

# The levying of estate duty and capital gains tax as double tax in South Africa

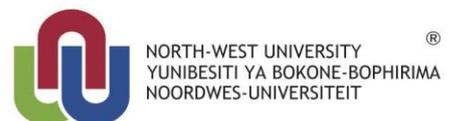
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It all starts here <sup>TM</sup>



## SUMMARY AND KEY TERMS

It is almost certain that there would be tax implications at the death of a natural person. Currently, estate duty is levied in terms of the *Estate Duty Act* at a flat rate of 20%. Capital gains tax on the other hand, is levied in terms of the Eighth Schedule of the *Income Tax Act* with an inclusion rate of 33,3% of the capital gain, after which it is taxed according to the progressive scale at which the deceased was taxed prior to his or her death.

South Africa is the only country in the world to have two forms of capital transfer tax. These taxes recently came under review, with ample grounds for the view that estate duty should be abolished. However, instead of abolishment the emphasis was on reforming estate duty to increase the efficiency of the tax.

Estate duty is considered a wealth tax, with the aim to tax the transfer of wealth. Capital gains tax, on the other hand, is widely considered as a wealth tax because it is levied on any income accruing to a person that is of a capital nature, created by the disposal of assets. Assets significantly increase the size of a person's estate, and therefore also their wealth. It is therefore regarded as a secondary or indirect wealth tax.

The levying of both estate duty and capital gains tax amounts to double taxation under certain circumstances – that is, in the instance that both are applicable to the estate of a deceased natural person. The definition of double taxation varies according to the circumstances to which it is applicable. This study considers these circumstances.

The aim of this study is to document the instances where both estate duty and capital gains taxes are applicable and how it amounts to double taxation. Double taxation is frowned upon internationally, and therefore this study focuses on the capital transfer taxes of Canada and Australia and the historic background of the taxes in these countries.

In light of treatment that double taxes receive internationally, the current review of capital transfer taxes in South Africa under the Davis Tax Committee is briefly

investigated and compared to international perceptions of double taxes. Taxation should be fair, neutral, effective and simple, and when double taxation occurs, these principles are undermined.

Key terms: Australia / Canada / capital gains tax / capital transfer tax / comparison / double taxation / estate duty / inheritance tax / South Africa / tax abolishment / tax review

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## **LIST OF ABBREVIATIONS**

SAJAR	South African Journal of Accounting Research
SARS	South African Revenue Service

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# 1 Introduction

Different forms of tax apply to a natural person during his or her lifetime. Each form of tax is levied in terms of its own prerequisites, according to the relevant rates levied for that specific tax, and to meet an objective determined by the authority imposing the tax.

Taxes can be categorized into direct taxes and indirect taxes, of which direct taxes consist of estate duty, income tax and capital gains tax, among others.<sup>1</sup> Indirect taxes on the other hand would consist of taxes levied on goods or services like Value Added Tax, fuel levies or similar taxes where all consumers of such goods and services are taxed for their consumption thereof.<sup>2</sup>

When a person passes away, a separate entity is created in terms of which income tax, the so-called normal tax, is dealt with in the final year of assessment.<sup>3</sup> This tax is imposed by and regulated by the *Income Tax Act*.<sup>4</sup> The tax liability of a person or entity is calculated using a progressive scale in terms of the *Income Tax Act*, with the effect being that the higher a person or entity's income is, the higher the rate will be at which tax is levied on his/her income.<sup>5</sup>

An individual's income is taxed in the final year of assessment up until the date of death. Should income accrue after date of death, this income is also taxed in the hands of the deceased's estate on the same scales. Capital gains tax may be applicable here, and further tax implications in the form of estate duty may arise on the death of the natural person. Depending on the assets that the deceased owned and the value of his estate, capital gains tax may be levied in addition to estate duty, giving rise to double taxation.<sup>6</sup>

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<sup>1</sup> Venter *et al* 'n *Studentebenadering tot Inkomstebelasting* 3.

<sup>2</sup> Venter *et al* 'n *Studentebenadering tot Inkomstebelasting* 3. For purposes of this study, it will only focus on direct taxes.

