5.4 Exemptions

10.5.4.1 Exemptions Applicable to Both Inheritances and Gifts

For the purposes of both inheritances and gifts, the Act provides that the following acquisitions are (subject to certain conditions) exempt from CAT:

- property which is taken for public or charitable purposes;¹⁶³
- certain heritage property (such as houses, gardens, pictures, prints, books, manuscripts, works of art, jewellery and scientific collections of national, scientific, historic or artistic interest), which are kept permanently in the state and in respect of which reasonable facilities for viewing are allowed to members of the public;¹⁶⁴
- property taken by a “spouse”¹⁶⁵ from another spouse (even where the spouses have been separated);¹⁶⁶
- property transferred between former spouses in terms of a court order following a divorce;¹⁶⁷

¹⁶³ S 76(2). See Bohan and McCarthy (2008) pars 11.03–11.10 for a discussion of what would be regarded as charitable under Irish law.

¹⁶⁴ S 77(1) to (6). See in general Bohan and McCarthy (2008) pars 11.17–11.29 and Doyle (2008) 843.

¹⁶⁵ Bohan and McCarthy (2008) par 11.15. A “spouse” is not defined in the Act. However, the term would be restricted to a partner in a legal marriage, which does not extend to same-sex couples and other cohabitants. Numerous commentators have consequently expressed their concern that the Irish law remains largely deficient in its recognition of same-sex relationships and family diversity. For further reading, see Willis (2002) *Conv Prop Law J* 58 *et seq*; Willis (2002) *Irish J Fam Law* 8 *et seq*; Gallagher (2003) *Conv Prop Law J* 76 *et seq*; Byrne (2004) *Irish Tax Rev* 485 *et seq*; Ryan (2006) *Irish J Fam Law* 3 *et seq* and Tobin (2008) *Irish J Fam Law* 10 *et seq*.

¹⁶⁶ Ss 70 (gifts) and 71 (inheritances). Inheritances were exempted with effect from 30 January 1985 and gifts were exempted with effect from 31 January 1990. See in general Bohan and McCarthy (2008) par 11.11 and Doyle (2008) 843.

¹⁶⁷ S 88. See Bohan and McCarthy (2008) par 11.15 for an outline of the various orders. See also discussion by Lillis and Walls (2003) *Irish Tax Rev* 269–271.



- subject to certain exceptions,¹⁶⁸ any retirement benefit or pension payment or redundancy payment acquired by an employee or former employee;¹⁶⁹
- the proceeds of a policy that was specifically effected to be a source of finance for the payment of inheritance tax or gift tax, to the extent that it has been applied to pay the relevant tax;¹⁷⁰
- an interest in a foreign life assurance policy (affected by a foreign assurance company) if neither the disponent nor the beneficiary was domiciled or resident in the state at the date of the disposition or at the date of the inheritance or gift respectively;¹⁷¹
- any unit of an investment undertaking or of a specified collective investment if neither the disponent nor the beneficiary was domiciled or resident in the state at the date of the disposition or at the date of the inheritance or gift respectively;¹⁷²
- government securities where the beneficiary is neither domiciled nor ordinarily resident in the state at the date of the gift or the date of the inheritance and where the securities were held by the disponent for a minimum period of fifteen years immediately before the date of the gift or the date of the inheritance;¹⁷³

¹⁶⁸ The exclusion is not applicable where the employee is a relative of the employer, or where the employer is a private controlled company as provided for by the Act (s 80(3)(a)). The relief is furthermore restricted to payments under a scheme approved by the Commissioners under the income tax legislation, provided that the payments are not excessive (s 80(3)(c) and (d)).

¹⁶⁹ S 80(2). See in general Bohan and McCarthy (2008) par 18.79.

¹⁷⁰ Ss 72, 73. See in general Bohan and McCarthy (2008) pars 18.02, 18.08–18.35, 18.38–18.45 for a comprehensive discussion. See also Doyle (2008) (2008) 843. Bohan and McCarthy (2008) pars 18.34–18.35 mention the difficulty that arises in assessing the extent to which the proceeds of a policy are applied to pay CAT in the instance where the proceeds is payable to the personal representatives of the deceased, in view of the fact that the proceeds would be available to meet other testamentary expenses and debts. To avoid such a situation, an insured commonly utilises a trust fund policy, where the trust document directs the trustees to firstly apply the proceeds for the payment of inheritance tax.

¹⁷¹ S 74 (a foreign policy issued in Ireland would otherwise be subject to a charge to CAT). See in general Bohan and McCarthy (2008) par 11.68.

¹⁷² S 75. See in general Bohan and McCarthy (2008) par 11.67.

¹⁷³ S 81(2). See Bohan and McCarthy (2008) pars 11.40–11.41 for a discussion on the historic position of this section. The exemption is not available to the trustees of a discretionary trust, even in a case where none of the trustees and none of the beneficiaries are domiciled or ordinarily resident in Ireland. See also Doyle (2008) 843.



- compensation or damages received in respect of injury suffered in respect of a person's person, property, reputation, means or livelihood;¹⁷⁴
- compensation received in respect of the death of another person;¹⁷⁵
- winnings from betting, gambling, and lottery;¹⁷⁶
- any benefit received from a bankrupt's friends or relatives or the remission of debts by the creditors of a bankrupt, where such contributions were made to enable the bankrupt to fulfil an offer of composition under the Bankruptcy Act;¹⁷⁷
- normal and reasonable contributions made by a disponent in respect of the support, maintenance or education of his or her spouse, child or dependant relative;¹⁷⁸
- any benefit received from a trust fund of a qualifying trust by an incapacitated individual;¹⁷⁹
- any contribution to the support, maintenance and education of a minor child from a discretionary trust at a time when both parents are dead;¹⁸⁰
- property acquired by a public company from an associated public company;¹⁸¹
- property which is taken exclusively for the purpose of discharging medical expenses of an individual who is permanently incapacitated;¹⁸² and
- residential property acquired by a cohabitant, subject to certain strict conditions.¹⁸³

¹⁷⁴ S 82(1)(a). See in general Bohan and McCarthy (2008) pars 11.50–11.51.

¹⁷⁵ S 82(1)(b). See in general Bohan and McCarthy (2008) par 11.52.

¹⁷⁶ S 82(1)(c). See in general Bohan and McCarthy (2008) par 11.53.

¹⁷⁷ S 82(1)(d). See also s 82(1)(e) for a similar exemption in respect of an arranging debtor. See in general Bohan and McCarthy (2008) pars 11.54–11.55.

¹⁷⁸ S 82(2). See in general Bohan and McCarthy (2008) pars 11.56–11.61.

¹⁷⁹ S 82(3). See in general Bohan and McCarthy (2008) par 11.62.

¹⁸⁰ S 82(4). See in general Bohan and McCarthy (2008) par 11.63.

¹⁸¹ S 83(3). See in general Bohan and McCarthy (2008) par 11.64.

¹⁸² S 84. See in general Bohan and McCarthy (2008) par 11.69.

¹⁸³ S 86. Bohan and McCarthy (2008) pars 8.19–8.21 discuss the historical position of this relief. See Bohan and McCarthy (2008) pars 11.73–11.89 and Keogh (2008) *Law Soc Gaz* 28 *et seq* for a comprehensive exposition of the contemporary provisions. See also Doyle (2008) 843 (for a brief summary).

10.5.4.2 Exemptions Applicable to Gifts Only

In respect of taxable gifts, the Act allows for a basic annual exemption of the first €3 000 of the total taxable value of all taxable gifts taken by a donee from any one disponent.¹⁸⁴ A person can therefore receive €3 000 tax-free from each and every disponent in the calendar year.¹⁸⁵

10.5.4.3 Exemptions Applicable to Inheritances Only

The Act provides that the following inheritances are exempt from CAT:

- an inheritance taken by a parent from a child on a child's death, but only where the child took a non-exempt gift or inheritance from either or both of his or her parents within a period of five years immediately prior to his or her death;¹⁸⁶ and
- the whole or any part of a retirement fund, if it is taken by a child of the disponent who attained the age of twenty-one years at the date of the disposition.¹⁸⁷

10.5.4.4 The Group Thresholds

Over and above the exemptions set out above, each taxpayer is entitled to three group thresholds, as explained in paragraph 10.1.2 above.

¹⁸⁴ S 69.

¹⁸⁵ Bohan and McCarthy (2008) pars 11.01–11.02. There is no claw-back of the exemption where a gift becomes an inheritance by virtue of the disponent's death within two years (Doyle (2008) 841). See also Doyle (2008) 842 example 34.13.

¹⁸⁶ S 79. See in general Bohan and McCarthy (2008) par 11.34 and Doyle (2008) 843.

¹⁸⁷ S 85. See in general Bohan and McCarthy (2008) par 11.70.



10.5.5 Miscellaneous Reliefs

The Act provides furthermore for certain miscellaneous matters such as relief for certain marriage settlements made prior to the introduction of CAT in 1976,¹⁸⁸ relief from double aggregation,¹⁸⁹ and relief where multiple charges arise on the same event.¹⁹⁰

10.6 TREATMENT OF SETTLEMENTS AND TRUSTS

10.6.1 The Trust: Broad Overview and Classification

Similar to the position in the United Kingdom law, it is basically important for the purposes of wealth transfer taxation to distinguish between a fixed trust, where each beneficiary has a fixed entitlement to a specific share in the trust property, and a discretionary trust, where the trustees have the discretion to distribute the income and/or capital for the benefit of the beneficiaries.¹⁹¹

10.6.2 The Position Prior to CATCA

Prior to the introduction of capital acquisitions tax, the British-based estate duty was levied in Ireland. Similar to the position in the United Kingdom, a person with an interest in possession in a fixed trust was treated as the outright owner of the property in which the interest subsisted. In respect of discretionary trusts, a special regime was introduced in 1969 to levy estate duty on the appropriate part of the property, determined with

¹⁸⁸ See Sch 2 prt 1 par 8 and Bohan and McCarthy (2008) par 8.15.

¹⁸⁹ See s 103 and Bohan and McCarthy (2008) par 8.22.

¹⁹⁰ See s 105 and Bohan and McCarthy (2008) pars 8.23–8.25.

¹⁹¹ See in general O'Connell and Fitzgerald (2003) *Conv Prop Law J* 90 and Bohan and McCarthy (2008) par 2.33.

reference to the income received by the beneficiary in the seven years prior to his or her death.¹⁹²

When CAT was introduced in 1975, there was a complete move away from the IIP and PET regimes. Where a person acquires an interest in possession, the interest is valued as a limited interest. The ultimate (capital) beneficiary will be liable for CAT on the full value of the property upon the break-up of the trust. However, because of the fact that the use of a discretionary trust could postpone a charge to CAT indefinitely, a special regime (the initial charge) was introduced in 1984 for discretionary trusts. This regime was extended to include an annual charge in 1986. The DTT regime is still in force and will be discussed more fully below.

10.6.3 The Contemporary Position: CATCA

10.6.3.1 *The Meaning of Settlement and Discretionary Trust*

The Act contains some special rules in respect of settlements or settled property. Although the Act does not contain a definition of a “settlement”, the term has been defined by various other statutes. According to the Taxes Consolidation Act, a settlement includes “any disposition, trust, covenant, agreement or arrangement, and any transfer of money or other property or of any right to money or other property”.¹⁹³ A settlement therefore includes arrangements such as trusts and civilian usufructs.¹⁹⁴

For the purposes of the Act, a discretionary trust is specifically defined as (a) any trust whereby, or by virtue or in consequence of which property is held on trust to accumulate

¹⁹² See Ch 8 par 8.6.2.

¹⁹³ Taxes Consolidation Act s 10(1).

¹⁹⁴ See Bohan and McCarthy (2008) pars 16.02–16.09 for a comprehensive discussion on the meaning of “settlement”.



the income or part of the income of the property, or (b) any trust whereby, or by virtue or in consequence of which, property (other than property to which for the time being a person is beneficially entitled for an “interest in possession”) is held on trust to apply, or with a power to apply, the income or capital or part of the income or capital of the property for the benefit of any person or persons or of any one or more of a number or of a class of persons whether at the discretion of trustees or any other person and notwithstanding that there may be a power to accumulate all or any part of the income.¹⁹⁵ It has transpired that a power to accumulate the income or capital by the trustees could bring a trust within the ambit of a discretionary trust, even in a case where the beneficiary is “entitled in possession” to the trust property, for example in a (traditional) fixed trust.¹⁹⁶

10.6.3.2 *Fixed Trusts*

The transfer of property to a fixed trust (where the beneficiaries have fixed interests) will usually constitute a gift or an inheritance under a disposition for the purposes of the beneficiary who acquires an interest in possession in such trust (e.g. the “life tenant”).¹⁹⁷ The life interest will, for the purposes of the calculation of CAT, be valued in accordance with the rules applicable to limited interests. The life expectancy of the beneficiary or the fixed period of time will therefore be relevant.¹⁹⁸ In view of the fact that a person only becomes liable to CAT on becoming entitled in possession to a benefit, the reversionary interest will not attract CAT. When property is subsequently distributed to a beneficiary absolutely on the termination of the settlement, the acquisition by the beneficiary will give rise to a charge to CAT on the full value of the property,¹⁹⁹ unless the reversionary interest holder paid consideration for the reversionary interest when it was first acquired,

¹⁹⁵ S 2(1) “discretionary trust”.

¹⁹⁶ Keogan (2007) *Law Soc Gaz* 41.

¹⁹⁷ Keogan (2007) *Law Soc Gaz* 43; Bohan and McCarthy (2008) par 16.10.

¹⁹⁸ See par 10.3.5.

¹⁹⁹ Bohan and McCarthy (2008) par 16.11.



in which case a deduction will be allowed for an amount equal to the same proportion of the taxable value as the consideration bore to the market value of the reversionary interest at that point in time. See example 1 in paragraph 10.7 below.

Where the trustees of a fixed trust have the power to accumulate income or capital, the trust will be treated as a discretionary trust (which will be discussed below). In view of the fact that a fixed trust can either be subject to DTT or be subject to a double charge to CAT (where the life tenant is also the ultimate beneficiary), a fixed trust can be quite tax-inefficient.²⁰⁰ Also, where the trustees have the discretion to distribute the property to a number of beneficiaries on the lapse of a fixed life interest and subsequently distribute the property to the life tenant there could effectively be a double charge to CAT.²⁰¹ Suppose, for example, that A settles property on B for a period of 10 years, with discretion to the trustees to distribute the property to B, C or D, then B will pay gift tax on the value of the life interest on the creation of the settlement. Where the property is distributed to B absolutely on the cessation of his life interest, B will be liable for CAT once again on the full value of the property.

