

## CHAPTER 6

### A CONTEMPORARY OVERVIEW OF ESTATE DUTY IN SOUTH AFRICA

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## 6.1 INTRODUCTION AND BROAD OVERVIEW OF ESTATE DUTY

As has been pointed out above,<sup>1</sup> estate duty is currently levied in terms of the Estate Duty Act of 1955 (hereafter “the Act”).<sup>2</sup> The duty is levied on the dutiable amount of a

<sup>1</sup> Ch 1 par 1.1.

<sup>2</sup> Act 45 of 1955.



deceased estate,<sup>3</sup> which is calculated by determining the gross value of all the deceased's property and deemed property at the date of his or her death<sup>4</sup> less any allowable deductions and less the primary abatement.<sup>5</sup> The tax is levied at the rates set out in the first schedule to the Act.<sup>6</sup> The tax was initially levied at progressive rates, but since 1988 it has been levied at a flat rate.<sup>7</sup> Similar to the position under donations tax,<sup>8</sup> the initial flat rate of 15 percent was increased to 25 percent in 1996, but decreased to 20 percent in 2001.<sup>9</sup> From the duty so calculated, certain deductions are granted for transfer duty<sup>10</sup> or foreign death duties paid<sup>11</sup> and a rebate in respect of successive deaths.<sup>12</sup>

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<sup>3</sup> S 2(2).

<sup>4</sup> As provided for in s 3. See par 6.2.4.

<sup>5</sup> As provided for in s 4 and s 4A. See par 6.5.2. See Stein (2004) Ch 1; Meyerowitz (2007) pars 27.1–27.3 and King and Victor (2008/2009) par 13.1 for a brief discussion of the basic calculation principles.

<sup>6</sup> S 2(2).

<sup>7</sup> 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.

<sup>8</sup> See Ch 5 par 5.1.

<sup>9</sup> See King and Victor (2008/2009) par 13.1. The 20% rate applies in respect of persons dying on or after 1 October 2001.

<sup>10</sup> S 16(a). See in general Stein (2004) 90; Meyerowitz (2007) par 30.8 and King and Victor (2008/2009) par 13.6.1. A deduction is granted for any transfer duty paid in respect of the acquisition from the deceased or his estate of any property included in the estate, by any person liable for the duty attributable to that property. In view of the fact that no transfer duty is payable on inherited property (Transfer Duty Act 40 of 1949 s 9(e)), this provision is currently ineffective.

<sup>11</sup> S 16(c).

<sup>12</sup> First Schedule to the Estate Duty Act. A rebate is allowed in respect of property included in the estate which formed part of the estate of a person who died within ten years of the deceased (see the first schedule of the Estate Duty Act): If the deceased died within 2 years of the death of the first-dying: 100%, between 2 and 4 years: 80%, between 4 and 6 years: 60%; between 6 and 8 years: 40%, between 8 and 10 years: 20%. See Stein (2004) 90–92 and Meyerowitz (2007) par 30.9 for examples of the relevant calculations.



## 6.2 TAX BASE

### 6.2.1 The Estate of Every Person

Unlike the Death Duties Act,<sup>13</sup> which levied a duty on the “passing of property” on death,<sup>14</sup> the Estate Duty Act levies a tax on the “estate” of “every person” who has died on or after 1 April 1955.<sup>15</sup> The focal point is therefore not the acquisition of an inheritance or a right by a beneficiary, but the ownership of property or rights vested in the deceased (his “estate”) immediately prior to his or her death.

### 6.2.2 Jurisdictional Basis

Although there seems to be no domiciliary, residential or geographical limitations in respect of the deceased persons liable under the primary charging provision in the Act, a distinction is drawn on the basis of residency – i.e. in respect of property of a person who died whilst ordinarily resident in the Republic of South Africa (“the republic”) and the property of a person who was not so resident at the date of his or her death.

#### 6.2.2.1 Residency

Except for a few exceptions (that will be discussed below), all the property of a person who died ordinarily resident in the republic is in principle chargeable under the Act. Although “ordinarily resident” is not specifically defined, its meaning is regarded to be similar to the meaning that the judiciary has attached to the same concept under income tax legislation, where this term has also been used but not defined.<sup>16</sup>

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<sup>13</sup> Act 29 of 1922.

<sup>14</sup> In *CIR v Estate Kohler & Others* 1953 (2) SA 584 (A) 601 Schreiner JA remarked that the expression “passing under a donation” means no more than “covered by or involved in a donation”. At 602 he added that “the word ‘pass’ in this kind of legislation is borrowed from the English provisions, where it is more at home than with us”.

<sup>15</sup> S 2(1).

<sup>16</sup> See Ch 5 par 5.2.2.1.



All of an ordinary resident's worldwide property is, however, not necessarily dutiable under the Act. Provision is made for the deduction of property included in the deceased estate, situated "outside the Republic",<sup>17</sup> and acquired by the deceased:

- before he or she became ordinarily resident in the republic for the first time,<sup>18</sup> or,
- in respect of property acquired by him or her after he or she became ordinarily resident for the first time,
  - if such property was donated to him or her by a person (other than a company) not ordinarily resident in the republic (at the date of donation),  
or
  - inherited by him or her from a person, who at the date of his or her death was not ordinarily resident in the republic,<sup>19</sup> or

acquired by him or her out of profits or proceeds of any such property, proved to the satisfaction of the Commissioner to have been acquired out of such profits or proceeds.<sup>20</sup>

### ***6.2.2.2 Location of Assets***

Where the deceased was not ordinarily resident in the republic on his or her death, certain "foreign" properties would basically be excluded from the tax. The Act provides for the exclusion of the following six categories of property:

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<sup>17</sup> The Act requires that the property is "situate outside the Republic" at the date of death. The value of foreign property that was acquired by the deceased before he became ordinarily resident in the republic, but that was brought or transferred into the republic prior to the date of death, would therefore not constitute an exclusion. See Meyerowitz (2007) par 28.13.

<sup>18</sup> S 4(e)(i). See in general Meyerowitz (2007) par 28.13.

<sup>19</sup> S 4(e)(ii). See in general Meyerowitz (2007) par 28.13.

<sup>20</sup> S 4(e)(iii). See in general Meyerowitz (2007) par 28.13. See also discussion by Stein (2004) *Tax Planning* 95–96. According to Stein (at 96) there are two possible interpretations for the requirement that the exemption applies only to a person "after he [or she] became ordinarily resident for the first time". On the one hand, in the case where a person was born in the republic, left the republic for some time and then returned to it, it may be argued that the deduction should be available in respect of all donations and inheritances from foreigners at any time. On the other hand, it may be argued that that the provision applies only to a person who became ordinarily resident in the republic after first having been ordinarily resident elsewhere.



- (a) any right in immovable property situated outside the republic;<sup>21</sup>
- (b) any right in movable property physically situated outside the republic;<sup>22</sup>
- (c) any debt not recoverable or right of action not enforceable in the courts of the republic, as well as any income derived from such debt or right of action;<sup>23</sup>
- (d) any goodwill, licence, patent, design, trade mark, copyright or other similar right not registered or enforceable in the republic or attaching to any trade, business or profession in the republic, as well as any income derived from such goodwill, licence, patent, design, trade mark, copyright or other similar right;<sup>24</sup>
- (e) any stocks or shares<sup>25</sup> held by him in a body corporate which is not a company,<sup>26</sup> and any stocks or shares held by him in a company in respect of which any change in ownership is not required to be recorded in the republic, as well as any income derived from such stocks or shares.<sup>27</sup>

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<sup>21</sup> S 3(2)(c). See in general Stein (2004) 13 and Meyerowitz (2007) par 27.11. The concept “immovable property” includes limited interests in such property. See Davis, Beneke and Jooste (2009) par 2.3.3.1.

<sup>22</sup> S 3(2)(d). See in general Stein (2004) 13 and Meyerowitz (2007) par 27.12. The concept “movable property” includes limited interests in such property. See Davis, Beneke and Jooste (2009) par 2.3.3.2.

<sup>23</sup> S 3(2)(e) and (h). Stein (2004) 12 refers to a life insurance policy issued by a foreign insurer and stocks and bonds issued by foreign governments. Meyerowitz (2007) par 27.10 refers to an annuity which is not enforceable in the courts of the republic. See also Meyerowitz (2007) pars 27.13 and 27.19.

<sup>24</sup> S 3(2)(f) and (h). See in general Stein (2004) 13 and Meyerowitz (2007) pars 27.14 and 27.19.

<sup>25</sup> “Stocks or shares” are defined in s1 as: “in relation to any company means any part of the share capital or member’s interest of that company and includes any debenture, debenture stock or any other like form of marketable security”. The definition is wide enough to include a member’s interest in a close corporation. See in general Stein (2004) 14.

<sup>26</sup> “Company” is defined in s 1 as: “any association incorporated or registered under any law in force in the Republic and any association which, although not so incorporated and registered, carries on business or has an office or place of business or maintains a share transfer register in the Republic”. The definition is wide enough to include a close corporation established under the Close Corporations Act of 1984. See in general Stein (2004) 14.

<sup>27</sup> S 3(2)(g) and (h). Stein (2004) 14 states that this exclusion would apply if the company law of the country of incorporation requires the shares to be registered in that country only, even if the company is trading in the republic. The exclusion would, however, not apply in the case where a company has its principal register in South Africa, even if the shares in foreign branches are registered in branch registers overseas. See also Meyerowitz (2007) pars 27.15–27.19 and Davis, Beneke and Jooste (2009) par 2.3.3.5.



Estate duty is therefore primarily levied on a worldwide basis, because the worldwide property of a person who died ordinarily resident in the country (with the exclusion of certain foreign assets listed above) falls within the jurisdictional basis of the tax. For the purposes of other persons (who were not ordinarily resident in the country at death), the tax base is extended to property or rights connected to the republic by location, registration or enforcement.

The Katz Commission concluded that donations tax and estate duty are effectively levied on a “source basis”, apparently in view of the fact that certain foreign assets belonging to resident donors fall outside the tax net.<sup>28</sup> It is submitted that this statement is technically incorrect.<sup>29</sup> Firstly, the term “source basis” is derived from income taxation where the “source” of income is used as a connecting factor to define the tax base.<sup>30</sup> Under wealth transfer taxation, the term “*situs* basis” would probably be a better term to describe the tendency to tax the transfer of property located in the jurisdiction where the taxpayer is not a resident (or domiciliary) of the jurisdiction. Secondly, donations tax and estate duty are primarily levied on the worldwide property of respectively “residents” and persons “ordinarily resident” in the republic.<sup>31</sup> Foreign assets are only excluded to the extent that they meet the requirements. Furthermore, assets located in the republic belonging to non-residents fall outside the scope of donations tax, which is in contrast with a *situs*-based approach.

### 6.2.3 Double Taxation

Relief for double taxation can be provided through double taxation agreements or, in the absence thereof, the granting of a unilateral tax credit in terms of section 16(c) of the Act.

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<sup>28</sup> Fourth Interim Katz Report (1997) par 13.1.

<sup>29</sup> This submission is supported by Davis, Beneke and Jooste (2009) par 18.3.6.

<sup>30</sup> See Ch 5 par 5.2.2.

<sup>31</sup> For donations tax purposes, see Ch 5 par 5.2.2.



Certain double taxation agreements, concluded with Botswana, Lesotho and Swaziland, the United States of America and Zimbabwe, under the provisions of the Death Duties Act, are still in force in view of the fact that the agreements continue to apply in respect of any similar taxes subsequently enacted by the contracting states. The only agreements entered into under section 26 of the Estate Duty Act are the agreements with Sweden (terminated with effect from 1 January 2005) and the United Kingdom (still in force).<sup>32</sup>

The general trend followed in all the agreements is that a contracting state is usually awarded the right to tax certain assets located in such state. The other state should either refrain from taxing those assets or provide a tax credit in respect of any tax payable in the first-mentioned state. The state in which the deceased was domiciled or ordinarily resident (in accordance with the rules of the agreement) usually has the right to levy taxation in respect of any other assets. What is of importance is that the fiscal domicile or residence is established with reference to the “deceased”.

Section 16(c) provides that, without modifying or adding to the rights of a person flowing from a double taxation agreement, where foreign death duty is levied on property situated outside the republic belonging to a person ordinarily resident at the date of his or her death, any such tax payable may be deducted from any estate duty payable in respect of such property (provided that the deduction may not exceed the amount of estate duty).<sup>33</sup>

#### 6.2.4 Object of Taxation: Property

The Act provides that the estate of any person shall consist of all “property of that person” as at the date of his or her death (as provided for in section 3(2)) together with all

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<sup>32</sup> The double taxation agreements are available at <http://www.sars.gov.za> (accessed on 28 August 2009).

<sup>33</sup> See in general Stein (2004) 89–90; Meyerowitz (2007) par 30.8 and King and Victor (2008/2009) par 13.6.2.





“property deemed to be the property of that person” (as provided for in section 3(3)).<sup>34</sup>

#### 6.2.4.1 Property

Section 3(2) provides a comprehensive description of property by declaring what it includes, as well as what it excludes. A deceased estate consists primarily of any right in or to property, whether “movable or immovable, corporeal or incorporeal”,<sup>35</sup> of the deceased at the date of his or her death.<sup>36</sup> The judiciary has confirmed that property as defined only embraces rights “vested” in the deceased at the date of his or her death, which means that a *spes* (such as a *spes* by a beneficiary to benefit from a trust) and a conditional right would be excluded.<sup>37</sup>

Although the Act discarded the wording “passes on death”, as in the Death Duties Act, Meyerowitz submits that the meaning of “property passing”, as set out in *Estate Crewe v CIR*,<sup>38</sup> namely “all the proprietary rights of the deceased which continue in existence after his death and constitute assets in his estate, in contradiction, *inter alia*, to those which cease and determine on his death”, is equally applicable to “property of that person”. This conclusion implies that the property (or the rights thereto) must be transferable.<sup>39</sup> This would also explain why the legislature chose to deem certain rights (which cease at the

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<sup>34</sup> S 3(1).

<sup>35</sup> See Ch 5 par 5.2.4 n 40 for meaning of “movable”, “immovable”, “corporeal” and “incorporeal”.

<sup>36</sup> S 3(1) read with s 3(2). See in general Stein (2004) 11–12 and Meyerowitz (2007) pars 27.21–27.27. If the deceased was married in community of property, only the share of the deceased constitutes his or her property. Property would also include all proprietary rights that continue to exist after the date of death of the deceased. See Stein (2004) 12; *CIR v Estate Crewe and Another* 1943 AD 656, 12 SATC 344 (decided under the Death Duties Act, but still instructive) and *CIR v Estate Hersov and Others* 1952 (4) SA 559 (A), 18 SATC 261 (decided under the Death Duties Act, but still instructive).

<sup>37</sup> See *CIR v Sive's Estate* 1955 (1) SA 249 (A), 20 SATC 66 (decided under the Death Duties Act, but still instructive) and *Burger v CIR* 1956 (1) SA 534 (W), 20 SATC 277 (decided under the Death Duties Act, but still instructive). See Stein (2004) 20 and Strydom LLD Thesis (2000) 253–267 for further reading.

<sup>38</sup> *Estate Crewe* case 666, 689.

<sup>39</sup> Meyerowitz (2007) par 27.21. Strydom LLD Thesis (2000) 229 concurs. See also discussion by Strydom LLD Thesis at 236–250.



death of the testator, to be property of the deceased. Although these ceasing rights are not “transferable” to another in the true sense of the word, their cessation results in the creation or expansion of someone else’s rights *ex lege*. The Act includes the following interests in property that were enjoyed by the deceased up to the time of his or her death:

- any fiduciary,<sup>40</sup> usufructuary<sup>41</sup> or other like interest in property (including a right to an annuity<sup>42</sup> charged upon property<sup>43</sup>) held by the deceased immediately prior to his or her death;<sup>44</sup>
- any right to an annuity (other than a right to an annuity charged upon any property) enjoyed by the deceased immediately prior to his or her death, which accrued to some other person on the death of the deceased.<sup>45</sup>

<sup>40</sup> For the meaning of a fiduciary interest, see Ch 5 par 5.2.4 n 45. See also Stein (2004) 20–21.

<sup>41</sup> For the meaning of a usufructuary interest, see Ch 5 par 5.2.4 n 42. In *Estate Watkins-Pitchford v CIR* 1955 (2) SA 437 (A) Centlivres CJ described the difference between a usufructuary interest and a fiduciary interest as follows (at 447): “... in the case of a fiduciary interest, the fiduciary has a vested right in the corpus of the fideicommissary property and may on the failure of the *fideicommissarius*, acquire full dominium in the property in respect of which he holds a fiduciary interest, whereas in the case of a usufructuary interest the usufructuary has no vested right in the corpus of the property in respect of which the usufruct is held and can never acquire the full dominium of that property”. See also *CIR v Lukin’s Estate* 1956 (1) SA 617 (A); *Estate Koster v CIR* 1963 (2) SA 716 (C) and Stein (2004) 21.

<sup>42</sup> The term “annuity” is not defined in the Act, but its characteristics are: (a) it is a fixed annual payment (even if it is divided in installments), (b) it is repetitive, (c) it is chargeable against property or is an obligation of someone and not merely a payment at will and (d) the capital fund (which gave rise to the annuity) should cease to exist. See *ITC 761* (1952) 19 SATC 103; *CIR v Watermeyer* 1965 (4) SA 431 (A) and *KBI v Hogan* 1993 (4) SA 150 (A) (where it was held at 159 that “[a]nnuities differ from other investments in that the capital sum invested is not returnable when the annuity ceases to be payable”). See also Stein (2004) 22.

<sup>43</sup> The term “charged against property” means that there is a particular fund or property out of which the annuity is payable: see *CIR v Estate Hobson* 1933 CPD 386 (decided under the Death Duties Act, but still instructive). Both Meyerowitz (2007) par 27.8 and Stein (2004) 23 submit that there must be a burden on the property by virtue of a real right or a subtraction from *dominium*, and not a mere obligation of a person.

<sup>44</sup> S 3(2)(a).

<sup>45</sup> S 3(2)(b). In *SIR v Jordaan* 1967 (3) SA 329 (A) the court stated that it does not matter whether the successor’s right is to a greater or lesser annuity than that enjoyed by the deceased. All that is required is that the deceased’s right ceases and the successor’s right of enjoyment accrues as a consequence of the deceased’s death.



A “like interest in property” would, for example, include an interest such as a *usus* or *habitatio*,<sup>46</sup> and even a vested right to income under a trust.<sup>47</sup> Since a limited interest only constitutes property if it was held by the deceased just prior to his or her death, it may be tempting to renounce such an interest just prior to death. However, such renunciation would be subject to donations tax.<sup>48</sup>

The Act specifically excludes from the tax base property belonging to a person who was *not ordinarily resident* in the republic at the date of his or her death (which has already been discussed above).<sup>49</sup>

In respect of persons dying on or after 1 January 2009, the Act furthermore excludes so much of any benefit which is due and payable by, or in consequence of, membership or past membership of any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as defined in the Income Tax Act.<sup>50</sup> This exclusion, which refers to pension fund benefits payable to the deceased estate, was introduced simultaneously with the removal of the provision deeming pension fund benefits (payable to third parties) to be property of the deceased estate (a provision that remains operative only in respect of persons who passed away before 1 January 2009).<sup>51</sup> The removal of the deeming provision in respect of “deemed property” necessitated a corresponding exclusion from “property”.

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<sup>46</sup> See *Estate Watkins-Pitchford* case 448.

<sup>47</sup> See *CIR v Lazarus' Estate* 1958 (1) SA 311 (A), SATC 379 393 (decided under the Death Duties Act, but still instructive); *CIR v Jordaan* 1967 (3) SA 329 (A) 335 and *ITC 1520* (1991) 54 SATC 168 172–173. See in general Stein (2004) 22 and Strydom LLD Thesis (2000) 231–234.