<sup>3</sup> South African Revenue Service 2016 <http://www.sars.gov.za/TaxTypes/PIT/Pages/default.aspx>.

<sup>4</sup> *Income Tax Act* 58 of 1962 (hereafter the *Income Tax Act*).

<sup>5</sup> Venter *et al* 'n *Studentebenadering tot Inkomstebelasting* 4.

<sup>6</sup> Bornman *Estate planning: The impact of estate duty and capital gains tax on offshore assets* 18.

Capital gains tax is levied in terms of the Eighth Schedule to the *Income Tax Act*, and is applicable to most disposed capital assets. When passing away, a natural person is considered to have disposed of all his assets immediately prior to death, and therefore capital gains tax may have a considerable impact on a deceased estate in possession of immovable property.

Estate duty, on the other hand, is governed by the *Estate Duty Act*<sup>7</sup> that came into effect on 1 April 1955. Estate duty is levied in terms of this Act on the deceased estate of a person, with certain deductions and exemptions applicable. It is regarded as a wealth tax, and is applicable to all immovable and movable property and proceeds in favour of the estate.<sup>8</sup>

Estate duty in South Africa was levied at a flat rate of 25% from 1988 up until the introduction of capital gains tax in 2001, when this rate was reduced to 20% to “reduce the onerous consequences of both estate duty and capital gains tax being levied on death”.<sup>9</sup> Professor J Roeleveld, in a paper concluded that the imposition of capital gains tax and estate duty constitutes double taxation. This was dismissed by the Davis Tax Committee on the grounds that capital gains tax is an income tax on capital income.<sup>10</sup> The Davis Committee’s argument that capital gains tax is not a wealth tax is not supported by any sources whatsoever, other than a denial of the fact by statement.

The central aim of this study is to determine the possibility of double taxation when both capital gains tax and estate duty is applicable to a deceased estate. Chapter 2 contains a brief introduction on the tax implications at the death of a South African citizen. The relevant sources of capital gains tax and estate duty have to be inspected to demonstrate their effect.

The study first considers what precisely constitutes double taxation is necessary, after which it examines the viewpoints of some authors. The proposals of the Davis Tax Committee, tasked with reviewing the current taxes in South Africa, are analysed to

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<sup>7</sup> *Estate Duty Act* 55 of 1945 (Hereafter the *Estate Duty Act*).

<sup>8</sup> Venter *et al* 'n *Studentebenadering tot Inkomstebelasting* 445.

<sup>9</sup> The Davis Committee *Second Interim Report on Estate Duty* 10.

<sup>10</sup> The Davis Committee *Second Interim Report on Estate Duty* 20.

gauge their effect on the position of the deceased estate and their take on double taxation.

Chapters 3 and 4 are devoted to the tax regimes of Australia and Canada in relation to the death of a taxpayer in these instances. Both these countries implement capital gains tax, although its application in these countries differs considerably. Both implemented inheritance taxes in the form of death duties previously, and with the introduction of capital gains taxes abolished death duties altogether.<sup>11</sup> The reasons for abolition of inheritance taxes in these two countries are of importance for the purposes of this study. Part of the reason for their abolishment was possible double taxation or other problematic effects.<sup>12</sup>

In Chapter 5 the position of the taxpayer or deceased estate in South Africa is compared to a similar situation in each of these countries to provide a clear picture of the differences between the three countries on the death of a natural person.

After evaluating these scenarios and the alternative solutions, the study arrives at certain conclusions. Based on these conclusions, the study closes with the suggestion that double taxation is unwanted and should be remedied.

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<sup>11</sup> Maloney 1988 *Ottawa Law Review* 605.

<sup>12</sup> Goodman 1995 *Canadian Tax Journal* 1366 – 1371; Pedrick 1981 *Tax Law* 35(1): 113-141.

## 2 Tax implications at the death of a South African Citizen

This chapter discusses the *Estate Duty Act* and the *Income Tax Act* with their relevant stipulations to explain how estate duty and capital gains tax is levied at the death of a person. Estate duty is first explained, followed by the *Income Tax Act* and specifically Schedule 8, which contains the provisions for capital gains tax. Possible amendments proposed by the Davis Tax Committee and other opinions on the matter are briefly discussed to illustrate their effects.