10.6.3.3 Discretionary Trusts

In the case of a discretionary trust, where the beneficiaries do not become entitled in possession to any immediate benefits in the trust capital or income, the initial transfer into the settlement will not attract mainstream CAT.²⁰²

However, where the disponent is resident or ordinarily resident at the date of the disposition or where the assets transferred to the discretionary trust are located in the

²⁰⁰ Keogan (2007) *Law Soc Gaz* 43; Keogan and O’Keeffe (2007) *Irish Tax Rev* 79.

²⁰¹ Keogan (2007) *Law Soc Gaz* 43; Keogan and O’Keeffe (2007) *Irish Tax Rev* 79.

²⁰² Keogan (2007) *Law Soc Gaz* 40; Bohan and McCarthy (2008) par 16.10.

state,²⁰³ the trustees will be deemed to take a “relevant inheritance”²⁰⁴ of the trust property at the latest of the three following dates (which will be the date of the inheritance), namely (a) the date on which the property becomes subject to the discretionary trust, or (b) the date of death of the disponent or (c) the date on which there ceases to be a “principal object” (namely a potential beneficiary which can either be a spouse, a child or a child of a predeceased child of the disponent)²⁰⁵ under the age of 21.²⁰⁶ The tax chargeable on the taxable value of such a relevant inheritance is computed at the rate of six percent of such taxable value.²⁰⁷ However, the initial DTT charge will decrease to three percent if a beneficiary or beneficiaries of the trust becomes or become beneficially entitled in possession to an absolute interest in the entire property within five years of the disposition.²⁰⁸

The valuation date is usually the later of (a) the valuation date as determined in terms of the normal rules²⁰⁹ or (b) the date on which the trustees take a “relevant inheritance” (as determined above).²¹⁰ Where, for example, a discretionary trust is created under A’s will

²⁰³ The ordinary jurisdictional rules apply for the deemed inheritance by the trustees, except for the fact that the residence status of the trustees at the date of the (deemed) inheritance is expressly excluded as a jurisdictional connecting factor (see par 10.2.2.1). In the absence of this exception, a charge to DTT could have arisen simply by reason of the trustees being resident or ordinarily resident in the state. See Bohan and McCarthy (2008) par 3.08.

²⁰⁴ See s 18(1).

²⁰⁵ S 14.

²⁰⁶ S 15(1). The fact that a charge to DTT is deferred until the youngest potential beneficiary (child of the disponent) reaches the age of 21 years creates ample opportunities for the provision for minor children through discretionary trusts in the event of the sudden death of parents. See O’Connell (2003) *Acc Ireland* 28 and Keogan and O’Keeffe (2007) *Irish Tax Rev* 77. However, the deferral of the tax opens up a door for tax evasion techniques. If a minor were to be included in the list of potential beneficiaries and the trust assets were to be appointed before the youngest child had reached the age of 21, no DTT would be payable. See O’Connell (2003) *Acc Ireland* 28.

²⁰⁷ S 18(2).

²⁰⁸ S 18(3). See s 18(1) for the calculation of the five-year period. See also Bohan and McCarthy (2008) pars 17.43–17.46 for some examples.

²⁰⁹ See par 10.3.1.

²¹⁰ S 30. See Bohan and McCarthy (2008) par 17.30.



in favour of B, C and D (who are all over the age of 21 years) at the date of A's death on 31 March 2007, but the executors were only able to transfer the property on 31 March 2009, then the valuation date will be 31 March 2009, on which date the liability for the six percent initial charge will arise.²¹¹

To provide relief for instances where tax avoidance was not likely to have motivated the settlement, the Act provides that the DTT charge shall not apply in relation to a discretionary trust, which has been created exclusively (a) for public or charitable purposes in the Republic of Ireland or Northern Ireland,²¹² or (b) for certain superannuation schemes that operate mainly on a discretionary basis,²¹³ or (c) for the purpose of a registered unit trust scheme,²¹⁴ or (d) for the benefit of one or more named individuals, who, because of age or physical, mental or legal incapacity, is or are unable to manage his/her or their own affairs,²¹⁵ or (e) for the purpose of providing for the upkeep of a house or garden.²¹⁶ DTT shall furthermore not apply in relation to a discretionary trust where the state takes an inheritance upon the termination of the settlement.²¹⁷

Where, under or in consequence of any disposition, property is subject to a "chargeable discretionary trust" on 31 December of any year, the trustees are deemed to become beneficially entitled in possession to an absolute interest in that property on such date and

²¹¹ See example at Bohan and McCarthy (2008) par 17.30.

²¹² S 17(1)(a).

²¹³ S 17(1)(b).

²¹⁴ S 17(1)(c).

²¹⁵ S 17(1)(d).

²¹⁶ S 17(1)(e).

²¹⁷ S 17(2)(a).

to take an inheritance on each such date.²¹⁸ The charge is levied at one percent per year.²¹⁹

A “chargeable discretionary trust” is a discretionary trust in relation to which the disponent is dead and none of the “principal objects” (namely potential beneficiaries which can either be a spouse, a child or a child of a predeceased child of the disponent)²²⁰ of the trust are under the age of 21 years.²²¹ To avoid a double charge to CAT, a chargeable discretionary trust is exempt from the annual levy in the year that the trust has been subjected to the initial six percent charge.²²² The same categories of discretionary trusts which are exempt from the initial six percent charge are also exempt from the annual levy.²²³ The valuation date for the annual charge is the 31 December each year after the date on which a trust becomes a chargeable discretionary trust (provided that the annual levy will not also be charged in the first year).²²⁴ Where, however, the valuation date (of the six percent charge) falls after the first chargeable date of the annual levy, the Act provides that the valuation date for the annual levy will be the same date as the valuation date of the six percent charge.²²⁵ In the example above, the discretionary trust will be exempt from the annual levy on 31 December 2007. The annual levy due on 31 December 2008 will be postponed until the valuation date for the six percent charge on 31 March 2009. The next annual levy will be charged on 31 December 2009.²²⁶

²¹⁸ S 20(1). See in general Bohan and McCarthy (2008) pars 17.47–17.51.

²¹⁹ S 23.

²²⁰ Ss 14, 19.

²²¹ S 19.

²²² S 20(4).

²²³ S 22.

²²⁴ S 21(b)(i). See in general Bohan and McCarthy (2008) par 17.53.

²²⁵ S 21(b)(ii).

²²⁶ See Bohan and McCarthy (2008) par 17.53.

In view of the fact that some avoidance techniques were developed that sought to escape the requirements for a discretionary trust on the chargeable date (31 December) by, for example, the appointment by the trustees of a 30-day interest in possession in the entire trust property in favour of one or more beneficiaries, an anti-avoidance provision was introduced which provides the following:

- where under or in consequence of a disposition, property was subject to a discretionary trust *prior* to the chargeable date; and
- where such property is not on that chargeable date subject to that discretionary trust, because a person is beneficially entitled or has an interest in possession in such property for the time being; and
- where such property is to be subjected to that chargeable discretionary trust again within a period of five years, then the trust will be subject to the annual levy.²²⁷

Where the trustees appoint trust assets to a beneficiary ultimately, the acquisition by the beneficiary will attract mainstream CAT (if the beneficiary acquires the benefit for less than full consideration).²²⁸ The beneficiary will be deemed to take an inheritance where the discretionary trust was created by will²²⁹ or by a disposition made within two years prior to the death of the disponent²³⁰ or by a disposition *inter vivos* in the case where such interest was only to come into operation on a death.²³¹ In all other circumstances, the beneficiary will be deemed to take a gift.²³² For this mainstream CAT charge the ordinary jurisdictional rules will apply,²³³ except for a gift taken under a discretionary trust, which

²²⁷ S 20(2).

²²⁸ Keogan (2007) *Law Soc Gaz* 40.

²²⁹ S 31(b)(i).

²³⁰ S 31(b)(ii).

²³¹ S 31(b)(iii). E.g. where an *inter vivos* settlement creates a life interest with the remainder to a discretionary trust. All appointments to trust beneficiaries after the death of the life tenant would be regarded as inheritances. See Bohan and McCarthy (2008) par 17.19.

²³² S 31.

²³³ See par 10.2.2.

will in addition to all the ordinary rules, also be subject to CAT where the disponent is resident or ordinarily resident at the date of the gift.²³⁴ For example, where A transferred non-Irish assets to a discretionary trust at a time when he was not resident or ordinarily resident in the state, a subsequent distribution by the trustees to a beneficiary (not resident or ordinarily resident at the date of the gift) at a time when A is resident or ordinarily resident in the state will qualify as a taxable gift for the purposes of CAT.²³⁵

10.7 TREATMENT OF LIMITED INTERESTS AND BARE *DOMINIUM*

10.7.1 The Position of Bare *Dominium*

For the purposes of CAT, bare *dominium* constitutes a reversionary interest, the taxation of which is deferred until the moment that the interest materialises into full ownership. See example 1 below. It should be evident that the deferral approach largely prevents taxpayers from concealing a passive transfer of property through passage of time.

10.7.2 The Creation of Limited Interests

The granting of a limited interest (whether *inter vivos* or on death) constitutes a taxable disposition to the extent that the interest is acquired for inadequate consideration. The limited interest is valued with reference to its period of enjoyment (whether the transfer occurs during life or on death).²³⁶

Example 1:

1.1 A (an Irish resident) donates bare *dominium* in South African property valued at €100 000 to his son C subject to a lifelong usufruct in favour of B (B did not provide any consideration to A). Assume that the value of the “life interest” valued with reference to B’s life expectancy at the date of the settlement

²³⁴ S 6(2)(b).

²³⁵ Bohan and McCarthy (2008) par 3.04.

²³⁶ See par 10.3.5.



is €70 000. B will be liable for CAT on the interest valued at €70 000 (less any exemptions). B (an Irish resident) dies five years later at a time when the market value of the property is €150 000. C will now take an inheritance from A (even if he is still alive) valued at €150 000 (less any exemptions).

1.2 A (an Irish resident) bequeaths bare *dominium* in South African property valued at €100 000 to his son C subject to a lifelong usufruct in favour of B. Assume that the value of the “life interest” valued with reference to B’s life expectancy at the date of the settlement is €70 000. B will be liable for CAT on the interest valued at €70 000 (less any exemptions). B (an Irish resident) dies five years later at a time when the market value of the property is €150 000. C will now take an inheritance from A valued at €150 000 (less any exemptions).

In the case of successive interests, the position will be as follows:

Example 2:

A (an Irish resident) bequeaths bare *dominium* in South African property valued at €100 000 to his son D subject to a lifelong usufruct in favour of B. A’s will provides that, on B’s death, C will be entitled to a lifelong successive interest in the property. B will be liable for CAT on the acquisition of the life interest calculated with reference to his own life expectancy (say €70 000). On the death of B (an Irish resident), C will become liable for CAT on the value of the interest calculated with reference to C’s life expectancy at that point in time (say €80 000). On the death of C (an Irish resident), D will become liable for CAT on the **full value** of the property.

10.7.3 The Termination of Limited Interests

A limited interest is terminated through passage of time, death or upon renunciation. The termination of an interest through the lapse of time or because of the death of an interest holder merely signals the acquisition of another interest in the hands of the successive beneficiary (either the successive interest holder or the reversionary interest holder). The transfer occurs between the initial transferor and the successive interest holder/bare *dominium* owner. As a consequence, any consideration paid for the earlier acquisition of the bare *dominium* by the bare *dominium* owner may be taken into consideration, as will appear more fully from the example below:

Example 3

Suppose that C (in example 1.2 above) paid consideration of €15 000 for the acquisition of the bare *dominium* (50% of the value of the bare *dominium* at that point in time (€30 000)). When C takes the

inheritance on B's death, a deduction will be allowed for 50% of €150 000. C will therefore be liable for CAT on €150 000 – €75 000 = €75 000 (less any exemptions).

Where a limited interest is terminated because of a renunciation, then special rules apply, the effect of which is generally to accelerate the acquisition for the successive interest holder or the bare *dominium* owner. The problem in this area is that any consideration paid by such beneficiary (to the original interest holder) on the renunciation cannot reduce the value of the transfer between the original owner and the successive interest holder/bare *dominium* owner.²³⁷

Example 4

Suppose that B (in example 1.1 above) renounces his usufruct in favour of C when the value of the usufruct is €50 000 and the value of the property is €120 000. C provides consideration of €5 000 to B for the renunciation. C will be liable for CAT on €120 000, which amount will not be reduced with the consideration of €5 000, because the transfer occurs between A (the original owner) and C.

10.8 GENERAL ANTI-AVOIDANCE RULE

Although the Act does not contain a general anti-avoidance provision, the Taxes Consolidation Act provides for a general provision which applies to any tax, levy, duty or charge placed under the administration and management of the Irish revenue authorities. The particular section provides that, in the event of a transaction giving rise to a tax advantage, revenue can hypothetically reconstruct the facts as if the transaction or scheme

²³⁷ The Act deems the initial disposition to have happened immediately before the ending of the relevant interest, which means that the primary inheritance tax liability will always be maintained as if the life tenant had died immediately prior to the earlier termination (s 33). In addition, the taking of the further interest on the renunciation will constitute a separate taxable event. However, to counter the double taxation, the Act provides that the net tax payable on the earlier event may be deducted as a credit against the later tax liability (up to the net amount of that liability), which effectively means that there will usually be no CAT payable on the renunciation (and only on the deemed inheritance on the full value of the property). See s 105. If there was any consideration paid for the renunciation, then such consideration will reduce the value of the taxable gift between the life tenant and remainder man. The consideration will not affect the value of the (deemed) taxable inheritance. This in turn means that any consideration paid for the interest will (because of the operation of the credit) have no effect on the tax payable. See CAT Manual pt 7 “Break-up of Settlements and Trusts”, available at <http://revenue.ie> (accessed on 30 August 2009). See Bohan and McCarthy (2008) pars 16.12–16.15 for example calculations.



has not taken place.²³⁸ One of the main defences to this provision is if the persons have entered into the transaction for a “legitimate business purpose”.²³⁹ However, Bohan and McCarthy mention that it is “difficult to see how such a defence would be available to CAT which depends on a gratuitous benefit for the charge to CAT to arise”.²⁴⁰

10.9 CAPITAL GAINS TAX

10.9.1 Capital Gains Tax Consequences

Capital gains tax was introduced in Ireland in 1975. A carry-over base-cost approach was initially applied in respect of unrealised capital gains on the death of the owner. However, a stepped-up base-cost approach was adopted in 1978, which is still in force today.²⁴¹ Gifts have, by contrast, always been regarded as chargeable disposals which are deemed to occur at open market value.²⁴²

A few brief comments on the position of trusts seem to be appropriate in view of the possible overlap with DTT. The basic idea is that the trustees of a trust are treated as a single continuing body of persons for the purposes of CGT.²⁴³ Any disposal of assets to a trust will therefore be regarded as a disposal for the purposes of CGT. A transfer for inadequate consideration will be regarded as a gift, notwithstanding the fact that the disposer may have an interest in the trust.²⁴⁴ Disposals of assets by trustees during the

²³⁸ Taxes Consolidation Act s 811. See Bohan and McCarthy (2008) par 20.28 *et seq* for a comprehensive discussion.