<sup>48</sup> Stein (2004) 20; Meyerowitz (2007) par 27.6 n 4 and accompanying text.

<sup>49</sup> See par 6.2.2.1.

<sup>50</sup> S 3(2)(i).

<sup>51</sup> See par 6.2.4.2.2.



#### 6.2.4.2 Deemed Property

The estate of a deceased person consists not only of vested proprietary rights and interests, but also of property which is deemed to be the property of the deceased in accordance with the provisions of the Act,<sup>52</sup> thereby creating a legal fiction.<sup>53</sup> Section 3(3) deems the following assets to be property of the deceased:

##### 6.2.4.2.1 Domestic Life Insurance Policies upon the Life of the Deceased

Although the proceeds of a life insurance policy payable to the deceased estate constitutes property of the deceased according to the general description,<sup>54</sup> the proceeds payable to a third party (the nominated beneficiary) does not fall within the ambit thereof.<sup>55</sup> To establish neutrality and to counter possible tax avoidance by merely nominating a third party as the beneficiary of the policy benefits, the Act provides that the benefit so

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<sup>52</sup> S 3(1).

<sup>53</sup> Meyerowitz (2007) par 27.28.

<sup>54</sup> In the *Hersov* case, Centlivres CJ (with reference to the proceeds of a life policy payable to a deceased estate) remarked (at 568) that “the Legislature regarded the deceased as having, during his lifetime, a proprietary right in the policy which passed on his death to his estate”. See Meyerowitz (1952) *Taxpayer* 236 *et seq* for a discussion of this case. See also Editorial (1993) *Taxpayer* 65 and Meyerowitz (2007) par 27.31.

<sup>55</sup> This position has recently been confirmed. In *Love v Santam Life Insurance* 2004 (3) SA 425 (SCA), the court held that the right to the policy proceeds vested in the nominated beneficiaries directly upon their acceptance of the benefits, and not via the estate of the owner of the policy (who was also the life insured under the policy). The proceeds were therefore never part of the deceased owner’s (insolvent) estate. The deceased’s creditors had no claim against the proceeds which were paid out to the beneficiaries. See also *Warricker NNO v Liberty Life Association of Africa Ltd* 2003 (6) SA 272 (W). This position follows from the fact that a life insurance contract (where the proceeds are payable to a nominated beneficiary) is constructed as a *stipulatio alteri*.



recoverable under any policy of insurance, which is a “domestic policy”<sup>56</sup> upon the life of the deceased,<sup>57</sup> should be regarded as deemed property of the deceased.<sup>58</sup>

Because of its wide wording, this provision is, however, not restricted to third-party policies. The proceeds of a domestic policy belonging to the estate, although already included as actual property in the estate, is therefore also expressly deemed to be property of the estate.<sup>59</sup> However, it is the practice to include these proceeds only once, in order to avoid any double taxation.<sup>60</sup>

The only connecting factor between the domestic life policy and the deceased is that the deceased should be the life insured under the policy agreement. Except for the specific exclusions (discussed below), it is immaterial whether or not the deceased affected the policy, had any financial interest in the policy, or paid the premiums in respect thereof.<sup>61</sup> If, however, a Public Benefit Organisation or a surviving spouse is the beneficiary of the policy, the proceeds of the policy would qualify as a deduction in terms of section 4(h) or 4(q) of the Act, respectively.<sup>62</sup>

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<sup>56</sup> According to s 1 a “domestic policy means any life policy as defined in section 1 of the Long-term Insurance Act of 1998, issued anywhere upon an application made or presented to a representative of an insurer (or to any person on behalf of such a representative) at any place in the Republic, excluding a life policy which has been made payable at a place outside the Republic, at the request of the owner, but including any life policy issued outside the Republic which has subsequently been made payable in the Republic at the request of the owner”. See in general Davis, Beneke and Jooste (2009) par 2.4.2.1.

<sup>57</sup> Meyerowitz (2007) par 27.32 submits that “on the life of the deceased” means that death is the contingency upon which the amount becomes due.

<sup>58</sup> S 3(3)(a). In the case of spouses married in community of property, the total value of a domestic policy would be included in the dutiable estate of the first-dying, whether or not the proceeds are payable to the joint estate. See Editorial (1993) *Taxpayer* 66 and Stein (2004) 13.

<sup>59</sup> Stein (2004) 12; Meyerowitz (2007) par 27.21.

<sup>60</sup> Stein (2004) 12.

<sup>61</sup> Stein (2004) 38; Meyerowitz (2007) par 27.29. The 1922 Death Duties Act also included life insurance policies, but only if effected by the deceased, and only to the extent that the deceased paid the premiums. See Death Duties Act s 3(4)(a).

<sup>62</sup> See par 6.5.2.2.



The value included is the amount due and recoverable to the extent that it exceeds the aggregate amount of any premiums or consideration proved to the satisfaction of the Commissioner to have been paid by the person entitled to the benefits under the policy, together with six percent per annum interest calculated on the premiums paid from date of payment to date of death.<sup>63</sup>

There are, however, three exceptions to this deeming provision.<sup>64</sup> Firstly, the proceeds of a policy recoverable by the surviving spouse<sup>65</sup> or child<sup>66</sup> of the deceased under a duly registered ante-nuptial or post-nuptial contract<sup>67</sup> are not deemed to be included in the estate.<sup>68</sup>

The second exemption provided for in the Act relates to the proceeds of a policy effected to fund a so-called “buy and sell arrangement”, which is an agreement between partners or shareholders, where it is agreed that, where one of them dies, the deceased partner or shareholder undertakes to sell, and the remaining partners or shareholders undertake to buy the interest of the deceased partner or shareholder. The exemption applies to the proceeds payable in terms of a policy that was taken out or acquired<sup>69</sup> by a person who on

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<sup>63</sup> S 3(3)(a). See Meyerowitz (2007) par 27.34 for a discussion on the deduction of premiums.

<sup>64</sup> Although the Death Duties Act provided for the exclusion of policy benefits that were ceded by the deceased during his lifetime *bona fide* and for full consideration, otherwise than as security for a sum of money or the fulfillment of any obligation (Death Duties Act s 4(a)(x)), such provision was not included in the Estate Duty Act.

<sup>65</sup> For the purposes of estate duty, the definition of a spouse (in s 1) is similar to the definition contained in the Income Tax Act. See Ch 5 par 5.5.3 n 93.

<sup>66</sup> A “child in relation to any person” includes any person adopted by him “(a) under the laws of the Republic, or (b) under the law of any country, other than the Republic, provided the adopted person is under such law accorded the status of a legitimate child of the adoptive parent and the adoption was made at the time when the adoptive parent was ordinarily resident in such country” (s 1 “child”).

<sup>67</sup> It is not clear what is meant with a “duly registered” contract. Meyerowitz (2007) par 27.36 submits that it appears to mean more than mere execution and that it should be registered in a deeds office in the republic as contemplated in the Deeds Registry Act of 1937.

<sup>68</sup> S 3(3)(a)(i). See in general Davis, Beneke and Jooste (2009) par 15.2.1.

<sup>69</sup> This will also include policies that have been acquired by cession. See Stein (2004) 40 and SARS *Buy-Sell Arrangements* (2008) 3.



the date of the death of the deceased was a partner or co-shareholder of the deceased, for the purpose of enabling that person to acquire the whole or part of the deceased's interest in the partnership or share (or like interest) in the company and any claim by the deceased against that company, provided that no premium on the policy was borne by the deceased.<sup>70</sup>

The requirements as set out above have given rise to some interpretation issues, anomalies and inequities, such as the following:

- Where the policy was taken out with the purpose of acquiring the whole or part of the deceased's interest, it appears as if it does not matter whether the proceeds were in fact used to acquire such interest. Conversely, where the policy was taken out or acquired for some purpose other than the acquisition of the deceased's interest, the exclusion would not apply (even where the proceeds were in fact used to acquire the interest).<sup>71</sup>
- Apparently the premiums would be "paid or borne" by the deceased even where he or she provided the funds in an indirect way, for example where a company paid the premiums of a policy on the life of the deceased and debited the deceased with the amount thereof on loan account.<sup>72</sup> Joffe points out that, very often, loan accounts are not created in practice or the premiums are split equally (instead of divided accurately), which would render the proceeds dutiable.<sup>73</sup>
- It is possible that the proceeds of the policy exceed the value of the deceased's interest or shares. If the difference is substantial, the Commissioner could exercise his discretion and disallow the exemption. However, if the difference could be motivated, for instance by a general decrease in that specific type of

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<sup>70</sup> S 3(3)(a)(iA).

<sup>71</sup> Stein (2004) 40; Meyerowitz (2007) par 27.37.

<sup>72</sup> SARS *Buy-Sell Arrangements* (2008) 3. A contrary view is taken by Davis, Beneke and Jooste (2009) par 2.4.2.1.

<sup>73</sup> Joffe (2009) March *De Rebus* 44.





business shortly before the death of the deceased partner or co-shareholder, the exclusion would apparently be allowed.<sup>74</sup>

- Where an employee takes out a policy on the life of his or her employer to enable such employee to finance the purchasing of the business in terms of a buy-and-sell arrangement on the death of the employer, the proceeds of the policy would be dutiable under the Act.<sup>75</sup>
- In practice, attempts have been made to utilise the buy-sell exclusion in the hands of a sole proprietor or sole shareholder (the planner) by setting up a trust and by selling part of the business or shares to the trust. The trust then becomes a partner or co-shareholder and, upon effecting a life policy on the life of the planner, it is contended that the proceeds of the policy (upon the planner's death) would be estate duty-free.<sup>76</sup> However, because a trust is not a "person" under the Act or in terms of the Interpretation Act,<sup>77</sup> SARS is of the opinion that a policy acquired by a trust would not qualify for the exclusion.<sup>78</sup> However, it appears as if SARS would still allow an exemption in the case where a trustee of a trust (being a "person" in terms of the Interpretation Act) acquires a policy on the life of a partner or co-shareholder (of the trustee in his capacity as trustee). This concession would apparently not be applicable if a natural person acquires a policy on the life of the trustee.<sup>79</sup>

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<sup>74</sup> See Stein (2004) 40; Meyerowitz (2007) par 27.37; Davis, Beneke and Jooste (2009) par 2.4.2.2 and SARS *Buy-Sell Arrangements* (2008) 4 (also for some practical examples).

<sup>75</sup> Joffe (2009) March *De Rebus* 43.

<sup>76</sup> See Davis, Beneke and Jooste (2009) par 15.2.

<sup>77</sup> Act 33 of 1957. See also *Philip Frame Trust v CIR* 1991 (2) SA 340 (W), 53 SATC 166.

<sup>78</sup> SARS *Buy-Sell Arrangements* (2008) 4–5.

<sup>79</sup> SARS *Buy-Sell Arrangements* (2008) 5. See also La Grange (2003) *Ins & Tax* 16 *et seq.*





The third exemption provided for in the Act is the so-called “key-man exemption”. It is provided that the proceeds payable in terms of a policy, that was not taken out or effected by the deceased or at the instance of the deceased, and in terms of which the benefits are not to be paid into the estate of the deceased, or utilised for the benefit of the deceased, any relative of the deceased, any person dependent for his maintenance upon the deceased, or any company which was at any time a family company in relation to the deceased, would not be deemed to be property in the deceased’s estate, provided that no premium was borne by the deceased.<sup>80 81</sup>

Similar to the position under the second exemption above, the requirements as set out above have given rise to some interpretation issues, anomalies and inequities:

- A policy would apparently have been “effected by the deceased” if he or she was the contracting party to the insurance contract with the insurer, whether or not he or she was the beneficiary under the policy.<sup>82</sup> The term “at the instance of the deceased” apparently means “at the request or suggestion” of that person. A policy would therefore be effected at the instance of the deceased if the proposer would not have effected the policy had he not been requested by the deceased to do so.<sup>83</sup>
- The exemption would not apply where the proceeds are to be utilised for the benefit of the deceased (or his or her estate), a relative, a dependant or a family company. A “relative” refers to the spouse of the deceased or anybody related to

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<sup>80</sup> Premiums would have been “paid or borne” by the deceased even if the deceased provided the funds in an indirect way, for example if a company paid the premiums of a policy on the life of the deceased and debited the deceased with the amount thereof on loan account. See SARS *Key-man Policies* (2008) 3.

<sup>81</sup> S 3(3)(a)(ii). See in general Editorial (1993) *Taxpayer* (B) 68; Meyerowitz (2007) pars 27.38–27.42. Apparently SARS would require (a) copies of the resolution taken by the company to take out such policy and (b) application made for the policy and other documentation to prove that the proceeds of the policy were not applied to benefit the estate, a relative, a dependant or a family company as envisaged in the subsection. See SARS *Key-man Policies* (2008) 3–5.

<sup>82</sup> Meyerowitz (2007) par 27.39; SARS *Key-man Policies* (2008) 3.

<sup>83</sup> Stein (2004) 42; Meyerowitz (2007) par 27.39; SARS *Key-man Policies* (2008) 3.



the deceased or such spouse within the third degree of consanguinity, including any spouse of anybody so related.<sup>84</sup> A “family company” is defined as “any company (other than a company whose shares are quoted on a recognised stock exchange) which at any relevant time was controlled or capable of being controlled directly or indirectly, whether through a majority of the shares thereof or any other interest therein or in any other matter whatsoever, by the deceased or by the deceased and one or more of his [or her] relatives”.<sup>85</sup> In view of the fact that the connection can be established “at any relevant time”, it means that, if a company constituted a “family company” in relation to the deceased at any given time in the past, any future policy proceeds payable on the death of such person would be dutiable.<sup>86</sup> Meyerowitz submits that the payment or benefit should be linked to some legal obligation, arrangement or undertaking in favour of such relative, dependant or family company.<sup>87</sup> This requirement can nevertheless have some harsh results. Where, for example, a shareholder (who owns a 10 percent shareholding in a company), stands personal surety for the company and the company takes out a life policy on the shareholder’s life to ensure that the bank can be repaid and the suretyship cancelled on the death of the shareholder, a strict application of the Act would render the proceeds of the policy dutiable, in view of the fact that it could be argued that the shareholder’s estate would be indirectly benefiting from the policy proceeds in that it would be relieved from the suretyship. However, it could be argued that the real liability to repay the loan rests with the company and that the company was in actual fact the real beneficiary under the policy.<sup>88</sup>

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<sup>84</sup> S 1 “relative”.

<sup>85</sup> S 1 “family company”.

<sup>86</sup> See Joffe (2005) *Ins & Tax* 19 and Joffe (2009) April *De Rebus* 41.

<sup>87</sup> Meyerowitz (2007) pars 27.41–27.42.

<sup>88</sup> Joffe (2005) *Ins & Tax* 19; Joffe (2009) April *De Rebus* 42.



- If only a portion of the policy benefits are payable to or utilised for the benefit of the deceased estate, a relative, a dependant or a family company, the question arises whether a pro rata exclusion would be allowed. Stein submits that the balance should qualify as an exemption.<sup>89</sup> Joffe, on the other hand, is of the opinion that the section does not allow for apportionment.<sup>90</sup> SARS also takes the approach that the proceeds should either qualify for the exemption or be subject to estate duty.<sup>91</sup>
- In a case where the deceased owned, for example, only 48 percent of the shares in a company, where two other persons (unrelated to the deceased) owned 26 percent each, and where the deceased was the only decision maker and key individual in the business, the question arises whether any proceeds payable in respect of a key-man policy on the life of the deceased would be exempt from estate duty. Apparently, SARS has never taken the approach to charge duty on a policy where the assured shareholder has owned less than 50 percent of the shareholding in the company. However, Joffe mentions that it could be open for SARS to argue that the deceased shareholder in fact controlled the company as required.<sup>92</sup>

#### 6.2.4.2.2 Retirement Benefits

Since the introduction of the Act in 1955, certain retirement benefits (with the exclusion of annuities) have been included as deemed property in the estate of the person as a result of whose death the benefits were payable.<sup>93</sup> In respect of persons dying on or after 1 January 2009, the deeming provision has been omitted from the Act.

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<sup>89</sup> Stein (2004) 42.

<sup>90</sup> Joffe (2009) *April De Rebus* 42.

<sup>91</sup> SARS *Key-man Policies* (2008) 4 (apparently a mere reversionary interest in the policy by the estate, for example where a beneficiary repudiates his benefit, would not disqualify the exemption).

<sup>92</sup> Joffe (2009) *April De Rebus* 42.

<sup>93</sup> S 3(3)(3)*bis* provided that the amount of any benefit which is due and payable by, or in consequence of the membership or past membership of, any fund on or as a result of the death of the deceased, to the extent that it exceeds the total amount of all the contributions paid by the beneficiary, together with interest at 6% Footnote continues on the next page



#### 6.2.4.2.3 Property Donated under a *Donatio Mortis Causa* / No Benefit until Death

Because a *donatio mortis causa*<sup>94</sup> and a donation, in terms of which the donee will not obtain any benefit until the death of the donor, are exempt from donations tax,<sup>95</sup> these donations are included in the deceased estate of the donor, unless such property is otherwise included as “property” in the deceased estate.<sup>96</sup>

#### 6.2.4.2.4 Accrual Claims

Any claim for accrual that the estate of the deceased may have against his or her former spouse, to whom he or she was married out of community of property, in respect of section 3 of the Matrimonial Property Act,<sup>97</sup> is deemed to be property of the deceased at the date of his or her death.<sup>98</sup>

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per annum calculated upon such contributions from the date of payment to the date of death, is deemed to be property in the deceased's estate. However, an annuity, except for the commuted part thereof, payable by a pension fund, a provident fund or a retirement annuity fund, as respectively defined in section 1 of the Income Tax Act, was excluded from this deeming provision. See in general Stein (2004) 43–44 and Davis, Beneke and Jooste (2009) par 2.4.3. Benefits payable by a fund, administered under the control of the Minister of Social Welfare and Pensions, to the widow, child or other dependant of a deceased member of such fund are not dutiable in terms of the General Pensions Act 29 of 1979 s 22. See Meyerowitz (2007) par 27.43.

<sup>94</sup> See Ch 3 par 3.3.2.2.1 n 123 for the meaning of a *donatio mortis causa*.

<sup>95</sup> In terms of Income Tax Act ss 56(1)(c) and (d). See Ch 5 par 5.5.3.

<sup>96</sup> S 3(3)(b) proviso. This proviso was introduced by the Revenue Laws Amendment Act 2005 to cater for a scheme where the property is included in the deceased estate, but the donee claims the donation as a debt against the estate. See *CSARS v Marx NO* 2006 (4) 195 (C) (which case was decided before the amendment) and Explanatory Memorandum on the Taxation Laws Amendment Bill (2005) 3. The proviso is only applicable in respect of persons dying on or after 8 November 2005. See also Olivier (2007) *TSAR* 589 *et seq* for further reading.

<sup>97</sup> Act 88 of 1984.

<sup>98</sup> S 3(3)(cA). See in general Meyerowitz (2007) par 27.52.



6.2.4.2.5 *Property which the Deceased was Competent to Dispose of for his or her Own Benefit or for the Benefit of his or her Estate (Section 3(3)(d) Deemed Property)*

Included in the deceased estate is property,<sup>99</sup> not otherwise chargeable or dutiable under the provisions of the Act, of which the deceased was, immediately prior to his or her death, competent to dispose of for his or her own benefit or the benefit of his or her estate (the so-called “section 3(3)(d) deemed property”).<sup>100</sup> A person shall be considered to have been able to dispose of property if he or she had the power (if he or she were *sui iuris*) to appropriate or dispose of such property as he or she so wished, whether exercisable by will, power of appointment or in any other matter.<sup>101</sup> The deceased will also be regarded as having the power to dispose of property if he or she, under a deed of donation, settlement, trust or other disposition retained the power to revoke or vary the provisions thereof, relating to such property.<sup>102</sup> The power to revoke, appropriate or dispose shall be deemed to exist if the deceased could have obtained such power directly or indirectly by the exercise, either with or without notice, of power exercisable by him or her or with his or her consent.<sup>103</sup>

### 6.3 VALUATION

For the purposes of the valuation of property, the Act distinguishes between property that was realised during the course of the liquidation and distribution process and property that was not so realised, except in the case of stocks or shares not quoted on a stock exchange (in respect of which a special rule applies whether or not the stocks were

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<sup>99</sup> The term “property” includes the profits of any property (s 3(5)(a)).