### 2.1 Estate Duty

Estate Duty is levied in terms of the *Estate Duty Act*, which came into effect on 1 April 1955. The South African Revenue Service administrates this tax and the other relevant taxes in this discussion. Estate duty is one of South Africa's considerable wealth taxes,<sup>13</sup> and in terms of the *Estate Duty Act*, the estate of all persons who have passed away on or after 1 April 1955 is subject to estate duty. Estate duty, previously known as succession duty, is regarded as a form of capital transfer tax, referring to a taxation of wealth.<sup>14</sup>

Section 3(2) of the *Estate Duty Act* outlines what is classified as the estate of a person. It reads as follows:

- (2) "Property" means any right in or to property, movable or immovable, corporeal or incorporeal, and includes—
  - (a) any fiduciary, usufructuary or other like interest in property (including a right to an annuity charged upon property) held by the deceased immediately prior to his death;
  - (b) any right to an annuity (other than a right to an annuity charged upon any property) enjoyed by the deceased immediately prior to his death which accrued to some other person on the death of the deceased,

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<sup>13</sup> Venter *et al* 'n *Studentebenadering tot Inkomstebelasting* 445.

<sup>14</sup> Bornman *Estate planning: The impact of estate duty and capital gains tax on offshore assets* 10.

A number of specific exclusions are found in sections 3(2)(bA) to 3(2)(i) of the *Estate Duty Act*. These sections are bulky and comprehensive. For purposes of this study, they are only referred to in passing when relevant.<sup>15</sup>

It can be accepted that all movable and immovable property and any claims in favour of the estate forms part of that estate.<sup>16</sup> All the property forming part of the estate constitutes its gross value. This includes property deemed as property of the estate, as found in section 3(3) of the *Estate Duty Act*. Property deemed as property includes any amount due and recoverable under a life insurance policy on the life of the deceased,<sup>17</sup> donations exempt from donations tax,<sup>18</sup> the amount of any claim against the surviving spouse in terms of the *Matrimonial Property Act*<sup>19</sup> in respect of accrual,<sup>20</sup> and property that the deceased was competent to dispose of immediately prior to his death for his own benefit or the benefit of his estate.<sup>21</sup> Property deemed as property comes into existence after the death of the deceased.<sup>22</sup> The gross value is calculated by adding the values of property and deemed property together.

The matrimonial property system in cases where the deceased and the surviving spouse was married obviously has an effect on the outcome and calculation of estate duty. If they were married in community of property, the calculation differs considerably from the other two matrimonial property regimes because half of the estate vests in the surviving spouse. Where the matrimonial property regime is out of community of property with accrual, the only difference in calculating the estate duty would be an

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<sup>15</sup> For a full discussion of these exclusions, refer to S 3 of the *Estate Duty Act* 45 of 1955.

<sup>16</sup> Abrie *et al Bestorwe Boedels* 169.

<sup>17</sup> S 3(3)(a) of the *Estate Duty Act* stipulates that in the case the premiums of a life insurance policy was paid by another person, the value of the policy exceeding the premiums and 6% interest from date of payment to date of death is taken into account. Furthermore, Sections 3(3)(a)(i) to 3(3)(a)(ii) sets out 3 exclusions, which can be explained as a policy under a registered ante-nuptial or post nuptial contract, a policy taken out to obtain the interest of the deceased in a partnership or company, and a policy taken out on the life of the deceased by another person, by which the deceased, his family or his estate does not benefit at all (also known as key-man policies).

<sup>18</sup> S 3(3)(b) of the *Estate Duty Act*.

<sup>19</sup> *Matrimonial Property Act* 88 of 1984.

<sup>20</sup> S 3(3)(cA) of the *Estate Duty Act*.

<sup>21</sup> S 3(3)(d) of the *Estate Duty Act*.