²³⁹ Bohan and McCarthy (2008) par 20.29.

²⁴⁰ Bohan and McCarthy (2008) par 20.29.

²⁴¹ Taxes Consolidation Act 39 of 1997 prt 19 Ch 3 s 573.

²⁴² Taxes Consolidation Act prt 19 Ch 3 s 547.

²⁴³ Taxes Consolidation Act prt 19 Ch 3 s 574.

²⁴⁴ Taxes Consolidation Act prt 19 Ch 3 s 575.



existence of the trust will be subject to CGT in the hands of the trustees according to the normal rules.²⁴⁵ Where a beneficiary becomes absolutely entitled as against the trustees to any assets the assets are deemed to have been disposed of by the trustees to the beneficiary and the trustees will be subject to CGT²⁴⁶ (unless the beneficiary becomes entitled to the property as a result of a life tenant's death, in which case there will be no taxable disposal and the base cost will be stepped up for the beneficiary²⁴⁷). In the event of a capital loss which cannot be deducted from other chargeable gains accruing to the trustees in the year, the loss will be treated as having accrued to the beneficiary.²⁴⁸

10.9.2 Interaction with CAT

Because the distribution of the asset to the beneficiary triggers a liability for CAT in the hands of the beneficiary, CATCA provides that any capital gains tax payable (by the trustees) may be allowed as a credit against the CAT in the hands of the beneficiary in so far as it has been paid, provided that the beneficiary does not dispose of the property within two years of having acquired it.²⁴⁹ Bohan and McCarthy concede that the allowance of this credit is illogical for two reasons, namely (a) capital gains tax is a liability of the disponent (the trustees), whereas CAT is the primary liability of the beneficiary and (b) CAT is usually payable in advance of the capital gains tax.²⁵⁰

²⁴⁵ Taxes Consolidation Act prt 19 Ch 3 s 568.

²⁴⁶ Taxes Consolidation Act 19 Ch 3 s 576(1).

²⁴⁷ Taxes Consolidation Act prt 19 Ch 3 s 577. If the assets remain settled in the trust, the base cost will be stepped up in the hands of the trustee.

²⁴⁸ Taxes Consolidation Act 19 Ch 3 s 576(2).

²⁴⁹ S 104. See in general Bohan and McCarthy (2008) par 8.26–8.31 and Doyle (2008) 856 (example 34.25).

²⁵⁰ Bohan and McCarthy (2008) par 8.26.



10.10 CONCLUSIONS

- (a) In Ireland the taxation of wealth transfers is currently levied in a single statute under Capital Acquisitions Consolidation Act (CATCA).²⁵¹
- (b) Although a single tax referred to as “CAT” (capital acquisitions tax) is levied on both gifts and inheritances under a broad range of over-arching levying provisions, the Act distinguishes between acquisitions taken “on death” (referred to as “inheritances”) and acquisitions taken “otherwise than on death” (referred to as “gifts”).²⁵²
- (c) For some purposes, the distinction is irrelevant, whereas for others it is significant. The jurisdictional basis for both gifts and inheritances is established according to the same rules. However, where the status of the recipient becomes relevant (where the disponer is not resident in Ireland) the rules refer to a “date of gift” (in the case of a gift) and a “date of inheritance” (in the case of an inheritance). Although it seems as if there is a distinction between gifts and inheritances, both dates refer to the date when the beneficiary becomes beneficially entitled to the property comprised in the gift or inheritance.²⁵³ The double tax agreements, unilateral relief provisions, tax rate and ordinary valuation rules (as discussed in paragraph 10.3) also apply to both gifts and inheritances.²⁵⁴
- (d) The preferential valuation regimes for agricultural property and business property apply for both gifts and inheritances. However, the minimum-ownership rules differ depending on whether the property is transferred by

²⁵¹ See par 10.1.1 n 2 and accompanying text.

²⁵² See par 10.2.1.

²⁵³ See par 10.2.2.

²⁵⁴ See pars 10.2.3, 10.1.2 and 10.3.2-10.3.5.



virtue of a gift (in which case the Act requires a period of five years) or by virtue of an inheritance (in which case the Act requires a period of two years only). This is understandable if one considers that, unlike a gift, death is usually an uncalculated event.²⁵⁵

- (e) A unique feature of the Act is that the liability for the tax is generally deferred until the moment of acquisition in the hands of the beneficiary (referred to as the “valuation date”), which may occur later in time than the disposition under which it was created. The valuation date of a gift differs, however, from the valuation date of an inheritance. The special circumstances of transfers on death (which are subject to a process of probate) in contrast to transfers during life, are taken into consideration. The valuation date for an inheritance usually occurs only once the deceased estate had been finalised.²⁵⁶
- (f) But for a few exceptions, most of the exemptions apply equally to gifts and inheritances. However, a few exemptions are applicable only to either a gift or an inheritance. The parental exemption, for example, applies only to inheritances taken after parental gifts. In addition, the Group A threshold applying to parents is relevant only in respect of inheritances. Furthermore, the small gifts exemption applies only in relation to gifts.²⁵⁷
- (g) The approach to wealth transfer taxation in Ireland took a radical change when the English-based estate duty was replaced by a recipient based tax with the introduction of capital acquisitions tax (CAT) in 1975.²⁵⁸ CAT

²⁵⁵ See par 10.5.3.

²⁵⁶ See par 10.3.1.

²⁵⁷ See par 10.5.4.

²⁵⁸ See par 10.1.1.



represents a typical example of a recipient-based tax where the relationship between the transferor and the recipient is significant for the calculation of the tax. The paragraphs below will highlight some characteristics and problem areas (similar to the areas identified under the South African wealth transfer tax system in Chapter 7).²⁵⁹

- (h) In regard to the demarcation of the jurisdictional basis of the Act, the legislature was confronted with the dilemma whether the connection of the tax base should be established with reference to the transferor or with reference to the recipient. Currently, the jurisdictional basis of the tax is determined with reference to both the transferor and the recipient. The connection with the transferor is a remnant of the transferor-based estate duty that was levied in Ireland prior to the introduction of CAT.²⁶⁰
- (i) In respect of some “dispositions” the Act requires impoverishment and enrichment, whereas for others, enrichment is sufficient. The absence of the impoverishment requirement for an acquisition under a “failure to exercise a right” (provided for in paragraph (h)) has, for example, caused the application of CAT to be so broad that a failure to take up a valuable right or a failure to exercise an option below market value would fall within the ambit of the tax base. Furthermore, a “disposition” (in whichever form) does not require an intention to donate (or confer a benefit). However, commentators have pointed out that it seems unfortunate that *bona fide* commercial transactions are not sheltered from the scope of CAT (such as in the United Kingdom).²⁶¹

²⁵⁹ See Ch 7 par 7.4.

²⁶⁰ See par 10.2.2.1.

²⁶¹ See par 10.2.1.

- (j) In line with the trend of the Act to attribute transfers made and received by a company to the beneficial owners of the company, a value-shifting arrangement in a close company is attributed to the individual participators therein.²⁶²
- (k) Because of the broad ambit of the charging provisions, life policy benefits (whether acquired through a deceased estate or through a third party nomination) are comfortably charged to CAT under the normal rules. What is noteworthy is that a person takes a taxable gift or inheritance only to the extent that the benefits are received otherwise than for full consideration. A beneficiary of a policy will therefore not be liable for CAT on benefits received to the extent that he or she paid the premiums in respect of such policy or any other consideration for the acquisition thereof. Business assurance and key-man policies will therefore usually be sheltered from the tax base (provided that the deceased did not contribute to the policy).²⁶³
- (l) Although the concepts of a *fideicommissum* and a usufruct are foreign to Irish property law, these interests are considered as “limited interests” for the purposes of CAT and are therefore treated in a similar fashion to the interests of life tenants under fixed trusts. Bare *dominium* property is therefore classified as a “reversionary interest”.²⁶⁴ For the purposes of CAT the taxation of bare *dominium* property is deferred until it materialises into full ownership.²⁶⁵

²⁶² See par 10.2.1.

²⁶³ See pars 10.2.1, 10.2.4 and 10.5.1.

²⁶⁴ See par 10.6.3.1.

²⁶⁵ See par 10.7.1.



- (m) As a consequence of the deferral of the taxation of the bare *dominium*, taxpayers will largely be prevented from concealing a passive transfer of property through passage of time.²⁶⁶
- (n) A limited interest is valued with reference to actuarial tables and its period of enjoyment, notwithstanding the fact that the full value of the bare *dominium* property would be taxed at a later event.²⁶⁷ This approach is comfortably accommodated in the system because CAT is levied from the perspective of the recipient.
- (o) On the materialisation of the bare *dominium* into full ownership, the transfer occurs between the original owner and the bare *dominium* owner, as a consequence of which any consideration paid for the bare *dominium* by the bare *dominium* owner to the original owner may be taken into account in the calculation of CAT.²⁶⁸
- (p) The death of an interest holder does not pose any significant difficulties for the system because such an event merely accelerates the acquisition of a successive interest in the hands of either a successive usufructuary or a bare *dominium* owner.²⁶⁹
- (q) The renunciation of a limited interest also accelerates the acquisition of a successive interest. The problem in this area is that any consideration paid by the successive interest holder/bare *dominium* owner (to the original interest holder) for the renunciation cannot reduce the value of the transfer

²⁶⁶ See par 10.7.1.

²⁶⁷ See par 10.7.2.

²⁶⁸ See par 10.7.3.

²⁶⁹ See par 10.7.3.

(of the property) between the original owner and the successive interest holder/bare *dominium* owner.²⁷⁰

- (r) Under the CAT regime, tax avoidance through the use of interest-free loans is countered by virtue of a provision that the free use or enjoyment of any property (to which a person is not beneficially entitled in possession) constitutes a gift of the annual value of such free use to the person enjoying the free use of the property.²⁷¹
- (s) Because the indefinite deferral of CAT in the case of discretionary trusts crystallised as a problem area, CATCA introduced a special discretionary trust tax (DTT) regime in the 1980s. The regime provides for special charges on the trustees of the trust, which is in line with the tax system's notion to personify trusts for fiscal purposes. Firstly, there is an initial charge of six percent on any acquisition by the trust (received under a disposition as defined). In addition, a chargeable discretionary trust will become subject to an annual levy (taxed at one percent on the value of the assets). Any subsequent appointment of a trust in a beneficiary will then attract mainstream CAT.²⁷²
- (t) In the area of capital gains tax, commentators have pointed out that it seems awkward that the tax systems allows a credit for CGT against the CAT payable on a distribution of property to a trust beneficiary, because CGT is payable by the trustees, whereas CAT is payable by the beneficiary.²⁷³ If one considers, however, that CGT payable on a distribution of property to a

²⁷⁰ See par 10.7.3.

²⁷¹ See par 10.2.1.

²⁷² See par 10.6.

²⁷³ See par 10.9.



beneficiary is basically charged on the growth of the property from its entrance into trust to the moment of distribution, over which period the trust was also liable for annual DTT levies, it is arguable that the CGT credit is a measure to relieve the excessive tax burden on the property.

- (u) Substantial relief is afforded to business property and agricultural property in the form of a substantial remittance of the tax liability.²⁷⁴
- (v) Administrative inefficiency, which is generally regarded as one of the major drawbacks of a recipient-based tax with a larger number of taxpayers, does not seem to plague the system, arguably because CAT is collected in terms of a self-assessment system.²⁷⁵

The next chapter contains the final conclusions and recommendations of this thesis.

²⁷⁴ See par 10.5.3.

²⁷⁵ See par 10.4.

CHAPTER 11

CONCLUSIONS AND RECOMMENDATIONS

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11.1 INTRODUCTION

In Chapter 1 it was stated that this study will at the outset investigate the conceptual justification for wealth transfer taxation in a South African context, especially in view of the fact that a deemed-realisation approach has been applied on the death of a taxpayer since the introduction of capital gains tax in the tax system in 2001. In addition, this thesis identified two key policy issues under the current (transferor-based) South African wealth transfer tax system, levied in the form of estate duty and donations tax. The first issue deals with the lack of integration experienced under the current system and the second issue deals with the centuries-old debate on whether a transferor-based tax or a recipient-based tax is best suited to tax wealth transfers.¹

It was concluded in Chapter 4 that principles of equity demand that wealth transfer taxation is indeed warranted and desirable for the South African tax system, but that, from a theoretical perspective, transferor-based taxation (together with a deemed-realisation capital gains tax approach) is unjustifiable and that wealth transfer taxation should ideally be levied on the recipient.² Paragraph 11.2 below provides conclusions and recommendations on the improvement of neutrality between *inter vivos* transfers and transfers on death in the South African wealth transfer tax system, while paragraph 11.3 addresses the transferor-based tax/recipient-based tax debate to arrive at some recommendations for the South African context.

¹ See Ch 1 par 1.1.

² See Ch 4 par 4.6(h) and (i).



11.2 THE INTEGRATION OF THE TAXATION OF *INTER VIVOS* TRANSFERS AND TRANSFERS ON DEATH

11.2.1 General

It was pointed out that the taxation of inheritances, some of the earliest forms of taxation, was gradually complemented by the taxation of gifts.³ It was proposed that this study would attempt to outline the level of integration that should ideally exist between the taxation of *inter vivos* transfers and transfers on death in a South African context. To arrive at a conclusion in this regard, the systems in the United Kingdom, the Netherlands and Ireland were examined in Chapters 8, 9 and 10 to *inter alia* explore possible ways to improve the integration of *inter vivos* transfers and transfers on death in a wealth transfer tax system. This subsection briefly points to the lack of integration in the current South African system and outlines the level of integration between *inter vivos* transfers and transfers on death in the international systems. Thereafter, some recommendations are provided for the improvement of integration under the South African system.

11.2.2 Discrepancies in the South African Wealth Transfer Tax System

Chapter 7 pointed out a number of discrepancies that exist between the taxation of *inter vivos* transfers and transfers on death under the current South African wealth transfer tax system, which are not conducive to equity, such as the following:

- estate duty is levied under the Estate Duty Act,⁴ whereas donations tax is levied under the Income Tax Act;^{5 6}

³ See Ch 3 par 3.4(a).

⁴ Act 45 of 1955.

⁵ Act 58 of 1962.

⁶ See Ch 7 par 7.2.2.1.