<sup>100</sup> S 3(3)(d). The section will, however, not apply to the deceased’s power to dispose of his or her spouse’s share in the joint estate, in the instance where the deceased was married in community of property (s 3(5)(d)). If the deceased, on the other hand, was able to dispose of property for the benefit of the joint estate, then s 3(3)(d) could be invoked. See Meyerowitz (2007) par 27.51.

<sup>101</sup> S 3(5)(b)(i).

<sup>102</sup> S 3(5)(b)(ii).

<sup>103</sup> S 3(5)(c).



realised). In respect of unrealised property, provision is made for a general rule (fair market value) as well as special rules in respect of usufructuary, fiduciary or other like interests, annuities, bare *dominium* property, section 3(3)(d) deemed property and property comprised in a *donatio mortis causa*. Provision is also made for a favourable valuation rule for agricultural property (this rule will more fully be discussed in paragraph 6.5.1 below). Property should in general be valued on the date of the death of the deceased.

### 6.3.1 Stocks or Shares Not Quoted on Stock Exchange: Special Rule

In the case of stocks or shares in a company not quoted on any stock exchange,<sup>104</sup> the value must be determined according to the provisions of section 5(1)(f)*bis* (whether or not the stocks or shares were realised in the liquidation process), which provides for the following rules:<sup>105</sup>

- no regard shall be had to any provision in the memorandum and articles of association, founding statement, association agreement or rules of the company, restricting the transferability of the shares therein, but it shall be assumed that such shares were freely transferable;<sup>106</sup>
- no regard shall be had to any provision in the memorandum and articles of association, founding statement, association agreement or rules of the company, whereby or whereunder the value of the shares of the deceased or any other member is to be determined;<sup>107</sup>
- if upon a winding-up of the company the deceased would have been entitled to share in the assets of the company to a greater extent *pro tanto* to his shareholding or membership than other shareholders or members, no lesser value shall be placed on

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<sup>104</sup> The modern term used for purposes of the law of securities is a “securities exchange”. See Securities Services Act 36 of 2004.

<sup>105</sup> S 5(1)(f)*bis*. See in general Stein (2004) 58–59; Meyerowitz (2007) par 29.7.

<sup>106</sup> S 5(1)(f)*bis*(i).

<sup>107</sup> S 5(1)(f)*bis*(ii).



the shares held by the deceased than the amount to which he would have been so entitled if the company had been in the course of winding-up and the said amount had been determined as at the date of death;<sup>108</sup>

- no regards shall be had to any provision or arrangement resulting in any variation of the rights attaching to the shares through or on account of the death of the deceased;<sup>109</sup>
- account shall be taken of any power or control exercisable by the deceased and the company where under he was entitled or empowered to vary or cancel any rights attaching to any class of shares therein, including by way of redemption of preference shares, if, by the exercise of such power he could have conferred upon himself any benefit or advantage in respect of the assets or profits of the company;<sup>110</sup>
- in the case where the company owns immovable property on which *bona fide* farming operations are being carried on in the republic, a special provision applies (see paragraph 6.5.1 below).

### 6.3.2 Property Realised During the Liquidation and Distribution Process

Except for stocks or shares not quoted on a stock exchange (in respect of which a special rule applies),<sup>111</sup> the purchase price of property which has been disposed of in terms of a *bona fide* sales agreement<sup>112</sup> in the course of the liquidation of the deceased estate (including agricultural property)<sup>113</sup> shall constitute the value of such property for purposes

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<sup>108</sup> S 5(1)(f)bis(iii).

<sup>109</sup> S 5(1)(f)bis(iv).

<sup>110</sup> S 5(1)(f)bis(v).

<sup>111</sup> See par 6.3.1.

<sup>112</sup> Whether the sale constitutes a *bona fide* sales agreement in the course of the liquidation of the estate is made a matter of opinion by the Commissioner, whose decision is conclusive, and only subject to review under the narrow grounds of *mala fides*, gross unreasonableness or misconstruction of the terms and objects of the Act. See *CIR v City Deep Ltd* 1924 AD 298 and *Holden's Estate v CIR* 1960 (3) SA 497 AD.

<sup>113</sup> Where property is sold in terms of an agreement that was entered into by the deceased during his lifetime, but delivery has not been effected on the date of his death, then the agreement will not constitute a transaction in the course of liquidation. See *CIR v Estate Kirsch* 1951 (3) SA 496 (A) and *CIR v Whiteaway* 1933 TPD 486 (although these cases were decided under the Death Duties Act of 1922, they are still Footnote continues on the next page



of the Act.<sup>114</sup> This general rule is subject to the proviso that, where conditions have been imposed by any person whomsoever, as a consequence of which the value of the property could or would be reduced for any reason at or after the moment of death, the value of the property should be determined as though those conditions had not been imposed.<sup>115</sup>

### 6.3.3 Unrealised Property

Where the property has not been realised during the course of the liquidation process, the Act provides for a general rule, as well as some special rules, as will more fully be set out in the discussion below.

#### 6.3.3.1 The General Rule

In terms of the general rule for unrealised property, which will apply in the absence of any special rule, the fair market value at the date of death of the deceased will constitute the value for estate duty purposes.<sup>116</sup> “Fair market value” means “the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm’s length in an open market”.<sup>117</sup> Similar to the general valuation rule for purposes of donations tax,<sup>118</sup> this general rule is subject to the proviso that, where the value of property could or would be reduced for any reason at or after the moment of death, as a result of conditions imposed by any person whatsoever, the value of the property shall,

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instructive). See also *CIR v Estate Streicher* 2004 (SCA), 66 SATC 282, where the court held that a sales agreement entered into by an heir in advance of him receiving transfer from the estate does not constitute a sales agreement entered into during the course of liquidation of the estate. See discussion by Stein (2004) 58 and Editorial (2004) *Taxpayer* 176 *et seq.*

<sup>114</sup> S 5(1)(a). See in general Meyerowitz (2007) par 29.2 and Davis, Beneke and Jooste (2009) par 2.7.2.

<sup>115</sup> S 5(1)(g) proviso. See in general Stein (2004) 57–58; Meyerowitz (2007) par 29.2.

<sup>116</sup> S 5(1)(g). See in general Stein (2004) 61–62; Meyerowitz (2007) par 29.3.

<sup>117</sup> S 1.

<sup>118</sup> See Ch 5 par 5.3.1.





unless the Commissioner otherwise directs, be determined as though such conditions had not been imposed.<sup>119</sup>

### 6.3.3.2 *Usufructuary, Fiduciary or Other Like Interests*

A usufructuary, fiduciary or other like interest, which was enjoyed by the deceased prior to his or her death, is valued by capitalising the annual value of the interest at 12 percent<sup>120</sup> to the extent to which the person, who upon the cessation of the said interest upon the death of the deceased (hereafter beneficiary), becomes entitled to any right of enjoyment of such property, whatever the nature of such right of enjoyment may be.<sup>121</sup> The extent to which the beneficiary would be regarded as having the right to enjoyment is established with reference to such person's life expectancy, or if such right of enjoyment is to be held for a lesser period than the life of such beneficiary, over such lesser period.<sup>122</sup> This is calculated by means of tables which furnish the value of R1 per annum capitalised at 12 percent over the expectation of life at various ages for both male and female (Tables A (life expectancy) and B (fixed periods) were published under the regulations under the Act).<sup>123</sup> The first tables were published in 1956,<sup>124</sup> applicable to persons dying on or after 14 April 1956, but before 1 April 1977, because a revised version of the tables was published in 1977 (applicable to persons dying on or after 1 April 1977; these tables still

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<sup>119</sup> S 5(1)(g) proviso. See *CIR v Sive's Estate* 1963 (3) SA 847 (A) and Stein (2004) 63.

<sup>120</sup> The annual value is equal to 12% upon the fair market value of the full ownership value of the property subject to the limited interest.

<sup>121</sup> S 5(1)(b). See in general Stein (2004) 23–29 and Meyerowitz (2007) par 29.8. In *SIR v Jordaan* 1967 (3) SA 329 (A) it was held that it is sufficient if a person, on the cessation of the deceased's right and in consequence of his death, becomes entitled to some extent to such right of enjoyment, whatever its nature and extent may be. If a beneficiary, however, obtains a fiduciary right in property subject to a usufruct, such fiduciary right does not constitute a "right of enjoyment" and is not capable of being valued for purposes of estate duty. See *Visser NO v CIR* 1968 (2) SA 78 (O).

<sup>122</sup> S 5(1)(b).

<sup>123</sup> See in general Stein (2004) 25 and Meyerowitz (2007) par 29.10.

<sup>124</sup> Government Notice No 641 of 13 April 1956 (see appendices to the Act).



apply).<sup>125</sup> The Act does not, however, provide for the taking into account of a condition imposed on such usufructuary or other like interest.<sup>126</sup> The beneficiary's health must also be ignored for the purposes of the calculation of his or her life expectancy, even in a case where he or she may be terminally ill.<sup>127</sup> Where more than one beneficiary becomes entitled to a usufructuary interest, each beneficiary's interest must be ascertained by allocating the annual value attributable to each beneficiary and by capitalising each beneficiary's interest over his or her particular life expectancy.<sup>128</sup>

The general valuation rule is subject to two specific provisos where the right of enjoyment accrues to the bare *dominium* owner, which will more fully be discussed in Chapter 7.<sup>129</sup> In addition to these limitations, it is provided that where it is not possible to ascertain the beneficiary upon the death of the deceased the value so established shall be determined by capitalising the annual value over a period of 50 years, unless the Commissioner and the executor agree to a lesser period, having regard to the circumstances.<sup>130</sup> Also, where the beneficiary is not a natural person, the annual value will be capitalised over a period of 50 years.<sup>131</sup> Furthermore, where the Commissioner is satisfied that the property cannot be expected to produce an annual yield of twelve

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<sup>125</sup> Government Notice No R1942 of 23 September 1977 (see appendices to the Act).

<sup>126</sup> *CIR v Snyman's Estate* 1972 (1) SA 1 (A).

<sup>127</sup> Stein (2007) *Tax Planning* 159–160.

<sup>128</sup> Stein (2007) *Tax Planning* 160.

<sup>129</sup> See Ch 7 par 7.4.4.1.

<sup>130</sup> S 5(1)(b) third proviso. This proviso was inserted subsequent to the decision in *CIR v MacNeillie's Estate* 1961 (3) SA 833 (A), where the court held that an interest to the income of a trust fund, which accrued to the trust capital upon the death of a trust beneficiary, to be kept in trust until some future event, constitutes property as contemplated in the Act in the estate of the deceased trust beneficiary, but which is not capable of being valued in the absence of an ascertainable beneficiary (to whom the right of enjoyment accrues as a result of the death of the trust beneficiary). In *Jackson and Others v SIR* 1969 (3) SA 217 (A) 226 it was held that the proviso even finds application where the vesting of the right of enjoyment is postponed until some future event.

<sup>131</sup> S 5(3).



percent, the Commissioner may fix a percentage that he considers to represent the annual yield.<sup>132 133</sup>

### 6.3.3.3 Annuities

Currently the Act contains a complicated set of valuation rules for annuities, distinguishing among (a) annuities charged on property, (b) annuities not charged on property and (c) insurance policy benefits or pension fund benefits taking the form of annuities.

#### 6.3.3.3.1 Annuities Charged upon Property

All annuities charged upon property, irrespective of whether they accrue to some other person upon the death of the deceased, are deemed to be the property of the deceased estate.<sup>134</sup> Such an annuity must be valued at the annual value capitalised at 12 percent over the expectation of life of the person<sup>135</sup> to whom the said right accrues on the death of the deceased, or if it is to be held over a lesser period, such lesser period.<sup>136</sup> If, however, the annuity does not accrue to some other person, the value is capitalised at 12 percent

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<sup>132</sup> S 5(2). Uncertainty prevails as to whether the Commissioner should assess the possible annual yield at the moment of death (or for that matter any period before death) or whether the Commissioner must have regard to the probabilities concerning the annual yield after death (especially during the period of enjoyment of the interest). For further reading, see Meyerowitz (1994) *Taxpayer* 22, 24; Meyerowitz (2000) *Taxpayer* 229; Meyerowitz (2001) *Taxpayer* 43; Stein (2007) *Tax Planning* 159 and Davis, Beneke and Jooste (2009) par 2.7.3.2.

<sup>133</sup> S 5(2) proviso provides that, where the property subject to the limited interest consists of books, pictures, statuary or other objects of art, the annual value shall be deemed to be the average net receipts (if any) derived by the person entitled to the right of enjoyment over such property during the three years immediately preceding the date of death of the deceased. Unless the books etc were put to commercial use, a limited interest for the right of enjoyment thereof will have no value for estate duty purposes. See in general Meyerowitz (2007) par 29.9 and Davis, Beneke and Jooste (2009) par 2.7.3.2.

<sup>134</sup> See par 6.2.4.1.

<sup>135</sup> If the person is not ascertainable until a future date, Meyerowitz (2007) par 29.14 submits that the right cannot be valued as provided for in the Act and estate duty will consequently not be payable (in analogy of the *Macneillie's Estate* case).

<sup>136</sup> S 5(1)(c)(i). See appendices to the Act for capitalisation tables. See in general Stein (2004) 29–30.



over the life expectancy of the person who on the death of the deceased is the owner of the property upon which the annuity is charged.<sup>137</sup>

#### 6.3.3.3.2 *Annuities Not Charged on Property*

An annuity not charged on property is only included as property in the deceased estate if it accrues to some other person on the death of the deceased.<sup>138</sup> The value of the annuity must be capitalised at 12 percent over the life expectancy of the person to whom the right to the annuity accrues, or if it is to be held over a lesser period, then such lesser period.<sup>139</sup>

#### 6.3.3.3.3 *Annuities Payable under an Insurance Policy or by Any Fund*

In the case of an annuity that is payable in terms of (a) an insurance policy or (b) in terms of a fund (only in respect of pension benefits payable as a result of a person dying before 1 January 2009) and therefore deemed to be property in the deceased estate,<sup>140</sup> the value of the annuity must be capitalised at 12 percent over the life expectancy of the annuitant, or if it is payable for a lesser period, over such lesser period.<sup>141</sup> The rule is subject to the proviso that, if the annuity ceases to be payable within five years after the death of the deceased, by reason of the death of or, in the case where the annuitant is the widow (or widower)<sup>142</sup> of the deceased, because of her (or his) remarriage, the value of the annuity

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<sup>137</sup> S 5(1)(c)(ii). See appendices to the Act for capitalisation tables. See in general Stein (2004) 30.

<sup>138</sup> See par 6.2.4.1.

<sup>139</sup> S 5(1)d). See appendices to the Act for capitalisation tables. See in general Meyerowitz (2007) par 29.15.

<sup>140</sup> As provided for in terms of s 3(3)(a) or s 3(3)(a)*bis*.

<sup>141</sup> S 5(1)(d)*bis*. See appendices to the Act for capitalisation tables.

<sup>142</sup> The Act refers only to a “widow” (female) and not a “widower” (male). The Interpretation Act 33 of 1957 s 6 states that, in every law (unless the contrary appears), words importing the masculine gender includes females. However, it seems as if no provision is made for the contrary position (words importing the female gender). It may therefore be suggested that the section unfairly discriminates against males in terms of s 9 of the Constitution (see Ch 2 par 2.4.3.3.3).



may not be more than the aggregate of all the amounts which accrued to the annuitant or his or her estate in respect of the annuity.<sup>143</sup>

For all three categories described above, the annuity must be capitalised over a period of 50 years where the beneficiary or owner is not a natural person.<sup>144</sup>

#### ***6.3.3.4 Bare Dominium in Property***

A right of ownership in movable or immovable property, which is subject to a usufructuary or other like interest in favour of a person (referred to as “bare *dominium* property”), is valued by deducting from the fair market value the value of such interest.<sup>145</sup> Although the Act (as has been described above) provides for specific valuation rules for usufructuary and other like interests, the valuation rule for the bare *dominium* property contains its own set of rules for the valuation of these interests. According to these rules, a usufruct or annuity is to be valued by capitalising at 12 percent the annual value of the interest or annuity over the life expectancy of the usufructuary or annuitant, or if such interest is to be held for a lesser period, such lesser period.<sup>146</sup> In the case of any other interest, such as a *usus*, *habitatio* or grazing rights, the Commissioner may determine the annual yield of such interest, which annual value must then be capitalised at 12 percent over the life expectancy of the person entitled to such interest, or lesser period.<sup>147</sup>

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<sup>143</sup> S 5(1)(d)*bis* proviso. See in general Stein (2004) 44–45. Any application for a refund should be made by the claimant to the Master’s Office which issued the original assessment. See Meyerowitz (2007) par 29.16 for an example.

<sup>144</sup> S 5(3).

<sup>145</sup> S 5(1)(f). See in general Stein (2004) 30–31.

<sup>146</sup> S 5(1)(f)(i) and (ii). See appendices to the Act for capitalisation tables. See in general Meyerowitz (2007) pars 29.18–29.19 for examples. If the usufructuary or annuitant is not a natural person, the period will be 50 years (s 5(3)).

<sup>147</sup> S 5(1)(f)(iii). See Meyerowitz (2007) par 29.20 for an example.



### 6.3.3.5 Section 3(3)(d) Property

Property which the deceased was competent to dispose of and included in the deceased estate in terms of section 3(3)(d) will be valued as follows:

- Where such property consists of profits, by capitalising at 12 percent the annual value of such profits over the life expectancy of the deceased immediately prior to his or her death;
- In the case of any other property, the fair market value of such property at the date of death of the deceased less any expenses and liabilities which the deceased would have had to bear or assume if he had at that date exercised his power of disposition.<sup>148</sup>

### 6.3.3.6 Donations Mortis Causa

A *donatio mortis causa*<sup>149</sup> must be valued according to section 62 of the Income Tax Act,<sup>150</sup> which provides for the valuation of donated property.<sup>151</sup> The property should be valued when the donation is deemed to take effect, which would be the date of death of the donor in the case of a *donatio mortis causa*.<sup>152</sup>

## 6.4 TAXPAYER AND PAYMENT OF THE TAX

All duty is payable in the first instance by and recoverable from the executor of the deceased estate (in his or her capacity as such).<sup>153</sup> The executor is responsible for the

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<sup>148</sup> S 5(1)(f)ter. See in general Meyerowitz (2007) par 29.23.

<sup>149</sup> See Ch 3 par 3.3.2.2.1 n 123 for the meaning of a *donatio mortis causa*.

<sup>150</sup> S 5(1)(e). See in general Stein (2004) 49–51 and Davis, Beneke and Jooste (2009) par 2.7.7.

<sup>151</sup> See Ch 5 par 5.3.

<sup>152</sup> Meyerowitz (2007) par 29.24; Davis, Beneke and Jooste (2009) par 2.7.7; King and Victor (2008/2009) par 13.11.3.