<sup>22</sup> Abrie *et al Bestorwe Boedels* 173.

accrual claim either in favour of or against the estate. For purposes of this discussion, the focus is on an out of community regime without accrual.<sup>23</sup>

Section 4 of the *Estate Duty Act* stipulates the deductions that are allowed to calculate the net value of the estate. These stipulations amount to all claims against the estate and all the estate's liabilities.<sup>24</sup> This includes the following, to name a few:<sup>25</sup>

- funeral costs;<sup>26</sup>
- debts due by the deceased to persons ordinarily resident in South Africa<sup>27</sup> and persons not ordinarily resident in South Africa;<sup>28</sup>
- the value of property situated outside South Africa, of which the deceased became owner before becoming a resident of South Africa or after becoming a resident via a donation or bequest;<sup>29</sup>
- administration costs for administration of the estate;<sup>30</sup>
- cost incurred in carrying out the requirements of the Master of the relevant High Court dealing with the estate;<sup>31</sup>
- certain improvements on the property in the estate by a person to whom such property accrues after death;<sup>32</sup>
- accrual claims<sup>33</sup> as discussed above and bequests to the surviving spouse;<sup>34</sup>

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<sup>23</sup> For a full discussion of matrimonial property regimes, refer to Abrie *et al Bestorwe Boedels* 9 – 19; Bornman *Estate planning: The impact of estate duty and capital gains tax on offshore assets* 13 – 14;

<sup>24</sup> Abrie *et al Bestorwe Boedels* 169.

<sup>25</sup> For a full discussion of the deductions allowed, refer to S 4 of the *Estate Duty Act*.

<sup>26</sup> S 4(a) of the *Estate Duty Act*.

<sup>27</sup> S 4(b) of the *Estate Duty Act*.

<sup>28</sup> S 4(f) of the *Estate Duty Act*.

<sup>29</sup> S 4(e) of the *Estate Duty Act*.

<sup>30</sup> S 4(c) of the *Estate Duty Act*.

<sup>31</sup> S 4(d) of the *Estate Duty Act*.

<sup>32</sup> S 4(i) – (j) of the *Estate Duty Act*.

<sup>33</sup> S 4(la) of the *Estate Duty Act*.

<sup>34</sup> S 4(q) of the *Estate Duty Act*.

After the net value of the estate has been calculated by subtracting the allowed deductions from the gross value, section 4A(1) of the *Estate Duty Act* makes provision for a further reduction of R3,5 million from the net worth of the estate before estate duty is calculated. Section 4A(2) of the *Estate Duty Act* further makes provision for a rollover, where the amount specified above is transferable between two estates if the first dying spouse bequeaths his or her whole estate to the surviving spouse. In effect, the estates then should have a net worth of R7 million before estate duty is levied.

A number of different deductions are allowed in terms of the *Estate Duty Act*. One of these is found in the First Schedule to the *Estate Duty Act*. This schedule makes provision for cases where estate duty was paid upon the death of any person with regard to an asset within 10 years prior to it becoming payable in the hands of the deceased. The amount of estate duty would be reduced according to the sliding scale for rates provided in the First Schedule.<sup>35</sup> The amount of estate duty payable is thereby reduced by between 20% and 100%.<sup>36</sup>

South Africa also has tax treaties with a number of countries worldwide in terms of which the right to claim taxes on the same asset is shared or divided between the two countries to avoid double tax.<sup>37</sup> Section 16(a) of the *Estate Duty Act* furthermore provides that transfer duty paid in respect of acquiring an asset is deductible from the amount of estate duty payable.

In terms of the First Schedule to the *Estate Duty Act*, estate duty is levied at a flat rate of 20% on the dutiable amount of the estate. The basic discussion of the different deductions and reductions above is set out in the table hereunder to provide clarity on how it is calculated:

**Table 2-1: Calculating the dutiable amount of estate duty<sup>38</sup>**

Description	Amount
Value of property	R xxx

<sup>35</sup> First Schedule to the *Estate Duty Act*.

<sup>36</sup> Refer to the First Schedule of the *Estate Duty Act* 45 of 1955 for a complete overview.

<sup>37</sup> Abrie *et al Bestorwe Boedels* 189.