- estate duty is levied on a (limited) worldwide as well as a *situs* basis, whereas donations tax is only levied on a (limited) worldwide basis;⁷
- estate duty is levied with reference to a person “ordinarily resident” in the republic, whereas donations tax is levied on a “resident”;⁸
- the double taxation agreements concluded for the purposes of wealth transfer taxation, with the exception of the agreement entered into with the United Kingdom, apply only to transfers on death;⁹
- unilateral relief is available under the estate duty provisions, but similar relief is not contained under the donations tax provisions;¹⁰
- the Estate Duty Act contains special valuation rules for unquoted shares, whereas the donations tax provisions do not contain a similar valuation rule;¹¹
- for the purposes of estate duty, usufructuary and other like interests are valued with reference to the life expectancy of the beneficiary (unless the period of enjoyment is fixed), whereas, for donations tax purposes, these interests are generally valued with reference to the life expectancy of the donor (unless the period of enjoyment is fixed);¹²
- some exemptions are, it is submitted, unjustifiably offered under the donations tax provisions, without corresponding relief provided for under the Estate Duty Act;¹³
- the general anti-avoidance rule contained in the Income Tax Act also applies to donations tax, whereas the Estate Duty Act does not contain a similar provision.¹⁴

⁷ See Ch 7 par 7.2.2.2.

⁸ See Ch 7 par 7.2.2.2.

⁹ See Ch 7 par 7.2.2.3.

¹⁰ See Ch 7 par 7.2.2.3.

¹¹ See Ch 7 par 7.2.2.4.

¹² See Ch 7 par 7.2.2.4.

¹³ See Ch 7 par 7.2.2.5.

¹⁴ See Ch 7 par 7.2.2.6.



It is therefore not surprising that the Margo Commission (in the 1980s) and the Katz Commission (in the 1990s) identified the lack of integration between the two different tax regimes as an area in need of tax reform and proposed the introduction of an integrated regime (referred to as a “capital transfer tax”) to integrate donations tax and estate duty in the South African tax system.¹⁵ Government still has to act on this recommendation.

11.2.3 The Level of Integration in the Countries Surveyed

It is evident from the comparative survey that the extent of integration between the taxation of donations (gifts) and inheritances differs from system to system. The most significant observation is that in all three systems gifts and inheritances are, contrary to the current position in South Africa, dealt with in a single statute.¹⁶

Despite the fact that gifts and inheritances are taxed in a single statute in the United Kingdom, the Netherlands and Ireland, all three acts differentiate between *inter vivos* transfers (referred to as “lifetime transfers” in the United Kingdom, “gifts” in the Netherlands and acquisitions taken “otherwise than on death” in Ireland) and transfers on death (referred to as “transfers on death” in the United Kingdom, “inheritances” in the Netherlands and acquisitions taken “on death” in Ireland).¹⁷

In the United Kingdom and the Netherlands, gifts and inheritances are taxed under separate charging provisions. In the United Kingdom the tax is referred to as “inheritance tax” in the case of both lifetime transfers and transfers on death, whereas in the Netherlands a distinction is made between “gift tax” (on gifts) and “inheritance tax” (on inheritances).¹⁸ Ireland, on the other hand, levies an integrated tax (referred to as capital

¹⁵ See Ch 1 par 1.1 and Ch 3 par 3.3.2.3.

¹⁶ See Ch 8 par 8.10(a); Ch 9 par 9.10(a) and Ch 10 par 10.10(a).

¹⁷ See Ch 8 par 8.10(b); Ch 9 par 9.10(b) and Ch 10 par 10.10(b).

¹⁸ See Ch 8 par 8.10(b); Ch 9 par 9.10(b).



acquisitions tax (CAT)) under a number of overarching charging provisions, which are designed to cater for both types of transfers.¹⁹

The provisions regarding the jurisdictional basis, unilateral double taxation relief and ordinary valuation rules²⁰ apply in general equally to *inter vivos* transfers and transfers on death in all three systems. In Ireland, the double taxation agreements cover both types of transfers. However, in the United Kingdom and the Netherlands some of the agreements apply to transfers on death only, which appears to be detrimental to tax neutrality, especially if one considers that the unilateral relief provisions provided for in those countries apply to both *inter vivos* transfers and transfers on death. The position is worse in the Netherlands, where the unilateral relief provisions are applicable only in the absence of a double taxation agreement, contrary to the position in the United Kingdom, where the unilateral provisions may provide relief even where a double taxation agreement is in place with a relevant country (which would mitigate inequities that may arise as a result of a double taxation agreement not covering lifetime transfers).²¹

The preferential valuation regimes for agricultural property (in the United Kingdom and Ireland), qualified country estates (in the Netherlands) and business property (in all three systems) apply equally to *inter vivos* transfers and transfers on death, except that all three systems' rules differentiate between the two transfers to a limited extent. For example, both the Dutch and Irish regimes require a longer period of minimum ownership in the case of a gift than in the case of an inheritance for the application of business relief (in the Netherlands and Ireland) and agricultural relief (in Ireland). In the United Kingdom,

¹⁹ See Ch 10 par 10.10(b).

²⁰ The valuation rules referred to in Ch 8 par 8.3, Ch 9 par 9.3 and Ch 10 par 10.3 (but not including the preferential valuation rules).

²¹ See Ch 8 par 8.10(c); Ch 9 par 9.10(c) and Ch 10 par 10.10(c).



special rules apply for a lifetime transfer (which qualified as a PET) where the transferor dies within seven years from the date of the transfer.²²

In the United Kingdom, the roll-over relief provided for non-agricultural woodlands applies to transfers on death only.²³

In the area of exemptions, all three systems differentiate between *inter vivos* transfers and transfers on death, although the level of differentiation differs. With only a few exceptions, the Irish system provides an example of a regime where virtually all the exemptions apply to both gifts and inheritances.²⁴ In the Netherlands, separate provision is made for the exemption of gifts and the exemption of inheritances. In some cases, an exemption for a gift is also correspondingly offered for an inheritance. In regard to the other exemptions, differentiation is (but for a few exceptions) in general justifiable.²⁵ In the United Kingdom, the majority of the exemptions apply to both lifetime transfers and transfers on death. There are, however, certain exemptions that differentiate between the two types of transfers. Of special significance is the potential exemption afforded to certain lifetime transfers (referred to as the “PET regime”), which is not extended to transfers on death. This regime has fuelled tax avoidance schemes utilising trusts to such an extent that it resulted in the relevant property regime being adopted for most interest in possession trusts since 2006. Because of the severe horizontal inequity that arises between lifetime transfers and transfers on death as a result of the PET regime, it is not surprising that the recently published Mirrlees Review recommended that this regime be repealed from the inheritance tax system.²⁶

²² See Ch 8 par 8.10(d); Ch 9 par 9.10(d) and Ch 10 par 10.10(d).

²³ See Ch 8 par 8.10(e).

²⁴ See Ch 10 par 10.10(f).

²⁵ See Ch 9 par 9.10(e).

²⁶ See Ch 8 par 8.10(f).



A unique feature of the Irish system is that the rules determining the date of liability (also the valuation date) differentiate between acquisitions taken “on death” and acquisitions taken “otherwise than on death”. Although CAT is usually due once the donee becomes entitled to the property under a gift, the liability for CAT on an inheritance is generally deferred until the estate administration has been finalised.²⁷ This, it is submitted, provides an excellent example of where the differentiation between the transfers serves as a measure to accommodate any special circumstances.

In both the Netherlands and Ireland the same rate structures apply equally to *inter vivos* transfers and transfers on death.²⁸ However, in the United Kingdom, transfers on death are taxed at 40 percent, whereas immediately chargeable lifetime transfers are taxed at a rate of 20 percent, unless the person dies within seven years from the transfer, in which case the property will be added to the deceased estate and any tax previously paid will be allowed as a credit. It was suggested that the different rate structures and credit system in the United Kingdom seem unnecessarily complicated and disturb the horizontal equity of the system.²⁹

The table below displays the level of integration between *inter vivos* transfers and transfers on death in the wealth transfer tax systems of South Africa, the United Kingdom, the Netherlands and Ireland. The symbol ■ indicates an area where the provisions are fully integrated and the symbol □ indicates an area where discrepancies exist between the two types of transfers.

²⁷ See Ch 10 par 10.10(e).

²⁸ See Ch 9 par 9.10(c) and Ch 10 par 10.10(c).

²⁹ See Ch 8 par 8.10(g).



	South Africa	United Kingdom	Netherlands	Ireland
Single statute	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Charging provisions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Jurisdictional basis	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Unilateral tax relief	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Double tax agreements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Ordinary valuation rules	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Preferential valuation rules (business property and/or agricultural property)	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/> however, special rule for a transfer on death following a PET	<input checked="" type="checkbox"/> however, different minimum-ownership rules	<input checked="" type="checkbox"/> however, different minimum-ownership rules
Exemptions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Anti-avoidance rule	<input type="checkbox"/>	N/A	N/A	N/A
Rates	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>

11.2.4 Conclusion and Recommendations

It is suggested that it seems conducive to equity, neutrality and tax administration that the rules relating to the jurisdictional basis, unilateral double taxation relief, ordinary valuation rules and preferential valuation regimes apply (in general) equally to *inter vivos* transfers and transfers on death in the wealth transfer tax systems comparatively surveyed. In addition, it seems fair that double taxation agreements apply to both *inter vivos* transfers and transfers on death, such as in Ireland. In most of the systems the same rates apply to all transfers. It is evident, however, that it remains necessary to distinguish between the two types of transfers, because this creates a flexible platform to accommodate special circumstances and differences, such as evidenced by the rules determining the valuation date in Ireland and the different minimum-ownership rules for gifts and inheritances under some of the preferential valuation regimes. Also, in the area of exemptions, it is sometimes warranted to take the type of transfer into consideration, such as the provision for an annual exemption for gifts. However, unjustified



discrepancies (even in the area of exemptions) undermine the equity of a system and should be avoided, such as evidenced by the PET regime in the United Kingdom.

Under the current estate duty and donations tax regimes, the lack of integration between *inter vivos* transfers and transfers on death could be improved by the following measures:

- For the purposes of donations tax, the extension of the tax base to the disposition of South African *situs* property by a donor other than a resident of the republic (in much the same way as provided for under the Estate Duty Act);
- For the purposes of defining the jurisdictional basis under the Estate Duty Act, the replacement of the term “ordinarily resident” in the republic with the term “resident” of the republic;
- The introduction of unilateral double taxation relief provisions for donations tax, based on the example provided under the Estate Duty Act;
- The adaption of the existing double taxation agreements to cover donations tax;
- The introduction of a valuation rule for unquoted shares for the purposes of donations tax, similar to the rule contained in the Estate Duty Act;
- For the purposes of estate duty, the amendment of the valuation rule for usufructuary or other like interests so that such an interest would be valued with reference to the life expectancy of the (deceased) interest holder just prior to his or her death (unless the period of enjoyment is fixed); which amendment would eliminate most of the anomalies under the current regimes (as extensively illustrated in Chapter 7).³⁰ Such an amendment would also necessitate the repeal of the section 5(1)(b) provisos and the exemption offered for the bare *dominium* owner who previously donated the usufructuary interest (or annuity), as explained in Chapter 7;³¹
- The review of the current exemptions offered under both regimes to eliminate any unjustified discrepancies; and

³⁰ See Ch 7 par 7.4.4.4.

³¹ See Ch 7 par 7.4.4.4.



- The inclusion of a general anti-avoidance rule in the Estate Duty Act, which could be premised on the rule currently provided for under the income tax legislation.

However, the appropriate level of integration would be to tax *inter vivos* transfers and transfers on death in a single integrated statute, similar to the systems in the United Kingdom, the Netherlands and Ireland. A single fiscal regime would provide the best platform to establish neutrality of treatment between *inter vivos* transfers and transfers on death.

It is consequently suggested that the Estate Duty Act and Part V of the Income Tax Act should be repealed and replaced with a new, integrated fiscal regime set up in terms of a single statute. Such a step would necessitate a comprehensive review of the current system, which could fruitfully be used as an occasion to re-evaluate key policy issues such as whether the system should operate as a transferor-based tax or a recipient-based tax. A major reform operation would also provide a platform to address problem areas such as those identified in Chapter 7.³²

11.3 TRANSFEROR-BASED TAX VERSUS RECIPIENT-BASED TAX

11.3.1 General

It was pointed out in Chapter 3 that common-law countries have traditionally preferred transferor-based (estate) taxation, whereas civil-law countries tended to impose recipient-based (acquisition) taxes.³³ With the replacement of the death duties system with estate

³² See Ch 7 par 7.4.

³³ See Ch 3 par 3.4(a).



duty and donations tax in 1955, South Africa has followed the trend of the common-law countries and moved away from recipient-based taxation.³⁴

The adoption of the English source-based concept of income precluded the taxation of wealth transfers (with the exception of certain remuneratory donations) under ordinary income taxation in South Africa.³⁵ Although it was explained that wealth transfers could conceptually be accommodated in a comprehensive income tax or even a comprehensive consumption tax,³⁶ these possibilities were never explored by the South African tax reform commissions.³⁷

It was suggested that a transition to a recipient-based wealth transfer tax system should be investigated for the purposes of the South African tax system, especially in view of the strong theoretical appeal of a recipient-based system (as summarised in 11.3.2 below). The possibility of merely including wealth transfers in the “gross income” of the recipient (for the purposes of the Income Tax Act of 1962) was explored in Chapter 4. It was, however, concluded that such a move would be politically and administratively unlikely. It was explained that, in a South African context, the taxation of wealth transfers in the hands of the recipients should instead be accomplished by a recipient wealth transfer tax, which may even be accommodated as a separate schedule to the existing Income Tax Act in much the same way as capital gains tax.³⁸

Although the South African tax reform commissions supported transferor-based taxation, it was pointed out that recipient-based taxation was never properly considered by any of them. Also, these commissions were not confronted with the double taxation produced by

³⁴ See Ch 3 par 3.4(i).

³⁵ See Ch 3 par 3.4(h).

³⁶ See Ch 2 par 2.5(a).

³⁷ See Ch 3 par 3.4(h).

³⁸ See Ch 4 par 4.6(f).



the simultaneous levying of capital gains taxation and estate duty/donations tax, because capital gains taxation was introduced in South Africa only in 2001.³⁹

Internationally, some of the factors that (apparently) contributed to the choice of transferor-based taxes include (a) administrative simplicity; (b) the fact that an estate tax is paid within a few months after death, whereas the recipient-based taxes are usually collected on the finalisation of the estate administration; (c) the apparent difficulty of fitting trusts into a recipient-based tax, and (d) the different approaches to estate administration between common-law and civil-law countries.⁴⁰

These issues, as well as aspects such as theoretical appeal, administrative feasibility, interaction with capital gains tax and certainty of law, are considered in the discussion below in establishing whether the South African transferor-based system should ideally be replaced with a recipient-based tax regime. In arriving at a thoroughly motivated recommendation in this regard, a selection of problem areas currently experienced under the estate duty and donations tax regimes were identified in Chapter 7.⁴¹ This was done to assist this study in establishing whether recipient-based systems experience similar problems and whether such systems could offer more appropriate solutions.