<sup>153</sup> S 12. However, the executor may be held personally liable if he has parted with the possession or control of property under his administration without first paying the estate duty. In such instance, the executor will be jointly and severally liable with the person to whom the assets have been distributed (s 19). When the Footnote continues on the next page



submission of an estate duty return,<sup>154</sup> which may be adjusted by the Commissioner.<sup>155</sup> Payment of the duty should be made on or before a date set out in the estate duty assessment issued subsequent to the receipt of the return.<sup>156</sup> Interest at a rate of six percent is chargeable on any outstanding duties. Interest also becomes automatically chargeable after a period of 12 months after the deceased's death.<sup>157</sup>

The executor may, however, recover duty from the heir, recipient or successor in the instances set out below:

- where the duty is levied on property which consists of a usufructuary, fiduciary or other like interest in property or annuity included in the deceased estate, the person to whom the advantage accrues (the successor) would be liable for the duty;<sup>158</sup>
- where the duty is levied on the proceeds of a life insurance policy which is recoverable by any person other than the executor, the beneficiary would be liable for the duty;<sup>159</sup>
- where the duty is levied on benefits from funds which accrue to a person other than the executor, then such person would be liable for the duty;<sup>160</sup> and
- where the duty is levied on a *donatio mortis causa*, the donee would be liable for the duty.<sup>161</sup>

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executor pays the duty, it is submitted that he has a right of recourse against either the estate or the person liable for the duty, or even the person to whom the property was distributed and from which the Commissioner was entitled to claim the duty. See Meyerowitz (2007) par 30.14.

<sup>154</sup> S 7.

<sup>155</sup> S 8.

<sup>156</sup> S 9.

<sup>157</sup> S 10 (unless extension has been granted by the Commissioner).

<sup>158</sup> S 11(a)(i).

<sup>159</sup> S 11(a)(ii).

<sup>160</sup> S 11(b)(iA).

<sup>161</sup> S 11(b)(ii).



The deceased estate would therefore be liable for duty in respect of any other ordinary property of the deceased, the proceeds of life insurance benefits payable to the deceased estate, fund benefits payable to the deceased estate, a claim under the accrual system and property which the deceased was competent to dispose of.<sup>162</sup> This liability must be satisfied out of the estate,<sup>163</sup> and more specifically, the residue of the estate, unless the deceased has provided by will that a legacy would bear the estate duty attributable to it.<sup>164</sup> If the residue of the estate is insufficient, the duty must be met *pro rata* from the legacies.<sup>165</sup>

## 6.5 RELIEF MECHANISMS

Relief can take various forms. Under the Estate Duty Act, relief is mainly granted by virtue of (a) a special valuation rule for agricultural property and (b) the allowance of certain deductions against the property (and deemed property) of the deceased estate.

### 6.5.1 Preferential Valuation: Agricultural Property

Where agricultural property<sup>166</sup> has been realised during the liquidation of the deceased estate, the purchase price obtained would constitute the value for estate duty purposes according to the general rule (as described in paragraph 6.3.3.1 above). Where, however, such property has not been so realised, the Act provides for a favourable valuation method in a fashion similar to that provided for under the donations tax provisions.<sup>167</sup> The

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<sup>162</sup> See in general Meyerowitz (2007) par 30.14; King and Victor (2008/2009) par 13.7 and Davis, Beneke and Jooste (2009) par 2.8.

<sup>163</sup> S 12.

<sup>164</sup> Meyerowitz (2007) par 30.14.

<sup>165</sup> Meyerowitz (2007) par 30.14 (if there are any pre-legacies, the other legacies must first be exhausted).

<sup>166</sup> Meaning immovable property on which a *bona fide* farming undertaking is being carried on in the republic (s 1 “fair market value”).

<sup>167</sup> See Ch 5 par 5.5.2.





“fair market value” may, apart from being established in terms of the main definition,<sup>168</sup> alternatively be determined by reducing the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm’s length in an open market by 30 percent.<sup>169</sup> In respect of agricultural property, in so far as it is relevant for the purposes of determining the valuation of the shares in a company, the value may also be determined by reducing the market value of such property by 30 percent.<sup>170</sup>

## 6.5.2 Allowable Deductions

The net value of the estate is determined by subtracting from the total value of property and deemed property the deductions allowable in terms of section 4 of the Act. For convenience, these deductions are categorised under deductible expenses, deductible exemptions and the primary rebate, which will be more fully discussed below.

### 6.5.2.1 Deductible Expenses

The Act allows for the deduction of the following expenses:

- so much of the funeral, tombstone and death-bed expenses of the deceased, which the Commissioner considers to be fair and reasonable;<sup>171</sup>
- all costs which have been allowed by the Master of the High Court in the administration and liquidation of the deceased estate, other than expenses incurred

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<sup>168</sup> Mitchell (2006) *Tax Planning* 43 highlights the fact that the executor has the choice to value the agricultural property either at its market value or at its market value less 30%. Where the value of the dutiable estate is less than the primary rebate (R3.5 million), it might be beneficial for the heirs to value the property at market value (not market value less 30%), in view of the fact that the base cost of the property for purposes of CGT would be higher.

<sup>169</sup> S 1.

<sup>170</sup> S 5(1A). See also definition of “fair market value” in s 1.

<sup>171</sup> S 4(a). See in general Meyerowitz (2007) par 28.2. In determining the half-share of the surviving spouse, where such spouse was married to the deceased in community of property, the funeral and death-bed expenses of the deceased are charges against the deceased’s share of the joint estate only. See Meyerowitz (2007) par 28.27.



in respect of any income accruing to the estate after the date of death;<sup>172</sup>

- all the expenditure incurred in carrying out the requirements of the Master or the Commissioner in pursuance of the provisions of the Act;<sup>173</sup>
- all debts due by the deceased to persons ordinarily resident<sup>174</sup> in the republic, which are proved to the satisfaction of the Commissioner to have been discharged from property included in the estate;<sup>175 176</sup>
- debts due to persons ordinarily resident outside the republic discharged from property included in the estate, but only to the extent that such debts exceed the value of any assets of the deceased situated outside the republic and not included in the deceased estate;<sup>177</sup> and

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<sup>172</sup> S 4(c). See in general Stein (2004) 70 and Meyerowitz (2007) pars 28.8–28.11 (referring to the usual charges such as advertisement costs, costs in respect of security furnished by the executor, executor’s commission, Master’s fees, valuation expenses, legal and accounting fees, realisation costs, transfer costs and costs of maintenance of estate assets).

<sup>173</sup> S 4(d). See in general Stein (2004) 70 (where the writer refers to e.g. the cost of a security bond required by the Master) and Meyerowitz (2007) par 28.12 (where the writer refers to e.g. the cost of valuations).

<sup>174</sup> For the meaning of “ordinarily resident”, see Ch 5 par 5.2.2.1. Although the Act is silent as to the time when the creditor should have been ordinarily resident in the republic, Meyerowitz (2007) par 28.5 submits that it should be interpreted as to be at the time of death of the deceased.

<sup>175</sup> S 4(b). See in general Meyerowitz (2007) pars 28.3–28.6. It is submitted that “debts due” would also include debts in respect of which the deceased has incurred a liability prior to his or her death, but which are due and payable at some time after the date of death. See *Myer NO v CIR* 1956 (4) SA 342 (T) and *ITC 1773* (2003) 66 SATC 251. See also Stein (2004) 71 and Meyerowitz (2007) par 28.4.

<sup>176</sup> To counter the avoidance scheme where property donated under a *donatio mortis causa* or a section 56(1)(d) donation is deemed to be included in the deceased estate (see par 6.2.4.2.3), but effectively omitted from the dutiable estate by virtue of the deduction of the corresponding claims against the estate as debts due by the deceased, the Act introduced provisions to exclude such claims as allowable deductions. Ss 4(b) proviso and 4(f) proviso (applicable to the estates of persons dying on or after 8 November 2005). Prior to the inclusion of these provisos, both donations tax and estate duty could have been avoided through the use of these donations. See Jooste (2004) *SALJ* 744 and Botha (2006) *Ins & Tax* 36 *et seq* for a description of a typical tax avoidance technique based on these donations.

<sup>177</sup> S 4(f). See in general Stein (2004) 72 and Meyerowitz (2007) par 28.14. See also n 176 directly above.



- the amount of any claim for accrual against the estate acquired by the surviving spouse of the deceased, who was married out of community of property to the deceased, in terms of the Matrimonial Property Act of 1984.<sup>178</sup>

### 6.5.2.2 Exemptions

The Act provides that the following may be deducted against the value of the deceased estate:

- the value of any property included in the estate (which has not been allowed as a deduction otherwise) which accrues to –
  - any public benefit organisation approved by the Commissioner;<sup>179</sup> or
  - certain institutions, boards or bodies exempt from income tax in terms of section 10(1)(cA) of the Income Tax Act, that have as their sole and principal object the carrying on of any public benefit activity approved by the Commissioner;<sup>180</sup> or
  - the state; or
  - any municipality;<sup>181 182</sup>
- the value of all books, pictures, statuary or other objects of art (hereafter “cultural property”), or so much of the value of any shares in a body corporate as is attributable to such body corporate’s ownership of cultural property, where such cultural property have been lent under a notarial deed to the State or any local authority within the republic or to any public institution within the republic for the advancement of

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<sup>178</sup> Estate Duty Act s 4(1A). For the calculation of the accrual claim, see Davis, Beneke and Jooste (2009) par 10.4.

<sup>179</sup> The organisation should be exempt from income tax in terms of section 10(1)(cN) of the Income Tax Act 58 of 1962. See in general Davis, Beneke and Jooste (2009) par 2.5.9 for a discussion on the meaning of a “public benefit organisation”. One of the requirements is that at least 85% of the organisation’s activities should be carried out for the benefit of persons in the republic.

<sup>180</sup> As contemplated in terms of section 30 of the Income Tax Act 58 of 1962.

<sup>181</sup> As defined in terms of section 1 of the Income Tax Act 58 of 1962.

<sup>182</sup> S 4(h). See in general Stein (2004) 72 and Meyerowitz (2007) par 28.16.



science or art or of a charitable, educational or religious nature, for a period not less than thirty years, and where the deceased died during such period;<sup>183</sup>

- subject to certain provisos,<sup>184</sup> the value of any property included in the estate, which had not been allowable as a deduction under any of the other provisions, which “accrues” to the surviving spouse of the deceased;<sup>185</sup>
- any interest included as property in the deceased estate under the provisions of section 3(2)(a) (such as a fiduciary, usufructuary or other like interest), where such interest was held by the deceased by virtue of a donation to him or her by the person to whom the right of enjoyment of the property, in which the deceased held the interest, accrues upon the death of the deceased (or where the interest consists of a right to an annuity charged upon property, where such an annuity was held by the deceased by virtue of a donation to him by the person who is the owner of the burdened property);<sup>186</sup>
- the value of any improvements made to property (included in the deceased estate) at the expense of the person to whom the property accrues at the death of the deceased, provided that the improvements were made during the lifetime of the deceased and with his or her consent;<sup>187</sup>

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<sup>183</sup> S 4(o). See in general Meyerowitz (2007) par 28.25.

<sup>184</sup> The deduction provided for in s 4(q) has, since 1987, been subject to two provisos. Firstly, the deduction shall be reduced by any amount that the surviving spouse is required in terms of the will of the deceased to dispose of to any other person or trust. This proviso is aimed at preventing a deduction where property is bequeathed to a surviving spouse with a requirement to pass it on to another person. Secondly, no deduction shall be allowed in respect of any property which accrues to a trust established by the deceased for the benefit of the surviving spouse, if the trustee of such a trust has a discretion to allocate such property, or any income there from, to any person other than the surviving spouse. A number of interpretation issues and anomalies exist in relation to the two provisos, but these fall outside the scope of this thesis. For further reading, see Editorial (1992) *Taxpayer* 161; Stein (2004) 75–78; Meyerowitz (2007) par 28.18; King and Victor (2008/2009) par 13.4.14 and Davis, Beneke and Jooste (2009) pars 2.5.16, 2.5A and 15.4.

<sup>185</sup> S 4(q). See in general Stein (2004) 75; Meyerowitz (2007) pars 28.17 and 29.22.

<sup>186</sup> S 4(g). Meyerowitz points out the unusual distinction between an annuity and any other interest in that the Act does not require that the enjoyment of such an annuity should revert to the owner of the property (burdened with the annuity), but only that the donor should still be the owner of the property (upon the death of the person who enjoyed such an annuity).

<sup>187</sup> S 4(i). See in general Stein (2004) 73–74 and Meyerowitz (2007) par 28.23.



- the value of any improvements made to property subject to a fiduciary, usufructuary or other like interest, where the value of such interest (which ceased upon the death of the deceased) had been enhanced by the improvements at the expense of the person to whom the enjoyment of the property upon the death of the deceased accrues, provided that the improvements were effected during the lifetime of the deceased and with his or her consent;<sup>188</sup> and
- the value of property, deemed to be property of the deceased in terms of section 3(3) of the Act<sup>189</sup> (as has not been allowed as a deduction under any of the other provisions), as the Commissioner is satisfied has been taken into account under the provisions of section 5(1)(f)*bis*<sup>190</sup> in the determination of the value of any company shares or a member's interest in a close corporation included as property in the estate.<sup>191</sup>

For a long period of time SARS had the practice of calculating any benefit that “accrues” to a residuary heir for purposes of computing a deduction in terms of section 4(g), 4(h) or 4(q), by reducing the deduction by the amount of estate duty that was payable.<sup>192</sup> The practice was, however, overturned by the Supreme Court of Appeal in *Commissioner for the South African Revenue Service v Executor Frith's Estate*,<sup>193</sup> where the court ruled that the value of the deduction should be established with reference to the deceased's will (and not the liquidation and distribution account)<sup>194</sup> and that “any suggestion that one

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<sup>188</sup> S 4(j). See in general Stein (2004) 74.

<sup>189</sup> See par 6.2.4.2.

<sup>190</sup> See par 6.3.1.

<sup>191</sup> S 4(p). See Dillon (2006) *Ins & Tax 22 et seq* for some examples. The reason for this provision is to deduct the value of deemed property, to the extent that it has been taken into account in the valuation of shares or a member's interest held by the deceased, from the deceased estate, in view of the fact that the value of the deemed property has already been included in the estate, and to therefore restrict an artificial increase in the deceased estate. See Stein (2004) 79; Meyerowitz (2007) par 28.26.

<sup>192</sup> See discussion by Stein (2004) 76–78 (with examples) and Davis, Beneke and Jooste (2009) par 2.5A.

<sup>193</sup> 2001 (2) SA 261 (SCA). See Editorial (2001) *Taxpayer 8 et seq* for case discussion.

<sup>194</sup> *Frith* case 275 and 277.



must engage in arithmetic or algebraic gymnastics when applying it” cannot be accepted.<sup>195</sup>

### 6.5.2.3 *The Primary Rebate (s 4A)*

The primary rebate allowed as a deduction against the net estate is currently an amount of R3.5 million.<sup>196</sup> In view of the fact that any benefit acquired by a spouse from the estate of a deceased spouse is exempt from estate duty, a primary rebate would be left unutilised in the case where a spouse bequeaths his or her total estate to the surviving spouse. A common estate planning technique developed whereby a testator bequeaths assets to the value of the primary rebate to, for example, a family trust, with the balance of the estate outright to his or her surviving spouse. The purpose of such a structure is to ensure that both spouses’ primary rebates would be utilised to pass assets tax-free to children.<sup>197</sup> In view of the fact that these schemes create compliance costs and are mainly used by wealthy taxpayers who can afford professional estate planning advice,<sup>198</sup> the Taxation Laws Amendment Act of 2009<sup>199</sup> implemented a roll-over in respect of a deceased person’s unused rebate to his or her surviving spouse.<sup>200</sup>

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<sup>195</sup> *Frith* case 275. Although the outcome of the case cannot be faulted, some commentators have suggested that the court could have arrived at its decision in a better fashion. Van der Linde and Franzsen (2001) *TSAR* 819 *et seq* argue that an “accrual” for purposes of the Act can only be computed by reference to the “property” or “deemed property” which accrues to the beneficiary. They also refer to the history of section 4(q), being a formula developed with reference to the spousal deduction that was allowed in respect of the levying of succession duty under the Death Duties Act, a duty levied on the *acquisition* of an inheritance by a beneficiary. Although the valuation of the benefit that accrues to the surviving spouse under the provisions of succession duty would have accounted for any duty payable, in view of the fact that the duty was levied on the actual amount acquired by the beneficiary, this was contrary to the nature of estate duty, a transferor-based tax that was levied with reference to property of the deceased estate.

<sup>196</sup> S 4A (the R3.5 million rebate is applicable to persons dying on or after 1 March 2007).

<sup>197</sup> See e.g. Duncan (2004) July *De Rebus* 33; King and Victor (2008/2009) par 13.5.1 and Davis, Beneke and Jooste (2009) par 9.2.

<sup>198</sup> See Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill (2009) par 6.1.

<sup>199</sup> Act 17 of 2009.

<sup>200</sup> S 4A (as amended by s 5(1) of Act 17 of 2009 with effect from 1 January 2010). The amendment makes provision for multiple spouses. See Explanatory Memorandum on the Taxation Laws Amendment Bill (2009) 89–90.



## 6.6 TREATMENT OF TRUSTS

There are various ways to benefit a trust under a person's will.<sup>201</sup> In *Kohlberg v Burnett*<sup>202</sup> the Appellate Division (as it then was) held that a bequest to an *inter vivos* trust is legal and effective. Although the trust is not a legal person, the trustees are entitled to act on behalf of the trust and to hold in their capacities as trustees property for the purposes of the trust.<sup>203</sup> In view of the fact that the Estate Duty Act levies the tax with reference to the property of a deceased (on the date of his or her death), any bequest to a trust or to a person to be administered in trust would not affect the taxability of the estate. The tax base does not relate to the completion of a transfer. It does not matter when the bequest vests in the heir. As a consequence, the issue whether or not a trust has (on behalf of the beneficiaries) inherited from the estate is generally not relevant. The focal point is not the acceptance of any benefit, which has posed some serious issues in respect of donations to trusts, as has been pointed out above.<sup>204</sup> However, where the identity of the beneficiary is relevant, for example in the determination of the value of a usufructuary interest enjoyed by the deceased prior to his or her death, the Act has introduced provisions to the effect that, where a beneficiary is unascertainable, the annual value of the interest must be capitalised over a period of 50 years.<sup>205</sup>

If the trust is a discretionary trust, it is accepted in practice that a beneficiary's interest in the trust, being only a contingent interest, would not fall into his or her deceased estate upon his or her death.<sup>206</sup> Estate duty could therefore be postponed indefinitely. This aspect will be addressed in more detail in Chapter 7.<sup>207</sup>

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<sup>201</sup> See Kernick (2008) April *De Rebus* 50–51 for further reading.

<sup>202</sup> 1986 (3) SA 12 (A).

<sup>203</sup> See Ch 5 par 5.6.2.

<sup>204</sup> See Ch 5 pars 5.6.2 and 5.6.3.

<sup>205</sup> See par 6.3.3.2. This amendment was effected subsequent to the *MacNeillie's Estate* case.

<sup>206</sup> See Strydom LLD Thesis (2000) 250–251 for further reading.

<sup>207</sup> See Ch 7 par 7.4.6.





## 6.7 GENERAL ANTI-AVOIDANCE RULE

Except for specific anti-avoidance measures such as section 3(3)(d)<sup>208</sup> and the valuation rule for unquoted shares in section 5(1)(f)*bis*,<sup>209</sup> the Estate Duty Act does not contain a statutory general anti-avoidance rule, such as is provided for in the Income Tax Act, Value-Added Tax Act<sup>210</sup> and Transfer Duty Act.<sup>211</sup> The income tax general anti-avoidance rule applies within the ambit of estate duty, but only to a limited extent. Where the planner's intention was to save estate duty as a consequence of which he or she saved income tax, the Commissioner may assess the planner on income tax (but not estate duty) as if the transaction, scheme or arrangement has never been entered into.<sup>212</sup>

The Katz Commission did not favour the introduction of a general anti-avoidance measure for purposes of estate duty. The reasons advanced were (a) at the time when the transaction is challenged, the founder would have died (which would make the entire issue of evidence difficult); (b) there would be much uncertainty (which would undermine sensible estate planning) and (c) it would result in a wasteful proliferation of litigation. The commission instead supported the introduction of some additional specific anti-avoidance measures such as can be found in the United Kingdom system.<sup>213</sup> However, none of these additional measures have since been introduced.

