

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.