After considering lessons from the systems comparatively surveyed, the subsection below aims to explain why an integrated recipient-based tax would be superior to the introduction of an integrated transferor-based tax for the purposes of the South African tax system. Chapter 8 provided an overview of the transferor-based tax (called “inheritance tax”) currently levied in the United Kingdom, a traditional common-law country. The system in the Netherlands (a civil-law jurisdiction), which was reviewed in Chapter 9, resembles an example of a classic recipient-based tax. What makes the Irish

³⁹ See Ch 3 par 3.4(i).

⁴⁰ See Ch 3 par 3.2.3.

⁴¹ See Ch 7 par 7.4.



system, described in Chapter 10, an appropriate choice for the comparative survey is that it provides an example of a common-law country that successfully replaced its estate tax with a recipient-based acquisitions tax.

11.3.2 Theoretical Appeal

It was pointed out in Chapter 4 that recipient-based wealth transfer taxation has strong theoretical appeal for the following reasons:

- The principle of ability-to-pay dictates that windfall gains should be taxed in the hands of the recipient, whose taxable capacity is increased by the unearned benefits;
- Equally situated taxpayers are taxed equally under a recipient-based tax, whereas the recipients of wealth transfers are taxed unequally under an estate tax;
- The double (capital gains) tax argument is deflected where wealth transfers are taxed on a recipient basis, because capital gains tax is a tax on the transferor, whereas an acquisitions tax is a tax on the recipient;
- A recipient-based tax encourages the redistribution of resources (a foundational justification for wealth transfer taxation in general), because each recipient will have an exemption threshold;
- From an economic perspective, deferred recipient-based taxation is apparently less likely to distort economic decision-making than taxing the person who accumulated (or saved) the wealth;
- A transferor-based tax is commonly perceived to be a “death tax”, whereas a recipient-based tax is more likely to be experienced as a “transfer tax”.⁴²

⁴² See Ch 4 par 4.6(e).



11.3.3 Timing of the Tax

A recipient-based tax can easily be designed to deem the acquisition to occur at a later stage than the time when the beneficiary acquires an interest in the property. The tax may for example be deferred until the person acquires the enjoyment or possession of the property (such as provided for under the Irish CAT system)⁴³ or even until the interest in the property is realised at a later event, such as recommended by Dodge in a recent article on a proposed cash-flow “accessions tax” for the United States.⁴⁴ The possibility of deferral may address valuation issues, contingencies and even liquidity concerns.⁴⁵

Although the deferred timing of a recipient-based tax was apparently one of the reasons why common-law countries preferred the imposition of transferor-based taxation,⁴⁶ it should be kept in mind that wealth transfer taxes raised significant revenues in the pre-income tax era⁴⁷ and that the timing of these taxes was indeed extremely relevant in those days. However, it was shown in Chapter 4 that the contribution of wealth transfer taxes to national tax revenues has generally dropped to below two percent.⁴⁸ As a consequence, the timing of wealth transfer taxation has become rather insignificant for the purposes of revenue-raising. In addition, Dodge explains that deferral in itself is not prejudicial to the tax system because “[t]he value of property is the sum of future returns reduced to present value”.⁴⁹ He emphasises that all future yield will appear in the wealth transfer tax base of one or more persons.⁵⁰

⁴³ See Ch 10 par 10.10(e).

⁴⁴ See Dodge (2009) *Hastings Law J* 997 *et seq*, who suggests that a realisation-based accessions tax is appropriate for the US.

⁴⁵ See Dodge (2009) *Hastings Law J* 1020.

⁴⁶ See Ch 3 par 3.2.3.

⁴⁷ See Ch 4 par 4.3.1.

⁴⁸ See Ch 4 par 4.3.1.

⁴⁹ Dodge (2009) *Hastings Law J* 1035.

⁵⁰ Dodge (2009) *Hastings Law J* 1035.



It is therefore suggested that the benefits derived by deferring the tax liability could fruitfully be employed in the South African wealth transfer tax system, if the current estate duty and donations tax regimes were to be replaced by a recipient-based regime. The deferral-benefit in the realm of limited interests will be discussed in more detail in paragraph 11.3.4.3 below and the deferral-problem posed by discretionary trusts will be addressed in paragraph 11.3.4.4 below.

11.3.4 Common Problem Areas

Chapter 7 identified a number of significant problem areas under the donations tax and estate duty regimes.⁵¹ It is evident from the discussions in Chapter 8 (United Kingdom), Chapter 9 (the Netherlands) and Chapter 10 (Ireland) that most of these problem areas are common to wealth transfer taxation in general. Paragraph 11.3.4.1 deals with the issues relating to the demarcation of the jurisdictional basis. Paragraphs 11.3.4.2 to 11.3.4.4 discuss the three problem areas where it is submitted that a recipient-based approach would offer a more appropriate solution for the South African context. Paragraph 11.3.4.5 points out that grossing-up rules are unnecessary in a recipient-based system and paragraph 11.3.4.6 refers to the neutral problem areas in respect of which it is immaterial whether the taxation is levied on a transferor basis or whether it is levied on a recipient basis.

11.3.4.1 Jurisdictional Basis

For the demarcation of the jurisdictional basis of a wealth transfer tax the connection with the tax base is sometimes established with reference to residency only (such as the position in the Netherlands)⁵² or a combination of residency/domicile and location of

⁵¹ See Ch 7 par 7.4.

⁵² See Ch 9 par 9.10(g).



assets (such as the United Kingdom and Ireland).⁵³ What is significant to note is that this choice is somewhat independent from whether a system operates on a transferor basis or a recipient basis. Although estate duty and donations tax are primarily levied on a worldwide basis with reference to the resident status of the transferor (combined with a *situs* basis for non-residents),⁵⁴ certain foreign assets owned by residents are excluded from the tax base.⁵⁵ The issue of whether it is still justifiable to exclude these assets was raised in Chapter 7.⁵⁶ It is beyond the scope of this thesis to provide any recommendations on this issue, except to observe that it could be addressed in whichever form wealth transfers are taxed in the South African tax system.

Although it seems obvious that a transferor-based tax focuses on the resident status of the transferor,⁵⁷ recipient-based systems do not necessarily link up with the resident status of the recipient, although such an approach would appear to be theoretically sound.⁵⁸ In the Netherlands, the jurisdictional basis is established with reference to the status of the transferor. Apparently, this is a remnant of transferor-based taxation that was imposed earlier.⁵⁹ It was also explained that a connection with the transferor is (globally speaking) the most popular approach. In addition, the 1982 OECD model convention allocates a higher preference to a contracting state levying taxation with reference to the status of the transferor (than a state levying taxation with reference to the recipient).⁶⁰ It is therefore not surprising that the Irish tax system provides for a connection with the recipient as

⁵³ See Ch 8 par 8.2.3 and Ch 10 par 10.2.2.

⁵⁴ See Ch 7 par 7.2.2.2.

⁵⁵ See Ch 5 par 5.2.2.1 and Ch 6 par 6.2.2.1.

⁵⁶ See Ch 7 par 7.4.1.

⁵⁷ This is the position in South Africa and the UK. See Ch 5 par 5.2.2.1, Ch 6 par 6.2.2.1 (SA) and Ch 8 par 8.2.3.1 (UK).

⁵⁸ See comments by Dutch scholars in Ch 9 par 9.2.4.1.

⁵⁹ See Ch 9 par 9.10(f).

⁶⁰ See Ch 9 par 9.10(h).



well the transferor,⁶¹ thereby acknowledging on the one hand that the status of the taxpayer should be used from a theoretical perspective and, on the other hand, overcoming the difficulties mentioned above. This dual-connection approach is apparently quite common in other European wealth transfer tax systems.⁶² Although it is beyond the scope of this thesis to make a recommendation on how a jurisdictional basis of a recipient-based system (if implemented in South Africa) should be established, it is noteworthy that the problems experienced in this area under recipient-based taxation are not insurmountable.

11.3.4.2 The Treatment of Life Insurance Benefits

Because wealth is “transferred” where a person finances a life policy in favour of a third party, it is in principle understandable that these benefits should be accommodated in the tax base. However, it would seem that transferor-based taxation has more difficulty in dealing with these benefits than recipient-based systems, arguably because the theoretical basis of a recipient-based tax focuses on the net benefits acquired from the perspective of a beneficiary, which is submitted to constitute the best approach to third-party life insurance benefits.

It was pointed out that the problem with life insurance benefits from the angle of (transferor-based) estate duty is that the policy benefits are not channelled through the deceased estate of the insured.⁶³ Although this was overcome by a deeming provision in South Africa,⁶⁴ the problem is that the mere inclusion of the benefits in the deceased estate would have created a harsh result had the beneficiary’s position not been taken into

⁶¹ See Ch 10 par 10.10(h). This approach has also been suggested for the system in the Netherlands. See Ch 9 par 9.2.4.1.

⁶² See Ch 9 par 9.2.4.1.

⁶³ See Ch 6 par 6.2.4.2.1 n 55.

⁶⁴ See Ch 6 par 6.2.4.2.1.



account. It is therefore not surprising that these benefits are accommodated under the South African estate duty regime on a recipient basis.⁶⁵ For the purposes of estate duty, the proceeds included in the tax base of the deceased insured may be reduced by the premiums paid by the beneficiary. In addition, the beneficiary is ultimately responsible for the estate duty attributable to the benefits.⁶⁶ Such an approach does not reflect the underlying policy of a transferor-based tax.⁶⁷ Although it is unclear why third-party policy benefits escape the (transferor-based) inheritance tax base in the United Kingdom,⁶⁸ it may at least be observed that the accommodation of these benefits in a transferor-based tax seems to be problematic.

For the purposes of recipient-based taxation, the area of life insurance is not without any challenges. Because a third party acquires life insurance benefits through contractual operation and not by virtue of a “gift” or an “inheritance”, the inclusion of the benefits under the main charging provisions may require some special provisions. For example, in the Netherlands life insurance benefits are deemed to be an inheritance by the beneficiary from the deceased insured through the construction of a fictitious acquisition.⁶⁹ However, where the main charging provisions are designed to cover a broad range of transfers, such as under the Irish CAT system, these benefits are comfortably charged to tax under the normal rules. As a consequence, third-party benefits are charged to CAT in the hands of the beneficiary to the extent that such beneficiary did not provide adequate consideration for the benefits.⁷⁰

⁶⁵ See Ch 7 par 7.4.3.

⁶⁶ See Ch 6 pars 6.2.4.2.1 and 6.4.

⁶⁷ See Ch 7 par 7.4.3.

⁶⁸ See Ch 8 par 8.10(l).

⁶⁹ See Ch 9 par 9.10(j).

⁷⁰ See Ch 10 par 10.10(k).



However, the simple and neutral approach followed under the Irish system is not necessarily mirrored in other recipient-based taxes, because of problems such as the establishment of the economic source of a policy. Prior to 1 January 2010, third-party benefits were taxed in the Netherlands in the hands of the beneficiary where the deceased contributed “something” to the policy. Although the gross value of the proceeds was in principle included, a deduction was offered for all the premiums paid by the beneficiary. This approach was amended with effect from 1 January 2010 to narrow down the deemed inheritance to embrace only benefits “to the extent” that the beneficiary did not provide adequate consideration for these.⁷¹ Third-party benefits are therefore (currently) treated in a way similar to that under the Irish CAT system.

It is submitted that the system in the Netherlands (as amended in 2010) and the Irish CAT regime offer the most appropriate approach to the treatment of life insurance benefits by including only the *pro-rata* benefits (directly or indirectly) “transferred” to the beneficiary, rather than offering a deduction for the premiums against the gross value of the proceeds. Although the deduction of premiums provides some relief, it is submitted that such an approach negates the very nature of life insurance, because the premiums comprise not only a negligible contribution to the capital of the policy but also compensation actuarially calculated to discount the risk factors involved. Also, the *pro-rata* approach eliminates the necessity for provisions exempting key-man benefits and benefits payable in terms of buy-and-sell arrangements from the scope of the tax.⁷²

Although recipient-based taxes are not immune to problems relating to third-party life insurance benefits, it seems as though they are better positioned to deal with these issues than transferor-based taxes. Under the South African wealth transfer tax system, life insurance benefits have indeed been taxed on a recipient basis. However, this approach is not conducive to the underlying theory of the system, which focuses on the transfer of

⁷¹ See Ch 9 par 9.10(j).

⁷² See Ch 9 par 9.10(j) and Ch 10 par 10.10(k).



wealth from the perspective of the transferor. It is therefore suggested that a transition to recipient-based wealth transfer taxation in South Africa would benefit the system from the perspective of life insurance benefits.

A final observation is that the current inclusion of all benefits reduced by premiums together with the exception of certain policies payable to a spouse or child, key-man policies and policies effected in terms of buy-and-sell arrangements (subject to certain requirements), seems to be overly complicated and too broad, thereby disturbing the equity of the system and fuelling a lucrative estate planning industry.⁷³ It is suggested that the *pro-rata* approach followed in Ireland and the Netherlands (since 1 January 2010), seems to provide a simpler and fairer measure to tax these benefits.

11.3.4.3 The Treatment of Limited Interests and Bare Dominium

The treatment of limited interests and bare *dominium* property (in the common-law systems referred to as fixed interests and reversionary interests respectively) is a complex area involving the accommodation of the creation and termination of these interests in the tax base, which is also inextricably linked to the valuation of these interests.

There are basically two broad approaches to the position of bare *dominium* property, which is not dependent on whether the system operates on a transferor or on a recipient basis. In terms of the first approach (which will be referred to as the “non-deferral approach”), the taxation of the bare *dominium* (or reversionary interest) is not deferred until it materialises into full ownership, but is immediately taxable. Such an approach is currently followed under the South African *transferor*-based system⁷⁴ as well as the *recipient*-based Dutch system.⁷⁵ In both systems the usufructuary interest and bare

⁷³ See the issues outlined in Ch 6 par 6.2.4.2.1.

⁷⁴ See Ch 7 par 7.4.4.2.