In 2008 the Draft Revenue Laws Amendment Act proposed to introduce a general anti-avoidance rule, similar to the rule contained in the Transfer Duty Act, to bring the Act in

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<sup>208</sup> See par 6.2.4.2.5.

<sup>209</sup> See par 6.3.1.

<sup>210</sup> Act 89 of 1991.

<sup>211</sup> Act 40 of 1949.

<sup>212</sup> King and Victor (2008/2009) par 13.12.

<sup>213</sup> Fourth Interim Katz Report (1997) pars 9.4 and 9.5.





line with the other fiscal statutes.<sup>214</sup> It was proposed that the Act be amended by the insertion of section 25B (which was proposed to come into operation on 23 September 2009).<sup>215</sup>

Following the publication of the draft legislation, commentators called on the legislature to reconsider the proposition. The main objection was that the rule was not specifically tailored for purposes of estate duty, because of the reference to the *bona fide* business purpose test. Estate planning primarily involves family matters, and decisions are usually motivated by considerations which could not be categorised as “arm’s length” in a business context. It was therefore deduced that the proposed formulation was inappropriate. Apparently, the Law Society of South Africa Estate Committee suggested that the alternative approach as provided for in the general anti-avoidance rule of the Income Tax Act, which relates to arrangements other than a business context,<sup>216</sup> could serve as a useful benchmark.<sup>217</sup>

The Portfolio Committee on Finance announced that the National Treasury had agreed to withdraw and reconsider the proposed general anti-avoidance rule, but vowed that current estate duty freezing techniques would be addressed in the short term.<sup>218</sup>

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<sup>214</sup> Draft Explanatory Memorandum on the Revenue Laws Amendment Bill (2008) 79, available at [www.finance.gov.za/legislation/Draft\\_Bills](http://www.finance.gov.za/legislation/Draft_Bills) (accessed 16 August 2009).

<sup>215</sup> Draft Revenue Laws Amendment Bill (2008) par 4, available at [www.finance.gov.za/legislation/Draft\\_Bills](http://www.finance.gov.za/legislation/Draft_Bills) (accessed 16 August 2009).

<sup>216</sup> See Ch 5 par 5.7.

<sup>217</sup> Editorial (2008) November *De Rebus* 18.

<sup>218</sup> See Response Document of the Portfolio Committee on Finance *Report Back Hearings on the Revenue Laws and Bills 2008* (21 October 2008), available at [www.finance.gov.za/legislation/Bills](http://www.finance.gov.za/legislation/Bills) (accessed on 16 July 2009); Sabinet Cape Town Office *Legislative Information* “News From Parliament: National Treasury Provides Responses to Public Hearings on Proposed Revenue Law Amendments” (12/09/2008), available at [http://www.sabinet.co.za/sabinetlaw/news\\_par808.html](http://www.sabinet.co.za/sabinetlaw/news_par808.html) (last visited 22 October 2008).



## 6.8 CAPITAL GAINS TAX

### 6.8.1 Capital Gains Tax Consequences

In terms of paragraph 40 of the Eighth Schedule to the Income Tax Act, a deceased person is deemed to dispose of all his or her assets (except for those transferred to a spouse and for assets consisting of domestic life insurance policies or retirement savings) to the deceased estate for an amount received or accrued to equal to the market value of the assets on the date of death.<sup>219</sup>

### 6.8.2 Interaction with Estate Duty

Any capital gains tax liability incurred by the deceased estate as a result of the deemed realisation at death will constitute an allowable deduction (under section 4(b)) against the value of the dutiable estate for purposes of estate duty.

In addition, the Eighth Schedule grants a concession where the capital gains tax exceeds 50 percent of the net value of the estate for estate duty purposes. In such a case, the heir is permitted to take the asset that would otherwise have to be sold to provide liquidity for the payment of the capital gains tax, and to pay the tax within three years after the executor has been given permission to distribute the estate.<sup>220</sup>

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<sup>219</sup> For further reading on capital gains tax and deceased estates, see Davis, Beneke and Jooste (2009) par 2A.7 and De Koker and Williams Vol 3 (2009) pars 24.121–24.125.

<sup>220</sup> Par 41 Eighth Schedule to the Income Tax Act. This relief was introduced because “[t]here may be cases where a significant capital gains tax charge arises due to the growth in the value of the assets although the deceased estate is heavily indebted and would not be liable for estate duty”. See Explanatory Memorandum on the Taxation Laws Amendment Bill (2001) 74.



## 6.9 CONCLUSIONS

This chapter provided an overview of the main characteristics of the estate duty regime. The following chapter will provide a discussion on some key policy issues and problematic aspects relating to donations tax and estate duty in the South African tax system.

**CHAPTER 7**  
**POLICY ISSUES AND PROBLEMATIC ASPECTS**  
**RELATING TO THE SOUTH AFRICAN**  
**WEALTH TRANSFER TAX SYSTEM**

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## 7.1 INTRODUCTION

Following on the discussion of the main framework and features of the current South African wealth transfer tax system in Chapters 5 and 6, this chapter points out key policy issues that will have to be considered. Paragraph 7.2 outlines the lack of integration between the taxation of *inter vivos* transfers and transfers on death under the current regimes and paragraph 7.3 subsequently identifies a number of significant problem areas. Paragraph 7.4 reopens the centuries-old debate on whether transferor-based taxation should be preferred over recipient-based taxation. This debate is located in a South African context.

## 7.2 THE INTEGRATION OF THE TAXATION OF *INTER VIVOS* TRANSFERS AND TRANSFERS ON DEATH

### 7.2.1 The Issue of Integration

In the light of the various discrepancies that exist between the taxation of *inter vivos* transfers and transfers on death under the current regimes (as will more fully be pointed out below), the first purpose of this study is to establish to what extent the taxation of the two types of transfers should be integrated under the South African wealth transfer tax system.



## 7.2.2 Current Discrepancies

### 7.2.2.1 Different Statutes

Wealth transfer taxation is currently provided for by virtue of two separate fiscal regimes. Estate duty is levied in terms of the Estate Duty Act,<sup>1</sup> whereas donations tax is provided for in Part V of the Income Tax Act.<sup>2</sup> The Margo Commission and the Katz Commission proposed that both legislative regimes should ideally be replaced by a single integrated legislative regime, referred to as “capital transfer tax”.<sup>3</sup> Government has not yet acted on these recommendations.

### 7.2.2.2 Jurisdictional Basis

Both estate duty and donations tax are primarily levied on a worldwide basis. In addition, for the purposes of estate duty, property located, registered or enforceable in South Africa belonging to a person who is not ordinarily resident in the republic at the date of his or her death will be subject to estate duty. Complementary to the worldwide basis, estate duty is therefore levied on a *situs* basis as well. By contrast, local property donated by a non-resident does not fall within the ambit of donations tax, implying that the jurisdictional basis for donations tax does not extend to a *situs* basis.<sup>4</sup> Some scholars mention rightly that it is odd that non-residents are liable for estate duty in respect of property situated in the republic, but are not liable for donations tax if such property is donated.<sup>5</sup>

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<sup>1</sup> Act 45 of 1955.

<sup>2</sup> Act 58 of 1962.

<sup>3</sup> See Ch 1 par 1.1 and Ch 3 par 3.3.2.3.

<sup>4</sup> See Ch 5 par 5.2.2 and Ch 6 par 6.2.2.

<sup>5</sup> Davis, Beneke and Jooste (2009) pars 2.3.3 and 2.9.1.



Also, the jurisdictional basis for estate duty is determined with reference to a person “ordinarily resident” in the republic,<sup>6</sup> whilst the jurisdictional basis for donations tax is established with reference to a “resident”, which term (as defined) includes a person “ordinarily resident” in the republic as well as a person who satisfies the physical presence test for a particular year of assessment.<sup>7</sup>

### ***7.2.2.3 Double Taxation Relief***

Because of the fact that *inter vivos* transfers and transfers on death are taxed in terms of two different statutory regimes, the double taxation agreements concluded with other countries in the realm of wealth transfer taxation do not necessarily apply to both types of transfers. In fact, all the double taxation agreements entered into, with the exception of the agreement concluded with the United Kingdom, provide relief towards transfers on death only.<sup>8</sup> Furthermore, the Estate Duty Act provides for unilateral relief in the case of double taxation, whereas the unilateral relief provided for in the Income Tax Act does not extend to donations tax.<sup>9</sup>

Double taxation may, for example, occur where a resident donates an asset located in a foreign country (which is not exempt from donations tax). Suppose that A, who has been a South African resident since his birth, owns property in the United States which he purchased as an investment. If A donates the property, he will be liable for South African donations tax. Assuming that the United States (transferor-based) federal gift tax applies to the transaction, A will also be liable for that tax. Because the double tax agreement entered into with the United States applies to transfers on death only, A will not be entitled to relief in terms thereof. In addition, A cannot rely on any unilateral relief

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<sup>6</sup> See Ch 6 par 6.2.2.1.

<sup>7</sup> See Ch 5 par 5.2.2.1.

<sup>8</sup> See Ch 5 par 5.2.3 read with Ch 6 par 6.2.3.

<sup>9</sup> See Ch 5 par 5.2.3 read with Ch 6 par 6.2.3.

provisions. Where, however, A does not donate the United States asset, but bequeaths it to his son, then A's deceased estate will be entitled to relief in terms of the United States double taxation agreement for the double taxation produced as a result of the operation of South African estate duty and the United States federal estate tax.

#### ***7.2.2.4 Valuation Rules***

The Estate Duty Act contains special rules for the valuation of unquoted shares,<sup>10</sup> whereas the Income Tax Act does not offer any corresponding provisions for the purposes of donations tax.

Also, for the purposes of estate duty, usufructuary, fiduciary and other like interests and annuities are valued with reference to the life expectancy of the beneficiary (unless the interest is to be enjoyed for a shorter period),<sup>11</sup> whereas for donations tax purposes these interests are primarily valued with reference to the life expectancy of the donor (unless the interest is to be enjoyed for a shorter period).<sup>12</sup> Because these valuation issues are inextricably linked to the approach towards limited interests in general, these issues will more fully be addressed under paragraph 7.4.4 below.

#### ***7.2.2.5 Exemptions***

If one compares the exemptions under the donations tax provisions with the exemptions provided for the purposes of estate duty,<sup>13</sup> it is evident that both regimes offer exemptions for the Government, municipalities, public benefit organisations and certain institutions exempt from income tax (although the wording used under the statutes differs slightly). Furthermore, both regimes provide for the exemption of transfers between spouses.

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<sup>10</sup> See Ch 6 par 6.3.1.

<sup>11</sup> See Ch 6 pars 6.3.3.2 and 6.3.3.3.

<sup>12</sup> See Ch 5 par 5.3.2 and 5.3.3.

<sup>13</sup> See Ch 5 par 5.5.3 and Ch 6 par 6.5.2.2.





The rest of the exemptions offered under both regimes differ to a large extent. Because of the difference in nature between transfers that occur during life and transfers that occur on death, it is understandable that there are discrepancies under the regimes. For example, the provision for the exemption of maintenance payments, donations cancelled within six months and certain voluntary awards (that are required to be included in the gross income of the recipient) are generally relevant in the realm of lifetime transfers. Similarly, the Estate Duty Act contains some exemptions as a consequence of the special circumstances that exist on the death of a person, such as the exemption provided for cultural property lent under a notarial deed to the State and the exemption offered for improvements effected to property by an heir.

However, it would seem that there are a number of discrepancies that are unwarranted. For example, donations to or by the following institutions are exempt from donations tax (but no corresponding exemption is granted where these institutions inherit from a deceased estate): any traditional council, traditional community or any tribe; a political party; a recreational club approved by the Commissioner; certain pension and retirement funds, a trade union, chamber of commerce or industries, a local publicity association approved by the Commissioner; a company, society or association established to promote the common interests of its members and a body corporate, share block company and association of persons (whose receipts and accruals are derived by way of levies from its members or shareholders).

#### ***7.2.2.6 General Anti-avoidance Rule***

Because donations tax is provided for in the Income Tax Act, the general anti-avoidance measure is also applicable for the purposes of donations tax.<sup>14</sup> On the other hand, the

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<sup>14</sup> See Ch 5 par 5.7.



Estate Duty Act does not enjoy the advantage of these provisions. In particular, there is no general anti-avoidance rule in operation for the purposes of estate duty.<sup>15</sup>

### 7.3 TRANSFEROR-BASED TAX VERSUS RECIPIENT-BASED TAX

When the first national legislation, namely the Death Duties Act,<sup>16</sup> was replaced by donations tax (levied in terms of income tax legislation) and estate duty (levied in terms of the Estate Duty Act) in 1955, it became evident that South Africa followed the example of common-law countries by preferring transferor-based taxation to recipient-based taxation.<sup>17</sup> It is to be noted, though, that traces of recipient-based taxation were left behind or later adopted in the estate duty regime, such as the following:

- The deduction provided for any amount that “accrues” to certain institutions of a charitable nature;<sup>18</sup>
- The deduction provided for any benefit that “accrues” to the surviving spouse;<sup>19</sup>
- A usufructuary, fiduciary or other like interest and an annuity is primarily valued with reference to the life expectancy of the beneficiary (the successor), unless the interest is to be enjoyed for a shorter period;<sup>20</sup>
- The beneficiary is in some instances accountable for the estate duty attributable to the property included in the deceased estate, such as the beneficiary of life insurance benefits and the person to whom the right of enjoyment of property accrues on the death of the deceased.<sup>21</sup>

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<sup>15</sup> See Ch 6 par 6.7.

<sup>16</sup> Act 29 of 1922.

<sup>17</sup> See Ch 3 pars 3.3.2.2 and 3.4(i).

<sup>18</sup> S 4(h) of the Estate Duty Act. See Ch 6 par 6.5.2.2.

<sup>19</sup> S 4(q) of the Estate Duty Act. See Ch 6 par 6.5.2.2.

<sup>20</sup> See Ch 6 pars 6.3.3.2 and 6.3.3.3. See also par 7.4.5.5, where it is explained that limited interests were basically valued with reference to the circumstances of the beneficiary for purposes of the Death Duties Act.

<sup>21</sup> See Ch 6 par 6.4.



Although transferor-based taxation was supported by the Franzsen Commission (1970), the Margo Commission (1986) and the Katz Commission (in 1995),<sup>22</sup> it was concluded that the possibility of the adoption of recipient-based taxation was not properly considered by any one of these commissions.<sup>23</sup> It was also explained that capital gains tax was only recently introduced into the South African tax system. As a consequence, the Margo Commission and the Katz Commission, which both rejected the idea of a capital gains tax, were not confronted with the double taxation produced by the levying of capital gains tax together with transferor-based wealth transfer taxation.<sup>24</sup>

Because it was concluded in chapter 4 that transferor-based taxation (together with a deemed-realisation capital gains tax approach) is unjustifiable and recipient-based taxation has substantive theoretical appeal,<sup>25</sup> this thesis aims to explore whether or not a transition from a transferor-based regime to a recipient-based system would offer a better way to tax wealth transfers in the South African tax system. Administrative viability should not be disregarded, especially because administrative convenience represents one of the main reasons why estate taxation has generally been preferred in a number of common-law countries.<sup>26</sup> A caveat was indeed noted in Chapter 4 on the administrative feasibility of recipient-based taxation.<sup>27</sup> The fact that estate duty and donations tax are well-established in the South African law should also be taken into consideration.<sup>28</sup>

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<sup>22</sup> See Ch 3 par 3.3.2.3.

<sup>23</sup> See Ch 3 par 3.4(i).

<sup>24</sup> See Ch 3 par 3.4(i).

<sup>25</sup> See Ch 4 par 4.6(i).

<sup>26</sup> See Ch 3 par 3.2.3.

<sup>27</sup> See Ch 4 pars 4.4.4.1 and 4.6(e).

<sup>28</sup> See Ch 4 par 4.4.2.



To arrive at a well-considered answer to the transferor-based tax/recipient-based tax debate, it is necessary to identify the significant problem areas under the current regimes. These are outlined in paragraph 7.4 directly below.

## 7.4 SELECTED PROBLEM AREAS

### 7.4.1 Jurisdictional Basis

Apart from the discrepancies in the jurisdictional basis of the donations tax regime in contrast to that of the estate duty regime pointed out above, a second issue relates to the demarcation of the worldwide basis of taxation under both regimes. The Katz Commission considered the extension of the tax base (for the purposes of both estate duty and donations tax) to all assets worldwide, but recommended that such an extension would exceed the enforcement capabilities of the tax authorities.<sup>29</sup> If one considers that estate duty and donations tax are already primarily levied on a worldwide basis,<sup>30</sup> it is submitted that what was actually considered is whether it is still justifiable to exclude certain foreign assets (as respectively listed in Chapters 5<sup>31</sup> and 6<sup>32</sup> above) from the tax base. It is submitted that the commission's recommendation is, in the words of Davis, Beneke and Jooste, "surprising", because the exclusion of certain foreign properties from the tax base must in itself create administrative difficulties for SARS.<sup>33</sup>

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<sup>29</sup> Katz Report (Fourth Interim) par 13.3.

<sup>30</sup> See par 7.2.2.2.

<sup>31</sup> See Ch 5 par 5.2.2.1.

<sup>32</sup> See Ch 6 par 6.2.2.1.

<sup>33</sup> Davis, Beneke and Jooste (2009) par 18.3.6.



### 7.4.2 The Characteristics of a Donation

The question whether the statutory definition of a donation, primarily including any disposal of property “for which nothing was received in return [that is], for which no consideration was received”,<sup>34</sup> also embraces the common-law meaning of a donation (a *donatio mera*) has for a long period been a controversial issue.<sup>35</sup> A common-law *donatio mera* can be described as an agreement which has been induced by disinterested benevolence or sheer liberality, whereby a person (the donor) under no legal obligation undertakes to give something to another person (the donee), or to waive a right in such person’s favour, in return for which the donor receives no consideration nor expects any future advantage. The donor must have an intention to donate (*animo donandi*). Furthermore, the estate of the donor must be impoverished and the estate of the donee enriched.<sup>36</sup>

The Supreme Court of Appeal has recently clarified the position in *Welch’s Estate v CIR*,<sup>37</sup> where Marais JA (with Zulman and Cloete JJA concurring) held that the legislature has not eliminated from the statutory definition the characteristic which the common law regards as essential to a donation, namely, that the disposition must be motivated by “pure liberality or disinterested benevolence”.<sup>38</sup> It seems therefore as if a donation as referred to in the principal levying provision effectively embraces the elements of a donation under the common law, requiring (a) an intention to donate; (b) impoverishment on the side of the transferor and (c) enrichment on the side of the recipient.

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<sup>34</sup> *ITC 1448* (1988) 51 SATC 58 63.

<sup>35</sup> See e.g. Meyerowitz on Income Tax (2001/2002) par 31.5, where the writer suggested that the provision for a specific statutory definition implies that the common-law characteristics of a donation are not required.

<sup>36</sup> See *Avis v Verseput* 1943 AD 331 347–353; *Estate Sayle v CIR* 1945 AD 388 394; *Ovenstone v SIR* 1980 (2) SA 721 (A) 736–737; *CIR v Estate Hulett* 1990 (2) SA 786 (A) 794; Owens in *LAWSA* (2005) pars 300–315, 321–323 and authority cited there; Sonnekus (2005) *THRHR* 154–159.

<sup>37</sup> 2004 (2) SA 586 (SCA), 66 SATC 303.

<sup>38</sup> *Welch* case 314 (par 30).



However, the question arises whether or not the disposition referred to in section 58(1) should also depict these characteristics. Should the deeming provision for example be restricted to transactions entered into with the intention to donate (*animus donandi*), or was the object to also include ordinary commercial transactions where the motive to donate is absent? Scholars seem to disagree. Some have expressed the view that the intention of the legislature could never have been to bring transactions within the ambit of the Act where the intention to donate is absent.<sup>39</sup> Others submit that the section can apply to any disposal of property for any motive, if the Commissioner is of the opinion that the consideration given is not adequate.<sup>40</sup> It seems also as if the judiciary does not require an intention to donate to be present for the provision to be invoked.<sup>41</sup> Although the Commissioner has apparently never invoked section 58(1) in transactions negotiated at arm's length,<sup>42</sup> it is submitted that it is undesirable that ordinary commercial transactions are arguably not sheltered from the tax base. This submission is bolstered if it is considered that the Commissioner may simply avoid proving *animus donandi* by merely invoking section 58(1), instead of relying on the primary charging provision.<sup>43</sup>

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<sup>39</sup> See Urquhart (1983) *SA Company Law J* 16–21 and Davis, Beneke and Jooste (2009) pars 2.9.4 and 13.8.

<sup>40</sup> See Meyerowitz on Income Tax (2007/2008) par 31.5 and De Koker and Williams Vol 3 (2009) par 23.5.

<sup>41</sup> See *CIR v Estate Kohler* 1953 (2) SA 584 (A); *Estate Furman & Others v CIR* 1962 (3) SA 517 (A); *ITC 1167* (1971) 34 SATC 48 (where the taxpayer sold his right to fell timber for a price below market value to a company whose shareholders were his major children); *ITC 1329* (1980) 43 SATC 62 (where the taxpayer renounced her usufructuary rights to her children for inadequate consideration); *ITC 1387* (1984) 46 SATC 121 (where the deceased's son, who adiated under a joint will massing his estate with the estate of his deceased father, was held to be liable for donations tax because he gave up more than he received); *ITC 1599* (1995) 58 SATC 88 (where the taxpayer sold his shares in a company to a trust, of which his children were the beneficiaries, for a consideration less than market value). See in general the discussion by Silke (1996) *Tax Planning* 89 *et seq.* See, however, Davis, Beneke and Jooste (2009) par 13.8 for a contrary view.

<sup>42</sup> Silke (1996) *Tax Planning* 95; Davis, Beneke and Jooste (2009) par 2.9.4.

<sup>43</sup> An attempt to tax a transfer under s 58(1) may, however, involve intricate valuation issues (in view of the fact that the gratuitous part of the transfer has to be established). For example, in the *Welch* case the Commissioner did not rely on section 58 (as it then was), presumably because it was difficult, if not impossible, to calculate the value of the contingent interests of the ultimate capital beneficiaries.



In addition, the question may be posed whether the donor should be impoverished and the donee enriched. The position seems to be unclear. There is Appellate Division case law providing authority that similar provisions under the former Death Duties Act and the Estate Duty Act (as it then read, before the transition of the deeming provision to the income tax legislation)<sup>44</sup> did not require impoverishment on the side of the donor.<sup>45</sup> These cases dealt with value-shifting arrangements where companies allotted shares to an incoming shareholder for inadequate consideration. The problem in this area is that, although the acquiring shareholder's estate is enriched, the person making the disposition (the company) is not impoverished. In both cases it was held that the transactions constituted dispositions as required (in the absence of the deeming provisions requiring impoverishment). However, the former provisions referred to a disposition whereby a person becomes "entitled" to property, thereby implying some form of enrichment, but not necessarily impoverishment.<sup>46</sup> In view of the fact that the current provision focuses on the donor and because it has been confirmed that the concept of a "disposition" implies a transferor and a recipient,<sup>47</sup> it is submitted that the provision (in its current form) implicitly requires some form of impoverishment and enrichment.<sup>48</sup> It is therefore arguable that value-shifting arrangements fall outside the scope of section 58(1) as it currently reads, which is unwarranted.

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<sup>44</sup> At that point in time, certain donations were included in the estate duty tax base. See Ch 3 par 3.3.2.2.

<sup>45</sup> *CIR v Estate Kohler* 1953 (2) SA 584 (A) (decided under the provisions of the Death Duties Act) and *Estate Furman & Others v CIR* 1962 (3) SA 517 (A) (decided under a former provision of the Estate Duty Act).

<sup>46</sup> See the Death Duties Act s 3(6) and Estate Duty Act s 3(4)(a) (which has since been repealed). S 3(4)(a) stated: "any disposition whereby any person becomes entitled to receive or acquire any property, for a consideration which, in the opinion of the Commissioner, is not a full consideration for that property, shall, to the extent to which the fair market value of the property exceeds the said consideration, be deemed to be a donation."

<sup>47</sup> See Ch 5 par 5.2.1.

<sup>48</sup> *Cf De Koker and Williams Vol 3 (2009) par 23.5. Meyerowitz on Income Tax (2007/2008) par 31.15 mentions the issue, but does not express an opinion.*



### 7.4.3 The Treatment of Life Insurance Benefits

It was pointed out in Chapter 6 that life policy benefits payable to the insured's deceased estate constitute "property" for the purposes of estate duty. To cater for the situation where the policy benefits are recoverable by a third party (usually the nominated beneficiary), the Estate Duty Act specifically includes as "deemed property" the benefits in the deceased estate of the insured (provided that the policy constitutes a "domestic policy").<sup>49</sup> However, these third party policies are treated on a recipient basis, because the estate duty attributable to the benefits is recoverable from the beneficiary of the policy.<sup>50</sup> This explains why any premiums payable by the beneficiary (plus interest at six percent) is deductible from the proceeds.<sup>51</sup>

On one level, the issue relates to the justification of a recipient approach within a transferor-based regime, where the focus is on the transferor. The problem with life insurance benefits from the angle of transferor-based taxation is that the policy benefits are not channelled through the deceased estate of the insured.<sup>52</sup> However, the mere inclusion of the benefits in the deceased estate would create a harsh result if the beneficiary's position is not taken into account. Although it is therefore understandable that the benefits are treated from the perspective of the beneficiary, it is not conducive to horizontal equity in the system. It was already pointed out in Chapter 4 that heirs are treated unequally under the estate duty regime, because the main burden of the tax falls on the residuary heir.<sup>53</sup> The allocation of the tax liability to certain heirs only, such as life insurance beneficiaries and successors to limited interests,<sup>54</sup> amplifies the equality issue.

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<sup>49</sup> See Ch 6 par 6.2.4.2.1.

<sup>50</sup> See Ch 6 par 6.4.

<sup>51</sup> See Ch 6 par 6.2.4.2.1.

<sup>52</sup> See Ch 6 par 6.2.4.2.1 n 55.

<sup>53</sup> See Ch 4 par 4.4.1.3.

<sup>54</sup> See Ch 6 par 6.4.



On a second level, the question may be posed whether it is justifiable to include policy benefits payable to third parties to the extent that the deceased did not contribute to such benefits. Where, for example, a third party were responsible for all the premiums on a life policy, he would have given adequate consideration for such benefits. It is arguable that to allow such person a deduction for the premiums only negates the very nature of a life insurance policy, where the amount of the premiums is actuarially calculated to reflect the risk factors (and not only the contribution to capital).

A third issue relates to the exclusions offered under the deeming provision. To neutralise the hardship caused by its wide scope, the Estate Duty Act allows for certain exclusions, namely benefits recoverable by a surviving spouse or child (in terms of certain nuptial contracts); benefits payable under a buy-sell arrangement and key-man policy benefits. It was pointed out in Chapter 6 that the strict requirements applicable to these exclusions (especially in regard to benefits payable under a buy-sell arrangement and key-man policy benefits) have given rise to interpretation issues, anomalies and inequities.<sup>55</sup> Moreover, because of all these requirements numerous sophisticated tax planning schemes were developed to ensure that policies could be categorised under one of the available options.

As a consequence, the Minister of Finance, in his budget speech of 1 February 2008, proposed to exempt in general a certain amount of life insurance benefits from estate duty (as long as that policy was not created shortly before death).<sup>56</sup> However, this proposal was withdrawn. The Treasury's Chief Director of Tax Policy told Parliament's Finance Committee that taxpayers could make their savings in one vehicle and then get it into their estate tax-free, which could initiate a significant avoidance problem.<sup>57</sup>

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<sup>55</sup> See Ch 6 par 6.2.4.2.1.

<sup>56</sup> Department of the Treasury *Budget Tax Proposals* (2008/2009) 30, available at <http://www.treasury.gov.za/documents/national%20budget/2008/guides/Budget%20Proposals%202008.pdf> (accessed on 21 October 2008).

<sup>57</sup> Hamlyn "Treasury Changes Its Mind on Estate Duty Exemption" *Mail & Guardian Online* (20/10/2008), available at [www.mg.co.za/article/2008-10-20-treasury-changes-its-mind-on-estateduty-exemption](http://www.mg.co.za/article/2008-10-20-treasury-changes-its-mind-on-estateduty-exemption)

Footnote continues on the next page



#### 7.4.4 The Treatment of Limited Interests and Bare *Dominium* Property

##### 7.4.4.1 General

Limited interests such as usufructuary and other like interests (including a vested interest to the income of a trust), annuities and fideicommissary interests<sup>58</sup> (hereafter “limited interests”) and bare *dominium* property pose problems for wealth transfer tax systems on various levels, such as the accommodation thereof in the tax base, which is inextricably linked to the valuation rules. The South African system provides an example of a system where limited interests and bare *dominium* property are valued with reference to actuarial values.

Before embarking on an analysis of the accommodation of these interests in the tax base, it is significant to point out that, for the purposes of donations tax, a limited interest is valued with reference to the life expectancy of the donor, unless the interest is to be enjoyed for a shorter period.<sup>59</sup> The focus is on the value of the property “given away” by the donor, who is also primarily responsible for the payment of donations tax – which is in line with a transferor-based tax. However, for the purposes of estate duty an interest is valued over the life expectancy of the beneficiary (the successive interest holder or the bare *dominium* owner), unless the interest is to be enjoyed for a shorter period.<sup>60</sup> An

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(accessed on 21 October 2008). See also Response Document of the Portfolio Committee on Finance *Report Back Hearings on the Revenue Laws and Bills 2008* (21 October 2008), available at [www.finance.gov.za/legislation/Bills](http://www.finance.gov.za/legislation/Bills) (accessed on 16 July 2009).

<sup>58</sup> The question may be posed whether it is justifiable to value a fiduciary interest (where the holder has *dominium* in the underlying property) similar to a usufructuary interest (where the holder does not have *dominium* in the underlying property). According to the Explanatory Memorandum on the Estate Duty Bill (1955) 8, the determination of the precise nature of an interest could sometimes involve intricate questions of law, which a uniform valuation regime would eliminate. It is submitted that the approach is justifiable, especially if one considers that it is often difficult to classify a trust beneficiary’s interest to the underlying trust property. See Strydom LLD Thesis (2000) 235, where the author submits that a vested right of a capital beneficiary can often be compared to a fiduciary interest.

<sup>59</sup> See Ch 5 par 5.3.2.

<sup>60</sup> See Ch 6 pars 6.3.3.2 and 6.3.3.3.



exemption is also offered for the value of any improvements effected to property during the lifetime of the deceased by the person who becomes entitled to the right of enjoyment of the property on the death of the deceased.<sup>61</sup> In addition, the beneficiary will ultimately bear the burden of the tax attributable to the cessation of the interest.<sup>62</sup> The interest is therefore valued from the perspective of the beneficiary. For the purposes of both donations tax and estate duty, the bare *dominium* property is valued as the difference between the fair market value of the underlying property and the particular interest (which interest is calculated with reference to the life expectancy of the interest holder).<sup>63</sup>

The discussion below will analyse the approach to limited interests by referring to (a) the position of bare *dominium* property (b) the creation of limited interests and (c) the termination of limited interests.

#### ***7.4.4.2 The Position of Bare Dominium Property***

For the purposes of donations tax and estate duty, the transfer of bare *dominium* property (whether *inter vivos* or on death) is immediately chargeable and not deferred until it materialises into full ownership. This position is sometimes exploited to conceal a passive transfer of wealth through passage of time, as will appear from the example below.

##### **Example 1**

A transfers the bare *dominium* in property worth R1 million to his son B (for no consideration) and retains a 20-year usufruct in the property for himself. A will be liable for donations tax on the value of the bare *dominium*, R103 672 (calculated as the difference between the market value of the underlying property and

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<sup>61</sup> See Ch 6 par 6.5.2.2. Meyerowitz par 28.24 argues (it is submitted, correctly) that, instead of providing for an allowable deduction in this way, it would be simpler to adapt the relevant valuation rules.

<sup>62</sup> See Ch 6 par 6.4.

<sup>63</sup> See Ch 5 par 5.3.4 and Ch 6 par 6.3.3.4.



the value of the usufruct).<sup>64</sup> However, the accrual of the right of enjoyment of the property after the lapse of 20 years will not constitute a donation.<sup>65</sup>

This scheme is especially attractive considering that it is likely that the low present value of the bare *dominium* property on date of initial acquisition is likely to fit into an exemption threshold for the purposes of donations tax.

The Margo Commission deemed it advisable to treat the holders of limited interests as having an interest in an appropriate portion of the full *dominium* of the underlying property itself.<sup>66</sup> Although it seems, at first glance, as if such a proposition would minimise the manipulation of the actuarial values associated with limited interests (which will more fully be explained in the paragraphs below), such an approach would require that the taxation of bare *dominium* property be deferred until it materialises into full ownership, which represents a totally different approach.

#### ***7.4.4.3 The Creation of Limited Interests***

Where a person, during his or her lifetime, grants a limited interest to another for inadequate consideration, such an act would constitute a disposition for the purposes of donations tax. It is therefore possible for an owner of property to “split” the property during his or her lifetime. The donations tax would then be calculated on the respective interests. However, where a testator “splits” property at his or her death by for example bequeathing property subject to a usufruct or an annuity, the splitting of the property would have no effect on the estate duty calculation, because the duty is calculated on the

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<sup>64</sup> Calculated as follows: R1 000 000 – R896 328 (R1 000 000 x 12% x 7.4694) = R103 672.

<sup>65</sup> The lapse of an interest does not constitute an occasion of charge. It is to be noted that, if the wealth holder does not survive the 20-year period, the cessation of the usufruct will be dutiable for the purposes of estate duty. See par 7.4.4.4. For further reading, see Muller (2007) *De Iure* 353 *et seq* and Davis, Beneke and Jooste (2009) pars 12.5 and 12.7. This scheme is apparently also used in the US, where a transferor-based estate tax is also levied (providing for actuarial values in the case of limited interests). See Dodge (2009) *Hastings Law J* 1051 for a more detailed discussion.

<sup>66</sup> Margo Report (1986) par 20.57.

property of the deceased estate (at the moment before death). It is evident from the example below that the *inter vivos* splitting of interests may be abused to save a significant amount of tax where the donor is older than the beneficiary (because the donor's age would be relevant for calculating the donations tax on the usufruct, whereas the beneficiary's age would be relevant for calculating the bare *dominium*). For the purposes of this thesis, this effect will be referred to as the "aged donor" phenomenon.

### Example 2

- 2.1 A (male, age 74) bequeaths property worth R1 million to his wife subject to a lifelong usufruct in favour of his grandchild B (male, age 24). Ignoring any exemptions and rebates, A's deceased estate would be liable for estate duty on R1 million.
- 2.2 A (aged 74) donates (during his life) a usufruct over land worth R1 million to his grandchild B (aged 24) and thereafter transfers the *bare dominium* to his wife (for no consideration). The value of the usufruct subject to donations tax would be determined with reference to A's life expectancy, which would be calculated at R568 188.<sup>67</sup> However, the value of the bare *dominium* subject to donations tax would be determined with reference to the life expectancy of the much younger B. The value of the bare *dominium* would therefore amount to R7 649.<sup>68</sup> In total, A would be liable for donations tax on only R575 837.

It is possible under South African law to create a successive interest. A person may, for example, transfer property (*inter vivos* or on death) to another person subject to a usufruct in favour of a third person with the burden that another person will, on the termination of the first usufruct, be entitled to a successive usufruct over the property. Because the South African wealth transfer tax base operates on a transferor basis, the acquisition of the successive usufruct by the successive usufructuary will not constitute a taxable event. However, the termination of the successive usufruct may have some tax consequences, as is evident from the discussion below.

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<sup>67</sup> Calculated as follows: R1 000 000 x 12% x 4.7349.

<sup>68</sup> Calculated as follows: R1 000 000 – (R1 000 000 x 12% x 8.26959).



#### 7.4.4.4 *The Termination of Limited Interests*

A limited interest may be terminated through lapse of time, death or renunciation. Under the donations tax regime, the lapse of an interest through passage of time does not constitute a taxable event.<sup>69</sup> This is understandable if one considers the underlying nature of the tax, because there is nothing left of the interest to “give away”.

Although the holder of a limited interest may generally not transfer his or her interest, such a holder may renounce the interest in favour of the successor to the enjoyment of the property. Because such an act “transfers” a benefit to another, the renunciation of an interest is understandably captured as a chargeable transfer under the donations tax base.<sup>70</sup>

A contentious issue for the purposes of wealth transfer taxation is the termination of an interest on the death of an interest holder, especially where the taxation of the bare *dominium* is not deferred until its materialisation into full ownership, such as in the South African system. The issue is that an untimely death may also be seen as the “transfer” of a benefit to the successor similar to the position under a renunciation as explained above. However, it is arguable that a benefit conveyed through a renunciation is intentional, whereas death occurs (usually) unintentionally. The South African legislature opted for the view that a passive “transfer” of the enjoyment of property on the death of the interest holder should be accommodated in the tax base, as a consequence of which the termination of an interest enjoyed immediately before the death of an interest holder is specifically included as a chargeable event for the purposes of estate duty.<sup>71</sup>

Although both renunciation and death constitute chargeable events under the tax base, the calculation of a renounced interest varies considerably from the calculation of an interest that ceases on death, because a renounced interest is valued from the perspective of what

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<sup>69</sup> Meyerowitz on Income Tax (2007/2008) par 31.4.

<sup>70</sup> See Ch 5 par 5.2.1.

<sup>71</sup> See Ch 6 par 6.2.4.1.



is “given away” by the transferor, whereas an interest that ceases on death is valued from the perspective of the successor. Suppose, for example, that a person (A) grants a 10-year usufruct to another person (B) for no consideration and transfers the bare *dominium* to a third person (C), who provides adequate consideration for the bare *dominium*. If B renounces the usufruct eight years later, the renounced interest will be calculated with reference to the unexpired two-year period. However, in the case where B dies eight years later, the indirect “transfer” of wealth will for estate duty purposes be calculated with reference to C’s life expectancy and not the two-year period. It should be clear that C would be in a detrimental position on B’s death, especially where C is very young. If one considers that, even from a recipient point of view, C’s “gain” is only the extended two years of enjoyment, it seems as though the estate duty angle includes even *more* than the successor’s gain.

The position of the successor, and especially the bare *dominium* owner, is therefore unenviable. In an attempt to mitigate some of the harsh consequences, the Estate Duty Act provides for the following limitations where the enjoyment of the property accrues to the bare *dominium* owner:

- The value of a ceasing *usufructuary* interest may be reduced by any amount equal to the consideration (previously) paid by the beneficiary for the bare *dominium*, plus interest thereon at six percent per annum from the date of payment to the date of death of the deceased (the section 5(1)(b) first proviso);<sup>72</sup>
- The value of a ceasing *usufructuary* interest should not exceed the value of the full ownership less the value of the bare *dominium* when such bare *dominium* was first acquired under the disposition creating the limited interest that was held by the deceased (the section 5(1)(b) second proviso).<sup>73</sup>

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<sup>72</sup> S 5(1)(b) first proviso. See in general Meyerowitz (2007) par 29.11.