⁷⁵ See Ch 9 par 9.10(k).



dominium property are valued with reference to actuarial tables. In terms of the second approach (referred to as the “deferral approach”), the taxation of the transfer of bare *dominium* property is generally deferred until the bare *dominium* property (or reversionary interest) materialises into full ownership. This approach was followed in the United Kingdom’s *transferor*-based inheritance tax system (prior to the 2006 amendments)⁷⁶ and is currently applied in the Irish *recipient*-based CAT system.⁷⁷ Although the current United Kingdom regime offers, strictly speaking, a third approach, by taxing limited interests under the discretionary trusts regime (relevant property regime),⁷⁸ it is suggested that such an option is totally foreign and would not be feasible in a South African context. This unconventional approach is not explored further in the discussion below.

A common problem experienced under the non-deferral approach followed in South Africa and the Netherlands is that the immediate taxability of the bare *dominium* property may be used to facilitate a passive transfer of wealth through passage of time, which may be amplified by the fact that the value of bare *dominium* (which is usually relatively low) is likely to fit into an exemption bracket.⁷⁹

However, the problems associated with the “aged-donor” phenomenon under the South African system⁸⁰ are not mirrored in the Dutch system.⁸¹ What should be noted is that the phenomenon does not arise as a consequence of the difference in valuation approaches followed under the estate duty and donations tax regimes, but as a result of taxing the transfer from the perspective of the transferor in a system where the taxation of the bare

⁷⁶See Ch 8 par 8.10(n).

⁷⁷ See Ch 10 par 10.10(l).

⁷⁸ See Ch 8 par 8.10(s).

⁷⁹ See Ch 7 par 7.4.4.2 and Ch 9 par 9.10(l).

⁸⁰ See Ch 7 par 7.4.4.3.

⁸¹ See Ch 9 par 9.10(m).



dominium is not deferred. It is evident from the Dutch system that a recipient-based approach ensures that the creation of interests (whether during life or on death) are treated in an equal manner.

Both the South African and Dutch systems seem to struggle with the accommodation of the *termination* of limited interests in the tax base. In both systems the mere lapse of a limited interest through passage of time has no tax consequences as such (except to the extent that such an event may lead to a taxable acquisition of a successive interest in the Netherlands). This position is justifiable because there is nothing left of the interest to “give away” or to “gain”. It is also understandable that both systems recognise in principle the renunciation of an interest as a taxable event, because the renunciation may confer a benefit to the successor of the enjoyment of the property.⁸² However, it seems as though the approach to the termination of an interest because of the death of the interest holder is problematic.

Under the South African system, the cessation of an interest enjoyed by the interest holder just prior to his or her death is specifically included in the estate duty tax base. It was pointed out that this position is, although debatable, on merit understandable if one considers that the untimely death of an interest holder (earlier than expected or before the expiration of a fixed period interest) may passively confer a benefit on the successor to the enjoyment of the property in much the same way as where the interest holder renounces the interest. However, it was shown that the difference in the valuation approaches under the donations tax regime (where limited interests are valued from the perspective of the transferor) in contrast to the estate duty regime (where limited interests are valued from the perspective of the successor) cause a number of anomalies which may largely be rectified by an amendment to the estate duty valuation rules to the effect that all limited interests are valued from the perspective of the transferor. Such a transition would furthermore create neutrality between a “transfer” as a result of

⁸² See Ch 7 par 7.4.4.4 and Ch 9 par 9.7.3.



renunciation and a “transfer” as a result of death. However, it was pointed out that it is arguable that it seems strange and unnatural to consider the life expectancy of the interest holder just immediately before his or her death.⁸³

On the other hand, it seems as if the recipient approach followed in the Netherlands, where the focus is on what is acquired by a beneficiary (and not on what is “given away”), offers a more natural approach. It seems to make more sense to determine a person’s life expectancy on the acquisition of an interest (in the beginning), than to establish a “hypothetical” life expectancy just prior to death (at the end). It is suggested that this may in fact be the reason why the South African legislature had chosen to value limited interests on the death of an interest holder over the successor’s life expectancy.

However, the accommodation of the death of an interest holder has also transpired to be problematic in the Netherlands. Contrary to the position in South Africa, an indirect “transfer” of wealth on the death of an interest holder is not captured in the tax base. As a result, there is no neutrality between a “transfer” of the unexpired period of enjoyment on a renunciation (which is included in the tax base) and a “transfer” of the unexpired period of enjoyment on the death of the interest holder (which is not included in the tax base). It was already pointed out that the justification for the inclusion of a “transfer” on the death of an interest holder is debatable. What complicates this issue in a recipient-based system is that the focus of the tax is on the acquisition of property, not on the termination thereof. However, the nub of the problem is that it is virtually impossible to accurately value a limited interest upon acquisition because its period of enjoyment is uncertain. Nevertheless and leaving aside the issue of whether a passive “transfer” occurs on death, it was shown that the absence of tax consequences on death creates some opportunities for tax avoidance through the use of artificial actuarial values, in the absence of any special provisions. The inclusion of the section 10 fiction was an attempt by the legislature to counter tax avoidance. It appears, however, as if the limited scope of the

⁸³ See Ch 7 par 7.4.4.4.



fiction falls short in a number of ways. It was therefore suggested that the Dutch system appears to be struggling to find a balance between, on the one hand, acknowledging that death (being a natural cause for the cessation of a limited interest) does not truly reflect an event where benefits are transferred to another, and on the other hand, recognising the possibility of exploitation.⁸⁴

It is arguable that the difficulties explained above could be avoided by merely providing for a deemed transfer on the death of the interest holder of the “unexpired period” of the interest to the successor of the enjoyment of the property, merely to act as a “correction” in the system. However, it may be difficult to justify a transfer on death (as explained above) and such a step would also struggle with the unnatural approach of valuing a benefit with reference to the life expectancy of the interest holder just immediately before his or her death.

What is significant to note is that the difficulties surrounding the death of an interest holder under a non-deferral approach are largely related to the fact that the taxation of the bare *dominium* is not deferred until it materialises into full ownership in such a system.

On the other hand, the difficulties surrounding the death of an interest holder and the possibility of concealing a passive transfer through lapse of time is largely avoided under a deferral approach, such as followed in the United Kingdom (prior to 2006) and Ireland.⁸⁵ In these systems each interest is generally taxed as and when it materialises into a “present interest” (meaning an interest conferring on the interest holder the right to the fruits of the property or the enjoyment thereof), which is also conducive to liquidity.

Because the date of liability for tax is deferred until the moment that the interest holder (or owner) acquires the enjoyment and/or fruits of the underlying property (which is

⁸⁴ See Ch 9 par 9.10(n).

⁸⁵ See Ch 8 par 8.10(o) and (q); Ch 10 par 10.10(m) and (p).



actually the moment that his or her taxable capacity is increased), a deferral approach best supports the principle of ability-to-pay.

When the Margo Commission briefly commented that it may be advisable to alter the approach towards limited interests under the South African wealth transfer tax system by treating a limited interest holder as the owner of the underlying property,⁸⁶ it is highly likely that the Commission was basing its proposition on the approach applied in the United Kingdom prior to March 2006. Although a usufruct, bare *dominium* property and *fideicommissum* are foreign to United Kingdom property law, these interests were taxed under the interest-in-possession regime (“IIP regime”) applicable to fixed trusts (prior to March 2006). Under the inheritance tax regime, usufructuary and fideicommissary interests are treated as “fixed (life) interests” and bare *dominium* property and fiduciary interests are treated as “reversionary interests”.⁸⁷ In the event where the granting of the limited interest is immediately taxable, inheritance tax would be levied on the full value of the underlying property and no concession would be granted, because a fixed interest is not valued with reference to actuarial tables. Every accrual of a “present interest” would therefore be treated as a disposition of the underlying property. However, it was pointed out in Chapter 8 that the provision of a concession would make no sense from a transferor perspective (where the tax is levied on what is given away) where the taxation of the bare *dominium* is deferred. The no-concession approach may, however, be justifiable in a United Kingdom context where the holder of a fixed life interest is legally regarded as the “beneficial owner” of the underlying property, especially if one considers that such an interest is usually freely disposable.⁸⁸ However, it is suggested that it would be absurd and unfair to regard the holder of a non-transferable usufructuary interest as the “owner” of the underlying property in a South African context, especially if one considers that these interests are generally subject to a number of restrictions.

⁸⁶ See Ch 7 par 7.4.4.2.

⁸⁷ See Ch 8 par 8.10(m).

⁸⁸ See Ch 8 par 8.10(p).



Usufructuary interests are, for example, not transferable under South African law and the underlying property does not fall in the estate of the usufructuary. Furthermore, these interests are often restricted to a short period of time.

Another problem that was pointed out under the United Kingdom regime is that any consideration paid by the bare *dominium* owner would not reduce the taxable transfer, because a necessary consequence of the deferral approach (in a transferor-based system) is that the transfer occurs between the interest holder and the bare dominium owner (and not the original owner and the bare *dominium* owner).⁸⁹

The Irish CAT regime, where limited interests and bare *dominium* property are also taxed under the fixed trusts regime as fixed interests and reversionary interests, provides an example of a recipient-based system applying a deferral approach.⁹⁰ It is significant to observe that the no-concession problem is not mirrored under such a system, because the focus is on the beneficiary. Where a limited interest such as a usufruct is initially granted, a valuation concession is granted in the hands of the usufructuary (which is also the taxpayer), or even a successive usufructuary (in the case of a successive usufruct).⁹¹ However, on the materialisation of the reversionary interest into full ownership, the full value of the property is taxed in the hands of the reversionary interest holder (bare *dominium* owner). Because such a transfer occurs between the original owner and the bare *dominium* owner (and not the interest holder and the bare *dominium* owner such as in the United Kingdom), any consideration paid for the bare *dominium* will pro-rata reduce the value of the transfer.⁹² A minor problem occurs in the event of a renunciation in that any consideration paid by the bare *dominium* owner to the original interest holder

⁸⁹ See Ch 8 par 8.10(r).

⁹⁰ See Ch 10 par 10.10(l).

⁹¹ See Ch 10 par 10.10(n).

⁹² See Ch 10 par 10.10(o).



will not reduce the taxable transfer to the bare *dominium* owner.⁹³ It is suggested, however, that provisions could be introduced to cater for this scenario.

In conclusion, it is proposed that a deferral approach provides the most appropriate way to accommodate limited interests and bare *dominium* (or fixed interests and reversionary interests) in a wealth transfer tax. The benefit of deferring the taxable event lies in the minimisation of abuse of the low bare *dominium* value, thereby countering schemes whereby property is passively transferred through passage of time. Moreover, the difficulty of capturing a “transfer” on the early termination of an interest on the death of the interest holder is avoided. In addition, the “aged-donor” phenomenon is deflected under such an approach (because the *inter vivos* “splitting” of interest would have no effect).

Furthermore, it should be clear that, in a South African context, the operation of a deferral regime would best be accommodated in a *recipient*-based system, because it allows the system to still accommodate actuarial values for limited interests, for example on the granting of a usufructuary interest. In addition, any consideration paid for the bare *dominium* by the bare *dominium* owner (to the original owner) could be taken into account in the calculation of the bare *dominium* owner’s tax liability (because the transfer of the property occurs between the original owner and the bare *dominium* owner).

A final observation is that, although a deferral approach was followed in South Africa under the Death Duties Act of 1922, it was illustrated in Chapter 7 that such an approach was part of a combined estate-and-succession-duty regime, involving a nightmare of complexities.⁹⁴ This regime was a far cry from the regimes currently operative in Ireland (or even the United Kingdom).

⁹³ See Ch 10 par 10.10(q).

⁹⁴ See Ch 7 par 7.4.4.5.



11.3.4.4 Discretionary Trusts

It was mentioned in Chapter 3 that the indefinite deferral of the acquisition of trust property in the hands of a beneficiary of a discretionary trust has apparently contributed to the preference for transferor-based estate taxes in some countries.⁹⁵ It is submitted, however, that the problems arising from the complex nature of discretionary trusts reaches much deeper than only deferred distributions to beneficiaries and that the problems are not only restricted to recipient-based taxation, as will appear more fully from the discussion below.

The problem in respect of a transfer of property to a discretionary trust centres on the characteristics required for a taxable transfer. Where the charging provisions require an intention to benefit (or donate), such as under the South African system and the regime in the Netherlands, the issue is whether a disposition occurs towards the trust in the absence of an intention to benefit the trustees.⁹⁶ The problem is exacerbated where the system requires enrichment in the hands of the beneficiary. Because of similar issues the approach towards a subsequent appointment of trust property to a beneficiary (by the trustees) is in general also troublesome. A further complicating matter is the absence of tax consequences on the death of a contingent beneficiary, or the disposal of a contingent interest during the duration of a trust has contributed to the use of discretionary trusts as generation-skipping tools in sophisticated tax avoidance schemes.

In analysing a system's approach to wealth transfers involving discretionary trusts, it is apparent that there are three positions to take into consideration, namely (a) a transfer of property into a discretionary trust, (b) the approach towards the contingent interests during the duration of a trust and (c) a subsequent appointment of trust property to a beneficiary of a trust. Table 11-1 below attempts to provide a brief summary of the

⁹⁵ See Ch 3 par 3.2.3.

⁹⁶ See Ch 5 par 5.6.2 and 5.6.3 and Ch 9 par 9.6.3.1.



position of discretionary trusts in the South African system and the other systems surveyed.

Table 11-1: Discretionary Trusts

	Transferor-based		Recipient-based	
	South Africa	United Kingdom	Netherlands	Ireland
Transfer into Discretionary Trust	Uncertainty because of requirements of intention/enrichment Special provisions were introduced to deem transfer to trust to be a transfer to trustees Donations Tax	No requirements for intention/enrichment An immediately chargeable transfer Inheritance Tax	Uncertainty because of requirements of intention/enrichment Initially: case law surprisingly held > taxable transfer to a stranger. But: 2010 introduced APV regime No tax consequences	No intention to benefit required, but focus of tax is on enrichment of beneficiary No CAT in terms of general charging provisions Introduced: Special DTT regime Entrance charge 6%
Duration of Trust	Contingent interests: No tax consequences on beneficiary's death or disposal of contingent interest No special regime	Contingent interests: No tax consequences on beneficiary's death or disposal of contingent interest Introduced: Relevant Property Regime Periodic charge of 6% every 10 years	Contingent interests: No tax consequences on beneficiary's death or disposal of contingent interest Introduced: APV regime. Inheritance tax on settlor's death	Contingent interests: No tax consequences on beneficiary's death or disposal of contingent interest Introduced: Special DTT regime Annual charge of 1%
Transfer out of Discretionary Trust	Uncertain position in law Specifically exempt from donations tax No tax consequences	Exit from trust not captured under general charging provisions Introduced: Relevant Property Regime Exit charge (fraction of periodic charge)	Uncertain position in law Introduced: APV Gift or inheritance from settlor or heir > gift/inheritance tax	Captured under general charging provisions Normal CAT



It is noteworthy that the challenges posed by discretionary trusts have created problems for recipient-based as well as transferor-based wealth transfer taxes. Special regimes to cater for these institutions were introduced in transferor-based systems such as the United Kingdom as well as recipient-based systems such as the Netherlands and Ireland.⁹⁷

Although the Margo Commission and Katz Commission proposed the introduction of a special regime to counter generation-skipping through discretionary trusts under the South African wealth transfer tax system in the 1980s and 1990s respectively, the legislature has not acted on these proposals to date.⁹⁸ Considering that this thesis investigates the possibility of replacing the current transferor-based system with a recipient-based regime, the question may be posed which system (recipient-based or transferor-based) would deal more satisfactorily with discretionary trusts in a South African context. Keeping in mind that trusts are generally personified for fiscal purposes in South Africa, it is suggested that the Dutch *afgezonderd particulier vermogen* (APV) regime, where trusts are basically “looked through” for income tax as well as inheritance and gift tax purposes in the Netherlands,⁹⁹ would be inappropriate for the South African context, because it would make no sense to tax the income of the trust in the hands of the trustees (or beneficiaries if distributed to them) for income tax purposes, while regarding the settlor to still be the owner of the trust property (for wealth transfer tax purposes). By contrast, the regimes operative in the United Kingdom and Ireland are both underpinned by the idea that trusts should (to a certain extent) be treated as separate taxpayers.