<sup>73</sup> S 5(1)(b) second proviso. See in general Meyerowitz (2007) par 29.12 and Davis, Beneke and Jooste (2009) par 2.7.3.5. To illustrate, suppose that on A’s death the value of a property is R1 million. In terms of A’s will the bare *dominium* in the property is bequeathed to C, subject to a lifelong usufruct in favour of B. The R1 million will be dutiable in A’s deceased estate. Suppose furthermore that the value of the usufruct on A’s death is R400 000 and the value of the bare *dominium* R600 000. Assume, for the sake of simplicity, Footnote continues on the next page

What seems unfortunate is that the two provisos apply only on the cessation of a *usufructuary interest*. Where the owner of property burdened with an annuity (who is also treated as having bare *dominium* in the underlying property) acquires the benefit of the full property on the cessation of the annuity on the death of the annuitant, the above limitations are not correspondingly applicable. Furthermore, because a fiduciary heir cannot be regarded as a bare *dominium* owner, the relief provided does not extend to the case where a fideicommissary interest ceases on the death of the fideicommissary heir.

The examples below will attempt to illustrate some of the anomalies created by the approach chosen by the legislature and will also point out that the two section 5(1)(b) provisos do not always effectively eliminate the inequities. For the sake of simplicity, exemptions and rebates are ignored except where it is crucial to illustrate the effect of a specific exemption (such as the spousal exemption in example 7 below). It should also be noted that, although the examples are mainly referring to usufructuary interests, the same anomalies will arise in the case of annuities (charged against property) and fiduciary interests – except that in these cases the complications may even be worse because of the absence of the operation of the section 5(1)(b) provisos.

**Example 3A:**

- 3A.1 During his life, A (male, 69) grants a lifelong usufruct over land valued at R1 million to B (female, 64) and simultaneously sells the bare *dominium* to C (male, 30). C provides adequate consideration for the bare *dominium* in the amount of R165 356, calculated as the difference between the market value of the land and the value of the usufructuary interest with reference to the life expectancy of B (R1 million – R834 644).<sup>74</sup>
- 3A.2 Suppose B renounces the usufructuary interest in favour of C one month later, then B (the donor) will be liable for donations tax on the renunciation of the interest, calculated with reference to her own life expectancy. B will therefore have to account for donations tax on R834 644.

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that the market value of the property is still R1 million on B's death and that the value of the ceasing interest is R700 000. The limitation reduces the value to the value of the usufruct created in A's will, namely R400 000.

<sup>74</sup> R1 000 000 – (R1 000 000 x 12% x 6.95537).





3A.3 However, suppose that B does not renounce the interest, but passes away one month after the creation thereof, then C (the bare *dominium* owner) will be liable for estate duty on the cessation of B's usufructuary interest. The duty will be calculated in accordance with the primary valuation rule with reference to C's life expectancy at that point in time:

Value of usufructuary interest: R1 million x 12% x 8.22694	R 987 233
Less section 5(1)(b) first proviso (consideration paid)	<u>(R165 356)</u>
	R 821 877
According to section 5(1)(b) second proviso, limited to	<u>R 834 644</u> <sup>75</sup>
C will consequently be liable for estate duty on	R 821 877

If the tax consequences of the renunciation are compared with the cessation on death, the results are as follows:

a) Taxable value on renunciation one month later	<b>R 834 644</b>
b) Taxable value on death on month later – before the operation of the provisos	R 987 233
c) Taxable value on death – taking the provisos into account	<b>R 821 877</b>
<i>(Difference between a and c is R12 767)</i>	

#### Example 3B:

3B.1 The facts are similar to the facts in 3A.1 above.

3B.2 Suppose B (at age 74) renounces the usufructuary interest in favour of C ten years after the creation of the usufruct, when the value of the property is R1.5 million. B (the donor) will be liable for donations tax on the renunciation of the interest, calculated with reference to her own life expectancy at that point in time, namely R1 000 337.<sup>76</sup>

3B.3 However, suppose that B does not renounce the interest, but passes away 10 years after the creation thereof, then C (at age 40) will be liable for estate duty calculated in accordance with the primary valuation rule with reference to C's life expectancy at that point in time:

Value of usufructuary interest: R1.5 million x 12% x 8.04030	R 1 447 254
Less section 5(1)(b) first proviso	<u>(R 264 569)</u>
(consideration paid plus interest at 6%)	R 1 182 685
According to section 5(1)(b) second proviso, limited to	<u>R 1 334 644</u> <sup>77</sup>
C will consequently be liable for estate duty on	R 1 182 685

<sup>75</sup> Calculated as follows: R1 000 000 – R165 356.

<sup>76</sup> Calculated as follows: R1 500 000 x 12% x 5.55743.

<sup>77</sup> Calculated as follows: R1 500 000 – R165 356.



If the tax consequences of the renunciation are compared with the cessation on death, the results are as follows:

- |   |                    |
|---|--------------------|
| a) Taxable value on renunciation 10 years later                                 | <b>R 1 000 337</b> |
| b) Taxable value on death 10 years later – before the operation of the provisos | R 1 447 254        |
| c) Taxable value on death – taking the provisos into account                    | <b>R 1 182 685</b> |

*(Difference between a and c is R182 348)*

Examples 3A and 3B illustrate that the operation of the two section 5(1)(b) provisos mitigate the punitive effect on the much younger C (who paid full consideration for the bare *dominium!*). It is significant to note that the net value of the ceasing interest in examples 3A.3 and 3B.3 is reduced by the operation of the provisos to an amount that is close to the value of the renounced interest in examples 3A.2 and 3B.2.

It is arguable that it would make more sense instead to value for estate duty purposes a ceasing interest with reference to the unexpired period of the interest (which is “given away”), which would be calculated with reference to the life expectancy of the interest holder just prior to his or her death (in the case of a lifelong usufruct) or the unexpired period of a fixed-period interest. Such an approach would create neutrality between the renunciation of a usufruct and a cessation thereof on death and there would be no need for complicated provisos. Under such a valuation approach the taxable value of the renounced usufruct in examples 3A.2 and 3B.2 would be equal to the taxable value of the ceasing usufruct in examples 3A.3 and 3B.3.

Furthermore, the proposition to value lifelong interests with reference to the life expectancy of the interest holder (for the purposes of estate duty) is bolstered by the fact that the theoretical underpinning of the provisos lacks a rational justification to a certain extent. In respect of the first proviso, it is submitted that it does not make sense to allow a deduction against the value of the ceasing usufruct for the consideration paid in respect of the prior acquisition of the bare *dominium*, because such consideration was already taken into account to assess whether the initial acquisition of the bare *dominium* constituted a donation. For example, the initial acquisition of the bare *dominium* by C in example 3A.1



above does not constitute a donation, because the consideration equals the market value of the bare *dominium* at that point in time. The value of bare *dominium* (R165 356) less the consideration (R165 356) equals zero, as a consequence of which there is no donations tax liability (on the initial acquisition). Why should the consideration (once again) be taken into account when C acquires full *dominium* in the property on the death of the usufructuary (as illustrated in examples 3A.3 and 3B.3 above)?

The operation of the second proviso, namely to limit the value of the ceasing usufruct (in the hands of the beneficiary) to the “growth” in the value of the bare *dominium* (on initial acquisition) to the value of full ownership (on cessation of the usufruct), would conceptually be justifiable where the bare *dominium* owner was liable for donations tax or estate duty on the initial acquisition of the bare *dominium* or where such person paid full consideration for the bare *dominium* (such as in the examples above), because it would eliminate the possibility of double taxation.<sup>78</sup> However, where the bare *dominium* owner acquired the bare *dominium* as a donation, the *donor* would have been liable for donations tax. Similarly, where the bare *dominium* owner acquired the bare *dominium* as an inheritance, the *deceased estate* of the previous owner would have been liable for estate duty. It is suggested that the operation of the proviso is not truly justifiable in these instances, except to act as an artificial measure to mitigate the harsh tax consequences for the bare *dominium* owner brought about by the application of a recipient-based approach to limited interests in a transferor-based estate duty regime.

Moreover, example 4 below illustrates that the provisos do not always effectively eliminate the difference in the value of a renounced usufruct and a usufruct that ceases on death. It will also be shown (in example 5) that the second proviso operates only where

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<sup>78</sup> For argument’s sake, suppose that a bare *dominium* owner pays donations tax on the acquisition of bare *dominium* valued at R400 000. Suppose furthermore that the bare *dominium* owner later acquires full ownership of the property on the death of the usufructuary when the value of the full property is R1 million. If the value of the ceasing usufructuary interest (valued with reference to the life expectancy of the bare *dominium* owner) amounts to R700 000, the taxation of such interest in the hands of the bare *dominium* owner would amount to double taxation to the extent that the value of the ceasing interest exceeds the increase in value from R400 000 to R1 million (R600 000).



the bare *dominium* was acquired under the *same disposition* that created the ceasing usufructuary interest, which may even worsen the dilemma.

**Example 4:**

- 4.1 During his life, A (male, 69) grants a 10-year usufruct over land valued at R1 million to B (female, 64) and simultaneously transfers the bare *dominium* to C (male, 29). C provides adequate consideration for the bare *dominium* in the amount of R321 976, calculated as the difference between the market value of the land and the value of the 10-year usufructuary interest (R1 million – R678 024).<sup>79</sup>
- 4.2 Suppose B renounces the usufructuary interest in favour of C 9 years after the creation of the usufruct, when the value of the property is R1.5 million. B (the donor) will be liable for donations tax on the renunciation of the interest, calculated with reference to the remaining period of the usufruct (1 year). B will therefore be liable for donations tax on R160 722.<sup>80</sup>
- 4.3 However, suppose that B does not renounce the interest, but passes away 9 years after the creation thereof, then C (at age 38) will be liable for estate duty calculated in accordance with the primary valuation rule with reference to C's life expectancy at that point in time:

Value of usufructuary interest: R1.5 million x 12% x 8.06781	R 1 452 206
Less section 5(1)(b) first proviso (consideration paid plus interest at 6%)	<u>(R 495 843)</u> <sup>81</sup>
According to section 5(1)(b) second proviso, limited to	<u>R 678 024</u> <sup>82</sup>
C will consequently be liable for estate duty on	R 678 024

If the tax consequences of the renunciation are compared with the cessation on death, the results are as follows:

- |  |                  |
|--|------------------|
| a) Taxable value on renunciation 9 years later                                 | <b>R 160 722</b> |
| b) Taxable value on death 9 years later – before the operation of the provisos | R 1 452 206      |
| c) Taxable value on death – taking the provisos into account                   | <b>R 678 024</b> |

*(Difference between a and c is R517 302)*

<sup>79</sup> R1 000 000 – (R1 000 000 x 12% x 5.6502).

<sup>80</sup> R1 500 000 x 12% x 0.8929.

<sup>81</sup> Calculated as follows: R321 976 + (R321 976 x 6% x 9 years).

<sup>82</sup> Calculated as follows: R1 500 000 – R321 976.

**Example 5:**

5.1 During his life, A (male, 69) grants a 10-year usufruct over land valued at R1 million to B (female, 64) and transfers the bare *dominium* to C (male, 29) four months later. C provides adequate consideration for the bare *dominium* in the amount of R360 616, calculated as the difference between the market value of the land and the value of the 9 year 8 months usufructuary interest (R1 million – R639 384).<sup>83</sup>

5.2 Suppose B renounces the usufructuary interest in favour of C 1 year before the expiration of the usufruct when the value of the property is R1.5 million. B (the donor) will be liable for donations tax on the renunciation of the interest, calculated with reference to the remaining period of the usufruct (1 year). B will therefore be liable for donations tax on R160 722.<sup>84</sup>

5.3 However, suppose that B does not renounce the interest, but passes away 1 year before the expiration of the usufruct, then C (at age 38) will be liable for estate duty calculated in accordance with the primary valuation rule with reference to C's life expectancy at that point in time:

Value of usufructuary interest: R1.5 million x 12% x 8.06781	R 1 452 206
Less section 5(1)(b) first proviso (consideration paid plus interest at 6%)	<u>(R 548 136)</u> <sup>85</sup> R 904 070
<b>Note:</b> Section 5(1)(b) second proviso not applicable, Because bare <i>dominium</i> not acquired under the disposition that created the usufruct	-
C will consequently be liable for estate duty on	R 904 070

If the tax consequences of the renunciation are compared with the cessation on death, the results are as follows:

a) Taxable value on renunciation 9 years later	<b>R 160 722</b>
b) Taxable value on death 9 years later – before the operation of the provisos	R 1 452 206
c) Taxable value on death – taking the provisos into account	<b>R 904 070</b>
<b>(Difference between a and c is R582 626)</b>	

<sup>83</sup> R1 000 000 – (R1 000 000 x 12% x 5.3282). The corresponding factor is the factor for a nine-year period, because fractions of a year are to be disregarded.

<sup>84</sup> Calculated as follows: R1 500 000 x 12% x 0.8929.

<sup>85</sup> Calculated as follows: R360 616 + (R360 616 x 6% x 8 years and 8 months). The interest is calculated from date of payment of consideration (4 months after creation of usufruct) to the date of cessation of the interest (1 year before the expiration of the usufruct = 8 years and 8 months).

What seems awkward is that the legislature provides special acknowledgement for the unenviable position of the bare *dominium* owner where that person previously donated a usufructuary interest (or an annuity)<sup>86</sup> and where the right of enjoyment of the property reverts to him or her on the death of the usufructuary (or the annuitant), in which case a full exemption is offered under the Act,<sup>87</sup> as will be illustrated by the example below:

**Example 6:**

- 6.1 During his life, A (male, 69) grants a 10-year usufruct over land valued at R1 million to B (female, 64), retaining the bare *dominium* for himself. A (being the donor) will be liable for donations tax on the value of the 10-year usufructuary interest (valued at R678 024).<sup>88</sup> Where B dies one day after the creation of the usufruct, A (being the beneficiary) will not be liable for estate duty on his “gain” (the early termination of the usufructuary interest), because of the operation of the exemption.
- 6.2 Suppose that, when A donated the usufructuary interest to B, he did not retain the bare *dominium* in the property, but simultaneously transferred it to C (male, age 29), who provided adequate consideration for the bare *dominium* in the amount of R321 976 (R1 million - R678 024). Where B dies one day after the creation of the usufruct and the transfer of the bare *dominium* to C, C will be liable for estate duty on the value of the usufructuary interest (the “gain”) calculated with reference to his life expectancy at that point in time, which will amount to:

Value of usufructuary interest according to primary valuation rules	R987 233 <sup>89</sup>
Less: Section 5(1)(b) first proviso (consideration)	<u>R321 976</u>
	R665 257
According to section 5(1)(b) second proviso limited to	<u>R678 024</u>
Estate duty payable on	R665 257

An exemption is presumably offered to A in example 6.1 above because estate duty (in its current recipient-based form) taxes a “transfer” which had already been covered by the

<sup>86</sup> Unlike the section 5(1)(b) provisos, this exemption is also applicable to the owner of property who burdened his property with an annuity (to the extent that he or she did not receive adequate consideration therefore), where the annuity ceases as a result of the death of the annuitant.

<sup>87</sup> See Estate Duty Act s 4(g). See Ch 6 par 6.5.2.2.

<sup>88</sup> R1 000 000 – (R1 000 000 x 12% x 5.6502).

<sup>89</sup> Calculated as follows: R1 million x 12% x 8.22694.



levying of donations tax in the hands of A (note that the system does not provide a credit for any donations tax paid “too much” for a usufructuary interest that lasted only a day). The *fiscus* therefore collects tax on only R678 024. However, under example 6.2 the *fiscus* effectively collects tax on R1 343 281 (donations tax payable by A on R678 024 as well as estate duty payable by C on R665 257). It is evident that in 6.1 the “excessive” donations tax paid is effectively cancelled by the exemption offered in respect of estate duty, whereas in example 6.2 no such “correction” occurs. Although, from a holistic point of view, something seems awkward about the difference in approach between examples 6.1 and 6.2, it is understandable that some form of relief is offered to A (in example 6.1 above) who would, in the absence of some form of relief, be liable for donations tax (as the donor) as well as estate duty (as the beneficiary). What needs to be understood here is that the awkward position of the bare *dominium* owner in A’s position (in the absence of some form of relief), is created by the difference in the valuation approach to limited interests under the donations tax regime (where a transferor-based approach is applied) in contrast to the approach followed under the estate duty regime (where a recipient-based approach is applied).

The difference in approaches has also inspired some estate planning schemes, such as the scheme whereby successive usufructs are used to manipulate the tax position. In practice the scheme is commonly referred to as the “one-year usufruct scheme”, the operation of which is illustrated by way of an example below.<sup>90</sup>

**Example 7:**

A (male, 69) bequeaths property valued at R1 million to ABC Family Trust, subject to the lifelong usufruct in favour of his spouse B (female, age 64). A’s will contains a further provision that, upon B’s death, his son C (age 30) will be entitled to a successive usufruct over the property for a period of one year. The full value of the property (R1 million) will be included in A’s deceased estate on his death, but the value of B’s usufruct (valued with reference to her life expectancy at that stage) will be allowed as an exemption.

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<sup>90</sup> See Divaris (2009) *Tax Planning* 23–24 for further reading on this avoidance scheme. See also Davis, Beneke and Jooste (2009) par 12.3 for a discussion on similar schemes (utilising the shorter period for valuation purposes).





Suppose that B dies 10 years later (at age 74) when the property is worth R1.5 million, then the value of the ceasing usufruct in B's deceased estate (in respect of which C will ultimately be accountable) will be determined over the period of one year only. Estate duty will therefore be payable on R160 722.<sup>91</sup> On the lapse of the usufruct one year later, there will be no estate duty or donations tax consequences. Should A's will not have provided for the successive usufruct, then the value of the ceasing usufruct in B's deceased estate (in respect of which the trust as the beneficiary would ultimately have been accountable for) would have amounted to R1 494 810 (because in the case of a person other than a natural person an interest must be valued over 50 years). The estate duty liability on B's death has been significantly reduced by the intervening one-year usufruct.

To counter the one-year usufruct scheme and similar schemes, the Draft Taxation Laws Amendment Bill 2009 proposed that interests should only be valued with reference to the life expectancies of the beneficiaries and that the reference to the lesser period should be omitted from the Act.<sup>92</sup> It is most surprising that a corresponding amendment to the Income Tax Act (Part V) was not also proposed. Fortunately, in August 2009 the Standing Committee on Finance announced that the proposed amendment was withdrawn for reconsideration, because it would unfairly penalise all other usufructs. The Committee acknowledged the concern that successive usufructs are often set up for legitimate reasons.<sup>93</sup>

It is submitted that the suggested solution offered only an artificial way to deal with the issue and negated the true nature of the problem, namely the recipient-based approach to usufructuary interests under the estate duty regime (in contrast to the transferor-based approach under the donations tax regime). Should estate duty on the usufruct that ceases on B's death in example 7 above have been calculated over the life expectancy of the

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<sup>91</sup> Calculated as follows: R1 500 000 x 12% x 0.8929.

<sup>92</sup> Draft Taxation Laws Amendment Bill (2009) s 6(1)(a) and 6(2), available at <http://www.sars.gov.za> (accessed on 24 July 2009). See also Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill 2009 par 6.2, available at <http://www.sars.gov.za> (accessed on 24 July 2009).

<sup>93</sup> Standing Committee on Finance *Report-back Hearings on the Taxation Law Amendment Bills 2009: Final Response Document* (2009) par 2.6.2, available at <http://www.sars.gov.za> (accessed on 30 September 2009).





usufructuary immediately before her death, then B's deceased estate would have been liable for estate duty on the value of R970 007.<sup>94</sup> This would have been the position whether the right of enjoyment accrues to the trust (as the bare *dominium* owner) or the child (for a year).

#### ***7.4.4.5 The Treatment of Limited Interests under the Death Duties Act***

The recipient-based valuation approach followed for the purposes of estate duty was adopted from the Death Duties Act of 1922, where limited interests were valued on a recipient basis for the purposes of both estate duty and succession duty. Because the complications in the area of limited interests was apparently one of the factors that contributed to the need to reform the death duties system in 1955,<sup>95</sup> it is worthwhile to briefly consider the position of limited interests (treated on a recipient basis) under the Death Duties Act, especially considering that this thesis explores the possibility of replacing the current South African transferor-based regime with a recipient-based system.

The following example suffices to illustrate the basic treatment of limited interests for the purposes of death duties (ignoring any exemptions and rebates and assuming the Death Duties Act applies in its form just prior to its repeal):<sup>96</sup>

#### **Example 8**

A bequeaths a farm to D subject to a lifelong usufruct in favour of B. A's will provides that, on B's death, C will be entitled to a successive usufruct for the duration of his life. On A's death, A's deceased estate will be liable for estate duty on the value of the farm. B will be liable for succession duty on the value of the usufruct, calculated with reference to B's life expectancy and the market value of the farm on A's death. D (the bare *dominium* owner) will also be liable for succession duty on the value of the bare *dominium*

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<sup>94</sup> Calculated as follows: R1 500 000 x 12% x 5.38893.

<sup>95</sup> See Ch 3 par 3.3.2.2.2 n 146 and accompanying text.

<sup>96</sup> For the position of limited interests under the Death Duties Act (just prior to its repeal), see Kriel (1953) 52, 83–96.

(valued as the difference between the market value of the farm and a usufruct calculated with reference to the life expectancy of the younger of B and C). On B's death, property will be deemed to pass to C and estate duty (recoverable from C) will be payable on the ceasing usufruct calculated with reference to C's life expectancy and the market value of the farm on the death of B. In addition to estate duty, C will also be liable for succession duty on the successive usufruct valued identically as for the purposes of estate duty. On C's death, D (the bare *dominium* owner) will be liable for estate duty (as well as succession duty) on the difference between the market value of the farm (on C's death) and the value of the bare *dominium* when it was first created on A's death. D will therefore be liable for succession duty on A's death and estate duty (and succession duty) on C's death.

It is evident from the above example that the treatment of limited interests was extremely complicated. What added insult to injury is the fact that the bare *dominium* owner's tax liability (on the materialisation of the bare *dominium* into full ownership) could only be ascertained with reference to the value of the bare *dominium* as reflected in the deceased estate of the original testator. In the case where the bare *dominium* was created before the effective date of the Death Duties Act (1 July 1922) the valuation was even more problematic. It is therefore understandable that the treatment of limited interests was an administrative nightmare under the Death Duties Act.

## 7.4.5 Estate Freezing Techniques

### 7.4.5.1 General

Where a wealth holder (the "estate planner") owns significant growth assets, a commonly used estate planning technique is to "peg" the value of the assets by disposing of the assets during the planner's lifetime to his or her heirs or other entities (sometimes referred to as "estate freezing"). The purchase consideration is usually left outstanding on loan account, usually interest-free, repayable on demand. On the death of the planner, the only significant asset is the outstanding balance on loan account. However, very often the loan accounts have been extinguished through the operation of prescription and the debtor's failure to claim the performance in time. Very often entities such as companies or trusts are also incorporated in these plans. A transfer of the assets to a company has

*inter alia* the advantage that the estate planner can remain in control of the assets through the utilisation of preference shares. The following paragraphs will explain the position of interest-free loans, the failure to claim performance as well as preference shares under the current wealth transfer tax system.

#### 7.4.5.2 *Interest-free Loans*

The well-embedded use of interest-free or low-interest loans has often been scrutinised for whether or not the lack of charging market-related interest constitutes a donation for the purpose of donations tax. Scholars generally conclude that the failure to charge interest does not constitute the waiver of a “right”,<sup>97</sup> although some commentators have pointed to the possibility that an interest-free fixed period loan (as opposed to a demand loan) may be construed as a section 58(1) disposition for inadequate consideration (valued at the difference between the face value and the present value of the loan).<sup>98</sup> Although the issue is far from settled, it is apparently the general practice of SARS not to levy donations tax on interest-free loans.<sup>99</sup> This is, however, no guarantee that it would not be attempted in the future. However, the broader policy consideration is whether some measures should be adopted to render the granting of an interest-free (or low interest) loan taxable. The Margo Commission recommended by the majority of the commissioners that the lack of interest charged should be regarded as a taxable capital transfer, to prevent erosion of the tax base.<sup>100</sup> The minority’s view was instead to ignore interest-free or low-interest loans, in view of the fact that any proposed provision for the taxation of the interest would raise very little revenue and would only result in the

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<sup>97</sup> For further reading see Editorial (1968) *Income Tax Reporter* 65 *et seq*; Editorial (1978) *SA Company Law J F-15 et seq*; Van Dorsten (1986) *SA Comm Law J 71 et seq*; Meyerowitz (2008) *Taxpayer* 110; Stark (2008) *De Iure* 174 *et seq* and Olivier (2008) *TSAR* 151 *et seq*.

<sup>98</sup> Davis, Beneke and Jooste (2009) par 13.6.

<sup>99</sup> De Koker and Williams Vol 3 (2009) par 23.3; Davis, Beneke and Jooste (2009) pars 2.9.6A and 13.6; King and Victor (2008/2009) par 12.4.

<sup>100</sup> Margo Report (1986) par 20.56. Loans payable on demand would require the setting of a standard rate of interest.

creation of new avoidance schemes.<sup>101</sup> The government noted the recommendation, but indicated that the issue required some further investigation.<sup>102</sup> In 1997, the Katz Commission evaluated the position once again. The commission reported that effective action against interest-free and low-interest loans has been relatively rare in foreign jurisdictions and that the complexities involved outweigh the advantages.<sup>103</sup>

#### *7.4.5.3 Failure to Claim Performance*

Commentators seem to agree that the mere failure to institute a claim for an outstanding performance does not constitute a renunciation of a “right”.<sup>104</sup> The allowing of a right to prescribe could therefore effectively “remove” an asset from a creditor’s estate without any adverse tax consequences.

#### *7.4.5.4 Preference Shares*

To facilitate control over assets transferred by a planner to a company, the planner is usually issued with sufficient preference shares in such company to secure control over the other shareholders. The preference shares are typically issued with a low dividend rate attached thereto without a right to participate in any surplus on a winding-up or deregistration of the company, thereby effectively minimising the value of the shares in the planner’s estate. Although the shares could be issued as consideration for the assets transferred, this is usually not done in view of the danger that the Commissioner may invoke section 58(1) of the Income Tax Act if the value of the shares constitutes inadequate consideration. The assets are therefore typically sold by the planner to the company with the purchase price payable on demand. In order to avoid the invoking of

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<sup>101</sup> Margo Report (1986) par 20.56.

<sup>102</sup> Deloitte Haskins & Sells (1988) 52.

<sup>103</sup> Fourth Interim Katz Report (1997) pars 7.1–7.8.

<sup>104</sup> See Meyerowitz on Income Tax (2007/2008) par 31.4 and Davis, Beneke and Jooste (2009) par 11.4.



section 3(3)(d)<sup>105</sup> or section 5(1)(f)*bis*<sup>106</sup> of the Estate Duty Act, the wealth holder is usually afforded less than 75 percent control of the overall votes of the company. The Katz Commission considered the issue of preference shares, but rejected any specific measures to remedy the problem in keeping with its approach to avoid unnecessary legislative complexity. However, it was mentioned that section 5(1)(f)*bis* of the Estate Duty Act could be appropriately amended to assist the problem in some way.<sup>107</sup> Although the government accepted this recommendation, it has not acted on it to date.<sup>108</sup>

#### 7.4.6 Discretionary Trusts

Very often an estate planner transfers assets to a discretionary trust. The initial transfer into trust will constitute a donation to the extent that it was made for inadequate consideration (because of the special provisions deeming the trustees to be the recipient under any donation to a trust).<sup>109</sup> Because of the conduit-pipe nature of a trust, the regime offers an exemption in respect of any subsequent distribution of the property to a beneficiary.<sup>110</sup> At the heart of the problem lies the fact that the trust property would not form part of the deceased estate of a contingent beneficiary nor would a disposal of a contingent interest constitute a donation for the purposes of donations tax. In view of the fact that the assets are typically held for a period extending beyond one generation, a discretionary trust has transpired to be a useful tool in deferring the payment of estate

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<sup>105</sup> See Ch 6 par 6.2.4.2.5.

<sup>106</sup> See Ch 6 par 6.3.1.

<sup>107</sup> Fourth Interim Katz Report (1997) par 8.3.

<sup>108</sup> For further reading on tax avoidance through preference shares, see Davis, Beneke and Jooste (2009) pars 13.7 and 13.8.

<sup>109</sup> The trustees are deemed to acquire the property on behalf of the beneficiaries for purposes of donations tax. See Ch 5 pars 5.2.1 and 5.6.3.

<sup>110</sup> See Ch 5 par 5.5.3.



duty for one or more generations, especially in the light of the absence of a rule against perpetuities.<sup>111</sup>

The Franzsen Commission rejected submissions suggesting that any appreciation in the value of the assets transferred to a discretionary trust should be subject to donations tax or estate duty.<sup>112</sup> The Commission nevertheless recommended that a section similar to the general anti-avoidance rule of the Income Tax Act should be inserted in the Estate Duty Act to counter possible tax avoidance schemes.<sup>113</sup>

The Margo Commission recommended that trusts should be subjected to capital transfer tax after the lapse of a certain period of time, for example fifteen years, to the extent that the beneficiaries have not obtained vested rights.<sup>114</sup> Although this recommendation was supported by the government, it was never implemented.

More or less a decade later, the Katz Commission endorsed the proposal of the Margo Commission that trusts should be subjected to capital transfer tax at periodic intervals on the value of their net assets (the “periodic tax”), notwithstanding the complexity of the legislation that would be required to achieve this objective. It was proposed that the tax should be levied at the rate applicable to *inter vivos* donations. Although the Commission left open the frequency of the period, it suggested that a period within the range of 25 to 30 years (reflecting more or less a generation) would probably be appropriate.<sup>115</sup> In addition, it was recommended that any subsequent vesting of trust assets in beneficiaries should also be subjected to the regime (the “exit tax”), in all circumstances other than

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<sup>111</sup> See Ch 5 par 5.6.1.2.

<sup>112</sup> Second Franzsen Report (1970) par 412.

<sup>113</sup> Second Franzsen Report (1970) par 415.

<sup>114</sup> Margo Report (1986) par 20.57.

<sup>115</sup> Fourth Interim Katz Report (1997) par 10.9.

where to do so would result in double taxation.<sup>116</sup> It was furthermore suggested that the value of the distribution subject to the exit tax should be limited to an amount that exceeds the amount on which estate duty or donations tax were paid on the original disposition to the trust.<sup>117</sup> It was also suggested that certain special trusts, created for the benefit of mentally or physically disabled children or established for the benefit of employees to provide for risks such as death, disability, unemployment insurance or medical expenses, should be exempt from the proposed provisions.<sup>118</sup> In respect of the concern raised that commercial trusts would be detrimentally affected by the proposed regime, the Commission commented that

“[i]f planners wish to use a trust to carry on their business activities as opposed to using a more conventional business form, then they must accept all the consequences of doing so”.<sup>119</sup>

Other than the principles that have been outlined above, the Commission did not provide any detailed guidelines for the proposed legislation, apparently in view of the fact that some useful precedents in overseas legislation exist. However, Parliament’s Portfolio Committee on Finance rejected the Commission’s proposal on the generation-skipping taxes in view of the administrative difficulties that the proposed regime would have posed for the tax authorities.<sup>120</sup> Commentators in general also did not support the proposal, mainly because of the complexity, administrative burden, and possible cost-inefficiency that it would bring to the tax system.<sup>121</sup>

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<sup>116</sup> Fourth Interim Katz Report (1997) par 10.12.

<sup>117</sup> Fourth Interim Katz Report (1997) par 10.13(a) and (b).

<sup>118</sup> Fourth Interim Katz Report (1997) par 10.16.

<sup>119</sup> Fourth Interim Katz Report (1997) par 10.7(a).

<sup>120</sup> Editorial (1998) *Income Tax Reporter* 68.

<sup>121</sup> See, e.g., Strydom LLD Thesis (2000) 375–401 for a more detailed discussion.



#### 7.4.7 Preferential Valuation Rules for Agricultural and/or Business Property

The provision for a preferential valuation method for agricultural property has become a well-embedded characteristic of the donations tax and estate duty regimes. Currently, agricultural property (unless it has been disposed of under a *bona fide* sales agreement in the course of the liquidation of the estate), may be valued at the fair market value of the property less 30 percent.<sup>122</sup>

On one level the question arises whether preferential valuation is justifiable for certain assets such as agricultural properties. The Franzsen Commission and the Margo Commission were both against special relief for agricultural property mainly because of horizontal equity concerns.<sup>123</sup> The Franzsen Commission stressed that it is the duty of every testator to provide for sufficient liquid assets in his or her estate.<sup>124</sup> Even where a testator had made no provision for the required liquid funds, it was argued that such funds could be obtained by means of mortgage or other loans.<sup>125</sup> The commission, however, supported the idea that the method of payment should be made as convenient as possible for the heirs, and suggested that the then Secretary for Inland Revenue<sup>126</sup> should continue to accommodate periodic payments spread over a couple of years.<sup>127</sup> Inextricably linked to the justification of preferential valuation relief is the question whether the relief offered (in its current form) is adequate, especially in view of the general decline in economic activity over the past few years as a consequence of the global recession.

On a second level the question arises whether the relief should be extended to other forms of business properties. In 1994 the Interim Katz Commission Report conceded that small

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<sup>122</sup> See Ch 5 par 5.5.2 and Ch 6 par 6.5.1.

<sup>123</sup> See Second Franzsen Report (1970) par 405 and Margo Report (1986) par 20.61.

<sup>124</sup> Second Franzsen Report (1970) par 378.

<sup>125</sup> Second Franzsen Report (1970) par 381.

<sup>126</sup> Currently known as the Commissioner for the South African Revenue Service (CSARS).

<sup>127</sup> Second Franzsen Report (1970) par 382.



and medium-sized enterprises constitute a significant share of the South African economy.<sup>128</sup> The commission, nonetheless, stressed that tax measures cannot be the major tool in the programme of promoting the smaller business sector in South Africa, but can certainly contribute to the creation of a favourable environment for such sector.<sup>129</sup> The final conclusion of the report did not favour specific tax incentives for small businesses in general.<sup>130</sup> The report, however, did not deal with incentives in the realm of estate duty.

The absence of some relief for businesses, and especially private businesses, in the realm of estate duty (and for that matter donations tax) is especially surprising if one considers that the capital gains tax legislation provides for a “small business assets” exclusion to offer relief to small business owners who have invested their resources in their businesses.<sup>131</sup>

#### 7.4.8 Estate Duty Levied on Estate Duty: The Absence of Grossing-Up Rules

Estate duty and donations tax are levied at the same rate. It seems therefore as if donations tax and estate duty are effectively the same, which means that donations tax is a form of estate duty paid in advance. However, this viewpoint is not quite correct. Davis,

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<sup>128</sup> Interim Katz Report (1994) par 10.1.1.

<sup>129</sup> Interim Katz Report (1994) par 10.1.2.

<sup>130</sup> Interim Katz Report (1994) par 10.6.18.

<sup>131</sup> Eighth Schedule to the Income Tax Act par 57. The exclusion (which applies only to natural persons) operates as follows: the first R750 000 of any capital gain made on the disposal of certain business assets should be disregarded. The assets that can qualify for the relief include (a) an active business asset of a sole proprietor; (b) an interest in an active business asset of a partnership and (c) an entire direct interest, which consists of at least 10 percent of the equity of a company, to the extent that the interest relates to active business assets. An “active business asset” is an asset used or held wholly or exclusively for business purposes, but it excludes financial instruments, assets held to produce “passive income” (such as annuities, rental income, foreign exchange gains, royalties or similar income). The exclusion will be available only where (a) the owner has held it for his own benefit for a continuous period of at least five years prior to the disposal; (b) the owner was substantially involved in the operation of the business during that period; (c) the owner has attained the age of 55 years or, if younger, has disposed of the asset or interest in consequence of ill-health, other infirmity, superannuation or death; and (d) all his or her qualifying capital gains must be realised within a period of 24 months, commencing on the date of his first qualifying disposal.

Beneke and Jooste provide the following example: suppose that A intends to give B as much of R120 as he can. Ignoring the annual exemption, A can give B R100 and pay the donations tax of R20. Where, however, A dies, leaving an estate worth R120 to B, the executor of A's estate would have to pay estate duty of R24 (ignoring the primary abatement for the purposes of comparison), which means that the beneficiary would only be entitled to R96. The estate duty amounts to R24 on the payment of R96 (25 percent).<sup>132</sup> Thus, effectively, "estate duty is levied on estate duty" in the absence of the provision for grossing-up rules in respect of donations.

## 7.5 CONCLUSIONS

- (a) There are a number of discrepancies between the donations tax base and the estate duty tax base, as well as the valuation rules and exemptions provided for under the two different fiscal regimes levied in terms of two different legislative frameworks. It was shown that, although the Margo Commission and Katz Commission suggested that the taxation of *inter vivos* transfers and transfers on death should be integrated into a single statute, the legislature has not acted on these recommendations to date. In a broader context, the aim of this study is to outline the level of integration that should exist between the taxation of *inter vivos* transfers and transfers on death in a South African context.<sup>133</sup>
- (b) The possible transition to a recipient-based wealth transfer tax system has never been extensively considered by the South African legislature. It is suggested that such a proposition requires further investigation, especially in view of the strong theoretical appeal of a recipient-based system (as outlined in Chapter 4). In exploring the possibility of replacing the current

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<sup>132</sup> Davis, Beneke and Jooste (2009) par 2.9.1.

<sup>133</sup> See par 7.1.

transferor-based system with a recipient-based regime, aspects such as administrative feasibility and certainty of law should be considered.<sup>134</sup>

(c) This chapter also detailed a selection of problem areas that exist under the current regimes. Apart from the issues that relate to the discrepancy between the taxation of *inter vivos* transfers and transfers on death (as referred to in paragraph (a) above), these problem areas include:

- The demarcation of the jurisdictional basis (and in particular the question whether it is justifiable to exclude foreign assets (as respectively listed in Chapters 5<sup>135</sup> and 6<sup>136</sup> above) from the tax bases of estate duty and donations tax;<sup>137</sup>
- The characteristics of a donation for purposes of donations tax (which involves aspects such as the accommodation of value-shifting arrangements in the tax base);<sup>138</sup>
- The treatment of life insurance benefits for purposes of estate duty;<sup>139</sup>
- The treatment of limited interests and bare *dominium* for purposes of donations tax and estate duty;<sup>140</sup>
- The countering of estate-freezing techniques such as interest-free loans;<sup>141</sup>
- The treatment of discretionary trusts;<sup>142</sup>

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<sup>134</sup> See par 7.2.

<sup>135</sup> See Ch 5 par 5.2.2.1.

<sup>136</sup> See Ch 6 par 6.2.2.1.

<sup>137</sup> See par 7.4.1.

<sup>138</sup> See par 7.4.2.

<sup>139</sup> See par 7.4.3.

<sup>140</sup> See par 7.4.4.

<sup>141</sup> See par 7.4.5.

<sup>142</sup> See par 7.4.6.



- Preferential valuation rules for certain properties;<sup>143</sup> and
  - The absence of grossing-up rules.<sup>144</sup>
- (d) Although it falls outside the scope of this study to offer solutions for all these issues, it is significant to compare these problem areas with the problem areas and possible solutions offered by the transferor-based system of the United Kingdom and the recipient-based systems of the Netherlands and Ireland.<sup>145</sup> This is done to establish whether recipient-based taxation offers more appropriate solutions.

The following chapters will provide a discussion of the wealth transfer tax systems of the United Kingdom, the Netherlands and Ireland. Firstly, these systems will be explored for ways and measures to improve the integration between the taxation of transfers on death and *inter vivos* transfers. Secondly, these systems will be evaluated against the background of the problems identified under the current South African system to assess whether a transition to a recipient-based regime would offer a more workable solution. The final comments on these issues will be attended to only in Chapter 11, once the comparative survey has been completed.

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<sup>143</sup> See par 7.4.7.

<sup>144</sup> See par 7.4.8.

<sup>145</sup> See par 7.3.