The United Kingdom relevant property regime and the Irish DTT regime are basically mirror-images of each other. Because the focus of the United Kingdom inheritance tax system falls on the disposition from the point of view of the transferor, a transfer to a

⁹⁷ See Ch 8 par 8.10(t); Ch 9 par 9.10(p) and Ch 10 par 10.10(s).

⁹⁸ See Ch 7 par 7.4.6.

⁹⁹ See Ch 9 par 9.10(p).

discretionary trust attracts inheritance tax in terms of the normal rules. Under the Irish CAT system, where the focus lies on the acquisition in the hands of the beneficiary, CAT is charged on an appointment of property to a beneficiary (in terms of the normal charging provisions). The United Kingdom relevant property regime basically provides for a periodic levy during the duration of the trust together with a special exit charge on the appointment of trust property in a beneficiary, whereas the Irish regime provides for a periodic levy during the duration of the trust together with a special entrance tax on the transfer of property into a trust.¹⁰⁰ However, the significant difference between the two regimes is their interaction with capital gains tax, as will more fully appear from the tables below, where the wealth transfer tax and capital gains tax consequences involving discretionary trusts are compared under the United Kingdom tax system and the Irish tax system:

Table 11-2: United Kingdom

Transfer into Trust		Duration of Trust and Appointment in Beneficiary		
Wealth Transfer Tax	Capital Gains Tax	Wealth Transfer Tax: Duration	Capital Gains Tax	Wealth Transfer Tax: Appointment
Inheritance Tax	CGT	Periodic charge Every 10 years	CGT on growth over the duration of the trust, levied when appointment is made to beneficiary	Exit charge (fraction of periodic charge)
<u>Transferor</u>	<u>Transferor</u> (unless stepped up on death)	<u>Trustees</u>	<u>Trustees</u>	<u>Trustees</u>
		Double taxation on the growth		
Double taxation on transferor: Hold-over Relief (In Case of Gift)		Double taxation on trustees when appointment is made: Hold-over relief		

¹⁰⁰ See Ch 8 par 8.10(t) and Ch 10 par 10.10(s).



Table 11-3: Ireland

Transfer into Trust		Duration of Trust and Appointment in Beneficiary		
Wealth Transfer Tax	Capital Gains Tax	Wealth Transfer Tax: Duration	Capital Gains Tax	Wealth Transfer Tax: Appointment
6% Entrance charge	CGT	Annual charge	CGT on growth over the duration of the trust, levied when appointment is made to beneficiary	CAT (full charge)
<u>Trustees</u> (Recipient)	<u>Transferor</u> (Settlor) (unless stepped up on death)	<u>Trustees</u> (Recipient)	<u>Trustees</u>	<u>Beneficiaries</u> (Recipient)
		Double taxation on the growth		
<u>NO</u> double taxation on transferor: However, credit for CGT available against CAT		<u>NO</u> double taxation on trustees/beneficiary when appointment is made: However, credit for CGT available against CAT		

It is arguable that the periodic charges under both regimes may be an over-kill if one considers that the growth in the trust assets is in any event subject to capital gains tax. However, the more prominent issue is the double taxation that occurs on a transfer into trust and an appointment of property in a beneficiary.

Under the United Kingdom (transferor-based) inheritance tax regime, double taxation arises in the hands of the transferor on an *inter vivos* transfer into a trust as well as in the hands of the trustees upon the appointment of property in a beneficiary. The double taxation is, however, mitigated by the provision for hold-over relief. Critics have indeed pointed to the failure of the United Kingdom legislature to successfully integrate the various taxes involved on transfers to and from discretionary trusts.¹⁰¹

By contrast, the Irish recipient-based regime seems to cope better with the harmonisation of CAT and capital gains tax. Although the system offers a credit for capital gains tax

¹⁰¹ See Ch 8 par 8.10(u).



against CAT payable in respect of the same event, commentators have pointed out that the relief lacks justification, especially because the taxes are payable by various taxpayers (on a transfer into trust as well as on an appointment to a beneficiary). If one considers, however, that CGT payable on a distribution of property to a beneficiary is basically charged on the growth of the property from its entrance into trust to the moment of distribution, over which period the trust was also liable for annual DTT levies, it is arguable that the CGT credit is a measure to relieve the excessive tax burden on the property.¹⁰²

Although it falls outside the scope of this thesis to establish whether or not a special regime for discretionary trusts should be introduced for the purposes of South African wealth transfer taxation,¹⁰³ it is relevant to determine whether such a regime (if implemented) would best be accommodated under a transferor-based system or a recipient-based system, considering that one of the objectives of this study is to establish whether the existing (transferor-based) wealth transfer tax system should be replaced by a recipient-based system. Because it is evident from the discussion above that the interaction of a special discretionary trust regime with capital gains tax is a prominent role player in the harmonisation of a tax system, the South African context should be considered in this regard. What needs to be kept in mind is that, under the South African capital gains tax system, a transfer to a trust constitutes a taxable disposition in the hands of the transferor (the settlor). However, although an appointment of property to a beneficiary constitutes a disposition by the trustees, the capital gains tax regime attributes any gain that accrues as a result of such appointment (over the duration of the period that the assets were kept on trust) to the particular beneficiary.¹⁰⁴

¹⁰² See Ch 10 par 10.10(t).

¹⁰³ In order to make a proper proposal on whether the South African legislature should introduce a special regime, all the alternatives should be considered. An example of a withholding/credit system (which was actually proposed for South Africa by the Katz Commission), was not even examined in this thesis. See Ch 7 par 7.4.6. For further reading and criticism on a withholding/credit system, see Dodge (2009) *Hastings Law J* 1041. See also the proposals by the Dutch scholars in Ch 9 par 9.6.3.2.

¹⁰⁴ See Ch 5 par 5.6.1.3.

The tables below attempt to provide an idea of how the interaction would operate in a South African context. For this purpose, two hypothetical systems are assumed, namely:

- A transferor-based estate duty and donations tax regime (as currently operative in the South African tax system), where a discretionary trust regime is provided for on the basis of the regime operative in the transferor-based United Kingdom inheritance tax regime (Table 11-4 below); and
- *Assuming that the current system is replaced by a recipient-based wealth transfer tax:*

A recipient-based acquisitions regime (similar to the CAT system operative in Ireland) where a discretionary trust regime is provided for on the basis of the regime operative in the Irish CAT system (Table 11-5 below).

Table 11-4: Hypothesis for South Africa: Current Estate Duty and Donations Tax System together with Discretionary Trust Regime (as provided for under the United Kingdom regime)

Transfer into Trust		Duration of Trust and Appointment in Beneficiary		
Wealth Transfer Tax	Capital Gains Tax	Wealth Transfer Tax: Duration	Capital Gains Tax	Wealth Transfer Tax: Appointment
Donations tax/Estate Duty	CGT	Periodic charge Every 10 years	CGT on growth over the duration of the trust, levied when appointment is made to beneficiary	Exit charge (fraction of periodic charge)
<u>Transferor</u>	<u>Transferor</u> (Deemed Realisation)	<u>Trustees</u>	<u>Beneficiaries</u> (because of attribution rules)	<u>Trustees</u>
		Double taxation on the growth		
Double taxation on transferor		<u>NO</u> double taxation when appointment is made		



Table 11-5: Hypothesis for South Africa: Recipient-based wealth transfer tax regime (based on CAT system in Ireland) together with Discretionary Trusts Regime (as provided for under the Irish CAT regime)

Transfer into Trust		Duration of Trust and Appointment in Beneficiary		
Wealth Transfer Tax	Capital Gains Tax	Wealth Transfer Tax: Duration	Capital Gains Tax	Wealth Transfer Tax: Appointment
6% Entrance charge	CGT	Annual charge	CGT on growth over the duration of the trust, levied when appointment is made to beneficiary	CAT (full charge)
<u>Trustees</u> (Recipient)	<u>Transferor</u> (Settlor)	<u>Trustees</u> (Recipient)	<u>Beneficiaries</u> (because of attribution rules)	<u>Beneficiaries</u> (Recipient)
		Double taxation on the growth		
<u>NO</u> double taxation on transferor		Double taxation on beneficiaries when appointment is made		

If Tables 11-4 and 11-5 above are compared, it seems as though a transferor-based system (with provision for a discretionary trust regime) produces double taxation in the hands of the transferor in the case of a transfer into trust. On the other hand, a recipient-based system (with provision for a discretionary trust regime) produces double taxation in the hands of the beneficiaries. In each case, the question is whether the double taxation is legitimate. It is submitted that the double taxation on the transfer into trust (under the transferor-based regime) constitutes illegitimate double taxation, for the reasons pointed out in Chapter 4 above.¹⁰⁵

In the case of the recipient-based system, the double taxation produced is a necessary corollary of the deferral scheme for trusts. As explained by Dodge (in his article on a

¹⁰⁵ See Ch 4 par 4.4.1.2.



proposed accessions tax for the United States),¹⁰⁶ capital gains tax would normally be imposed first and only thereafter would an acquisitions tax be imposed on the (after tax) wealth that is transferred gratuitously.¹⁰⁷ Assuming that the discretionary trust was instead regarded as the taxpayer under the recipient-based system (and the main taxable event therefore not deferred until the appointment in the beneficiary), then the double taxation argument would disappear.¹⁰⁸ Regarding the trust as the taxpayer would cause the full charge for capital acquisitions tax to be shifted from the appointment of the property in the beneficiary to the initial acquisition by the trust (taxable in the hands of the trustees) and the six percent initial charge to be replaced by a six percent exit charge when the property leaves the trust (taxable in the hands of the trustees). This “reversed” system is illustrated in Table 11-6 below:

Table 11-6: Hypothesis for South Africa: Recipient-based wealth transfer tax regime (based on CAT system in Ireland) together with Discretionary Trusts Regime (reversed DTT regime)

Transfer into Trust		Duration of Trust and Appointment in Beneficiary		
Wealth Transfer Tax	Capital Gains Tax	Wealth Transfer Tax: Duration	Capital Gains Tax	Wealth Transfer Tax: Appointment
CAT (full charge) Trust regarded as taxpayer	CGT	Annual charge	CGT on growth over the duration of the trust, levied when appointment is made to beneficiary	6% Exit charge
<u>Trustees</u> (Recipient)	<u>Transferor</u> (Settlor)	<u>Trustees</u> (Recipient)	<u>Beneficiaries</u> (because of attribution rules)	<u>Trustees</u> (Recipient)
		Double taxation on the growth		
<u>NO</u> double taxation		<u>NO</u> double taxation		

¹⁰⁶ The double taxation produced on the appointment of property is also relevant for Dodge’s accessions tax proposal, because capital gains (being income) realised on the appointment of trust property are taxed either to the trust or the beneficiaries under the US tax system. See Dodge (2009) *Hastings Law J* 1038 n 176.

¹⁰⁷ Dodge (2009) *Hastings Law J* 1039.

¹⁰⁸ Dodge (2009) *Hastings Law J* 1042.



It is therefore submitted that the double taxation produced under the recipient-based system (in Table 11-5 above) is legitimate, because it is merely a consequence of the timing of the taxes (and not the same property/income taxed in the hands of the same taxpayer).

A final (minor) issue relates to the timing of the tax. Under the recipient-based Irish CAT discretionary trust regime, the main charge to CAT is levied on the appointment of trust property to a trust beneficiary, contrary to the relevant property regime operative in the United Kingdom. If South Africa were to adopt a recipient-based regime (similar to the CAT system and special DTT regime), then the question may be posed whether the unlimited deferral of the (main) tax liability would pose any significant problems for the tax system, especially in the absence of a rule against perpetuities in the South African trust law.¹⁰⁹ Two answers can be provided here. Firstly, it was already pointed out above that the timing of wealth transfer taxation is relatively insignificant given its low revenue yield.¹¹⁰ Secondly, if timing seems to be an issue, then the system outlined in Table 11-6 above presents evidence that the tax burden can easily be shifted to the initial acquisition by the trust.

In conclusion, it seems as if discretionary trusts set challenges for recipient-based as well as transferor-based wealth transfer taxes. It is evident from the systems comparatively surveyed that systems often introduce special regimes to cater for the unique features of transfers to and from discretionary trusts. It was shown, however, that a recipient-based regime for discretionary trusts interacts better than a transferor-based regime with a co-existing capital gains tax system, which would also be the position for a South African context (as explained above). Furthermore, it was shown that the deferral of the (main) tax liability to the appointment of trust property in a beneficiary does not pose any problems for a recipient-based wealth transfer tax system.

¹⁰⁹ See Ch 5 par 5.6.1.2.

¹¹⁰ See par 11.3.3.



11.3.4.5 Grossing-up Rules

In the case of a transferor-based tax, an *inter vivos* transfer would principally exclude the tax attributable to the transfer, whereas a transfer on death (the value of the deceased estate) would not exclude the tax, as a consequence of which *inter vivos* transfers and transfers on death are not treated equally. An example in Chapter 7 illustrated that this is indeed the position under the current South African wealth transfer tax system.¹¹¹

This problem is sometimes overcome by grossing-up rules which provide that the value of the transfer should include the tax attributable to it, such as found under the United Kingdom inheritance tax regime.¹¹² However, the valuation of property taking an amount of tax into account, which is on the other hand dependent on the value of the property, requires a complicated mathematical calculation which may make it difficult for some taxpayers to calculate their tax liabilities.¹¹³

By contrast, there is no need to equalise wealth transfers under an acquisitions tax, because the tax (borne by the recipient) would not reduce the value of the acquisition.

11.3.4.6 Other Problem Issues

It is evident that the remaining problem areas outlined in Chapter 7 have to a large extent also been encountered in the United Kingdom, the Netherlands and Ireland (in some or other form). What is significant to observe, however, is that these issues (and any solutions offered) are independent from whether the system operates on a transferor basis or a recipient basis. These issues include:

¹¹¹ See Ch 7 par 7.4.8.

¹¹² See Ch 8 par 8.10(w).

¹¹³ South Africa has experienced difficulty in this area under the application of the s 4(q) spousal exemption. In *CSARS v Executor Frith's Estate* (2001) 2 SA 261 (SCA) the court was confronted with the question whether the value of the s 4(q) benefit was calculated taking the estate duty liability into account, or not. See Ch 6 par 6.5.2.2 n 192 – n 195 and accompanying text.



- the defining of the characteristics of an *inter vivos* transfer;¹¹⁴
- the provision for special rules to accommodate e.g. omissions; value-shifting arrangements and estate-freezing techniques (such as interest-free loans) in the tax base;¹¹⁵ and
- the provision of relief for business properties and/or agricultural properties.¹¹⁶

11.3.5 Estate Administration Process and Administrative Issues

It was pointed out in Chapter 3 that the distinctly different estate administration processes followed in common-law and civil-law countries have apparently influenced the preference for either transferor-based or recipient-based taxation. Anglo-American law provides for a process of probate, where an executor finalises the administration of an estate and pays all the outstanding debts and taxes; this contributed to the notion of transferor-based taxation in those countries. Conversely, the civil-law jurisdictions generally follow a process where the liabilities and outstanding tax charges are carried over to the heirs, which apparently influenced a preference for recipient-based taxes in those countries.¹¹⁷ It is understandable that an estate tax would be difficult to administer in a civil-law country in the absence of a process of probate or estate administration. However, a process of probate should not counter the proper operation of a recipient-based tax.

Although one can in principle concede that it would be administratively simpler to keep a deceased estate liable for the duty,¹¹⁸ it is difficult to admit that this point outweighs the

¹¹⁴ See Ch 8 par 8.10(i); Ch 9 par 9.10(i) and Ch 10 par 10.10(i).

¹¹⁵ See Ch 8 par 8.10(j), (k); Ch 9 par 9.10(o) and Ch 10 par 10.10(j), (r).

¹¹⁶ See Ch 8 par 8.10(v); Ch 9 par 9.10(q) and Ch 10 par 10.10(u).

¹¹⁷ See Ch 3 par 3.2.3.

¹¹⁸ This point was heavily relied on by all three the South African tax reform commissions. See Ch 3 par 3.3.2.3. It was also indicated in Ch 3 par 3.2.3 that administrative convenience represents one of the main reasons why estate taxation had generally been preferred in traditional common-law countries.



advantages of a recipient-based tax outlined above, especially if one considers that it would be relatively easy to involve the executor in the compliance process, such as provided for in the Dutch system.¹¹⁹ It is therefore not surprising that it has been claimed that the administrative advantages of a transferor-based tax are not that significant.¹²⁰ This view is bolstered if one considers that an executor, under the current South African estate duty regime, is already required to recover estate duty from heirs or beneficiaries in certain instances.¹²¹

In addition, most taxpayers in South Africa are in any event required to submit information on inheritances and donations received by them in their income tax returns. In fact, the possibility was already raised that a recipient-based tax could even be accommodated in a separate schedule to the Income Tax Act, as in the case of capital gains tax.¹²² The use of the income tax assessment form as a reporting vehicle seems especially relevant considering that inheritances and donations are actually akin to income in the economic sense of the word.¹²³ In fact, donations tax has been levied under income tax legislation in an independent form since 1955.¹²⁴ In addition, an incorporation of the new system under the Income Tax Act may benefit from its administrative provisions and the anti-avoidance rule. However, the question whether or not the incorporation of the new system under income tax legislation would be feasible from an administrative point of view requires further investigation. This falls outside the ambit of this thesis, particularly because it requires information on SARS's administrative

¹¹⁹ See Ch 9 par 9.10(r).

¹²⁰ O'Brien Report (1982) 444.

¹²¹ See Ch 6 par 6.4.

¹²² See Ch 4 par 4.6(f).

¹²³ See Ch 2 par 2.2.2.2 This is also recommended by Dodge for his accessions tax proposal for the US. See Dodge (2009) *Hastings Law J* 1010.

¹²⁴ See Ch 3 par 3.3.2.2.



capacity. Which provisions of the Income Tax Act could apply to the new regime would also have to be assessed, a study which would have to point out any incompatibilities.

11.3.6 Certainty of Law

Estate duty and donations tax are well embedded in the South African system. These taxes have been the subject of numerous court cases and tax practitioners and some taxpayers are familiar with the basic structure of these taxes.

11.3.7 Conclusions and Recommendations

In the light of the discussion above, it is submitted that the advantages of a recipient-based tax outweigh those of a transferor-based tax. This conclusion is further bolstered if one considers that tax reform commissions in the United Kingdom, United States, the Netherlands and Ireland have advocated the acquisition or retention of recipient-based taxes.¹²⁵ It is interesting, though, to observe that the proposal to governments by the commissions in the United Kingdom and United States, to convert the transferor-based taxes to recipient-based taxes, fell on deaf ears.¹²⁶ This may, at least in part, explain some of the pressure currently experienced on the transferor-based taxes in those countries. It is furthermore not surprising that the decline of wealth transfer taxes in OECD countries has in fact been much greater among countries with transferor-based taxation than in countries which levy recipient-based taxes.¹²⁷

The replacement of the existing wealth transfer tax system with a recipient-based regime would be a step in the right direction if greater equity were to be sought in respect of the taxation of capital in the South African tax system. It is therefore recommended that the

¹²⁵ See Ch 3 par 3.2.3.

¹²⁶ See Ch 3 par 3.4(f).

¹²⁷ See Ch 3 par 3.4(e).



Estate Duty Act and Part V, Chapter II of the Income Tax Act should be repealed and replaced with a single, recipient-based wealth transfer tax regime. The recipient-based systems operative in the Netherlands and Ireland may serve as useful examples in the design of a new integrated tax for South Africa. It is suggested that the over-arching integrated charging provisions of the Irish system seem to present a modern and efficient way to levy taxation on *inter vivos* transfers as well as transfers on death.¹²⁸ Similar provisions could be designed for the purposes of the South African context. However, some basic principles and rules of the existing estate duty and donations tax regimes (such as valuation rules) could be adapted in such a way that a transition could be effected with minimal disruption, also taking into consideration the recommendations made above on integration issues. The proper design of the relevant law (be it a separate statute or as a further part or schedule to the Income Tax Act) as well as the administrative implications that will ensue will have to be properly investigated by National Treasury in liaison with SARS.

¹²⁸ See Ch 10 par 10.2.1.



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SARS <i>Transfer Duty Handbook</i> (2007), available at http://www.sars.gov.za	SARS <i>Transfer Duty Handbook</i> (2007)
SARS <i>Reference Guide: Estate Duty Implications on Buy-and-Sell Arrangements, Where Shares are Held in Trust</i> (AS-ED-01) (2008) 3, available at http://www.sars.gov.za/home.asp?pid=183	SARS <i>Buy-and-Sell Arrangements</i> (2008)



SARS <i>Reference Guide: Estate Duty Implications on Key Man Policies</i> (AS-ED-02) (2008) 3, available at http://www.sars.gov.za/home.asp?pid=183	SARS <i>Key-man Policies</i> (2008)
HMRC - United Kingdom	
HMRC <i>Inheritance Tax: Customer Guide</i> , available at http://www.hmrc.gov.uk/CTO/customerguide/page20.htm#11 (accessed on 20 November 2009)	HMRC <i>Inheritance Tax: Customer Guide</i>
HMRC <i>Inheritance Tax Manual</i> , available at http://www.hmrc.gov.uk/MANUALS/inhmanual/index.htm (accessed on 30 November 2009)	HMRC <i>Inheritance Tax Manual</i>
HMRC <i>Inheritance Tax and Settled Property</i> , available at http://www.hmrc.gov.uk/trusts/iht/intro.htm (accessed on 29 June 2009)	HMRC <i>Inheritance Tax and Settled Property</i>
HMRC <i>Inheritance Tax on Transfers into Trust</i> , available at http://www.hmrc.gov.uk/trusts/iht/transfers-in.htm (accessed on 27 June 2009)	HMRC <i>Inheritance Tax on Transfers into Trust</i>
Revenue (Irish Tax & Customs) - Ireland	
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Gale WG and Slemrod J <i>Rhetoric and Economics in the Estate Tax Debate</i> , a paper prepared for the National Tax Association Spring Symposium, Washington DC (7-8 May 2001), available at http://www.brookings.edu/views/papers/gale/20010522.pdf (last accessed 20 August 2008))	Paper by Gale and Slemrod <i>Estate Tax Debate</i> (2001)
Holtz-Eakin D and Maples D <i>Estate Taxes, Labor Supply and Economic Efficiency</i> , a paper prepared for the American Council for Capital Formation Center for Policy Research (January 2001), available at http://www.accf.org/publications/reports/sr-estatetaxes-laborsupply.html (accessed on 24 September 2008)	Paper by Holz-Eakin and Maples <i>Estate Taxes, Labor Supply and Economic Efficiency</i> (2001)
Robbins G and Robbins A <i>The Case for Burying the Estate Tax</i> , a paper issued under the auspices of the Institute for Policy Innovation (1999)	Paper by Robbins and Robbins <i>The Case for Burying the Estate Tax</i> (1999)

Shev J A <i>Study of Some of the Combined Tax Effects of Capital Gains Tax and Estate Duty and a Comparison with Similar Legislation in the United States and the United Kingdom</i> , a paper presented to the Department of Accounting, University of Cape Town, for the degree MBS (2003)	Paper by Shev <i>The Combined Tax Effects of Capital Gains Tax and Estate Duty</i> (2003)
Sonneveldt F and Zwemmer JW “Avoidance of Multiple Inheritance Taxation in Europe”, a paper delivered at the annual conference of the <i>European Association of Tax Law Professors</i> in Maastricht (2001), available at http://www.eatlp.org/index.html (assessed on 1 March 2009)	Paper by Sonneveldt and Zwemmer <i>Avoidance of Multiple Inheritance Taxation in Europe</i> (2001)
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Beckham NF <i>Some Aspects of Estate Duty on Deceased Estates in the RSA – with Special Reference to the Problems and Effects of Double Taxation Occurring in relation to the German Erbschaftsteuergesetz (Inheritance Tax Act)</i> , a thesis submitted for the degree Magister Legum, University of Cape Town (1993)	Beckham LLM Thesis (1993)
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Holmes K <i>The Concept of Income: A Multi-disciplinary Analysis</i> , a thesis submitted for the degree Doctor of Philosophy, Victoria University of Wellington, published by IBFD Publications BV (2001)	Holmes PhD Thesis (2001)
Olivier PA <i>Aspekte van die Reg insake Trust en Trustee met Besonderse Verwysing na die Amerikaanse Reg</i> , a thesis submitted for the degree Doctor Legum, University of Pretoria (1982)	Olivier LLD Thesis (1982)
Sonneveldt F <i>De Private Express Trust in de Nederlandse Successiewet 1956</i> , a thesis submitted for the degree Doctor of Law, University of Utrecht (2000)	Sonneveldt Doctoral Thesis (2000)
Strydom S <i>Die Aansprake van 'n Trustbegunstigde in die Suid-Afrikaanse Reg</i> , a thesis submitted for the degree Doctor Legum, Potchefstroom University (2000)	Strydom LLD Thesis (2000)
Theron L <i>Regsteoretiese Ondersoek na 'n Landbougrondbelasting vir Suid-Afrika</i> , a thesis submitted for the degree Doctor Legum, Rand Afrikaans University (1994)	Theron LLD Thesis (1994)

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Report of the <i>Commission of Inquiry into the Tax Structure of the Republic of South Africa</i> , chaired by Margo CS (RP 34/1987) Government Printer, Pretoria (1986)	Margo Report (1986)
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Report of the Joint Committee on Taxation, Congress of the United States <i>The Economic of the Estate Tax</i> , chaired by Saxton J and Thornberry M, The Joint Economic Committee, Washington (1988)	Report of the Joint Committee of Taxation <i>The Economics of the Estate Tax</i> (1988)
Special Report released under the auspices of the American Council for Capital Formation <i>New International Survey Shows US Death Tax Rates Among Highest</i> (August 2007), available at http://www.accf.org/pdf/sr-death-tax-survey.pdf (accessed on 9 August 2008)	Special Report ACCF <i>New International Survey</i> (2007)
United Kingdom	
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Netherlands	
Rapport van die Werkgroep Modernisering Successiewetgeving <i>De Warme, De Koude en De Dode Hand</i> , chaired by Moltmaker JK, Ministerie van Financien (2000)	Moltmaker Report (2000)
Ireland	
First Report of the Commission of Taxation <i>Direct Taxation</i> , chaired by O’Brien (1982)	O’Brien Report (1982)
Canada	
Report of the Royal Commission of Taxation Volume 1, chaired by Carter K, Queen’s Printer, Ottawa (1966)	Carter Report Vol 1 (1966)
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Australia	
Report of the Australia Taxation Review Committee, chaired by Asprey KW, Australian Government Publishing Service, Canberra (1975)	Asprey Report (1975)
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OECD	
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Ascher ML “Curtailling Inherited Wealth” (1990) 89 <i>Michigan Law Review</i> 69	Ascher (1990) <i>Michigan Law Rev</i>
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Bankman J and Griffith T “Social Welfare and the Rate Structure: a New Look at Progressive Taxation” (1987) 75 <i>California Law Review</i> 1905	Bankman and Griffith (1987) <i>Calif Law Rev</i>



Bankman J and Fried BH “Winners and Losers in the Shift to a Consumption Tax” (1998) 86 <i>Georgia Law Review</i> 539	Bankman and Fried (1998) <i>Georgia Law Rev</i>
Bankman J and Weisbach DA “The Superiority of an Ideal Consumption Tax over an Ideal Income Tax” (2006) 58 <i>Stanford Law Review</i> 141	Bankman and Weisbach (2006) <i>Stanford Law Rev</i>
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Burke KC and McCouch GMP “A Consumption Tax on Gifts and Bequests?” (1998) 17(4) <i>Virginia Tax Review</i> 657	Burke and McCouch (1998) <i>Virginia Tax Rev</i>
Burt K “The Approach in <i>WT Ramsey Ltd v IRC</i> : Elucidation Long Overdue” (2004) 121 <i>South African Law Journal</i> 745	Burt (2004) <i>SALJ</i>
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