<sup>38</sup> Abrie *et al Bestorwe Boedels* 169.

ADD: Value of property deemed as property	R xxx
GROSS VALUE OF THE ESTATE	R xxxxx
SUBTRACT: Allowable deductions (S 4 of the Act)	R xx
NET VALUE OF THE ESTATE	R xxx
SUBTRACT: Section 4A reduction	R xx
DUTIABLE AMOUNT	R xx
ESTATE DUTY PAYABLE (DUTIABLE AMOUNT x 20%)	R x

## **2.2 Income tax and its relevance to capital gains tax**

A brief look into the basics of income tax is necessary as capital gains tax contain a small element of this. Income tax is levied in terms of the *Income Tax Act*. This act is vast and contains extensive principles regarding income tax, and therefore only the relevant part is discussed.

Income tax is regarded as a normal tax. For natural persons taxes are imposed on a progressive scale that increases as their taxable income increases in the year of assessment.<sup>39</sup> As with all taxes in South Africa, it is administered by the South African Revenue Service (SARS). Income tax is imposed on every natural person, and the liability is established by Section 5 of the *Income Tax Act*. Section 5 reads as follows:

5. Levy of normal tax and rates thereof.—(1) Subject to the provisions of the Fourth Schedule there shall be paid annually for the benefit of the National Revenue Fund, an income tax (in this Act referred to as the normal tax) in respect of the taxable income received by or accrued to or in favour of—

(c) any person (other than a company) during the year of assessment ended the last day of February each year; and

(d) any company during every financial year of such company.

The normal tax rates applicable to all persons and companies as imposed by Section 5 above must be fixed annually by Parliament.<sup>40</sup> Thereafter, it is the responsibility of the

<sup>39</sup> De Koker & Williams *Silke on South African Income Tax* 1.2.

<sup>40</sup> De Koker & Williams *Silke on South African Income Tax* 1.2.

South African Revenue Service (SARS) to administer and collect the taxes. This is done in two different ways, namely employee tax and provisional tax payments.<sup>41</sup> Employee tax is deducted by the employer of a natural person from his monthly salary or remuneration and paid directly to SARS, while provisional tax payments are made by a person with income other than remuneration, for example income from a business.<sup>42</sup> The current normal rates of taxes are set out below.

**Table 2-2: Tax rates for the 2015/2016 tax year<sup>43</sup>**

<b>Taxable income</b>	<b>Rate of tax</b>
R0 - R181 900	18% of each R1
R181 901 - R284 100	R32 742 + 26% of the amount above R181 900
R284 101 - R393 200	R59 314 + 31% of the amount above R284 100
R393 201 - R550 100	R93 135 + 36% of the amount above R393 200
R550 101 - R701 300	R149 619 + 39% of the amount above R550 100
R701 301 +	R208 587 + 41% of the amount above R701 300

The taxable income of a person is calculated by subtracting exempt income and allowable deductions from his or her gross income,<sup>44</sup> after which the tax liability is determined according to Table 2.2 above. The definition of 'gross income' is found in Section 1 of the *Income Tax Act*, which is vast and comprehensive. Venter<sup>45</sup> breaks it down into these elements applicable to South African residents: a resident, the total amount in cash or otherwise received or accrued to during a year or period of assessment and accruals of a capital nature. All of these elements should be present for the amount to be gross income.<sup>46</sup>

<sup>41</sup> Musviba date unknown <http://www.sataxguide.co.za/sa-income-tax/>.

<sup>42</sup> De Koker & Williams *Silke on South African Income Tax* 1.2.

<sup>43</sup> SARS 2015 <http://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Rates%20of%20Tax%20for%20Individuals.aspx>.

<sup>44</sup> Musviba date unknown <http://www.sataxguide.co.za/sa-income-tax/>.

<sup>45</sup> Venter *et al* 'n *Studentebenadering tot Inkomstebelasting* 24-25.

<sup>46</sup> Venter *et al* 'n *Studentebenadering tot Inkomstebelasting* 24-25.

Regarding accruals of a capital nature, it is not always clear what constitutes such an accrual.<sup>47</sup> The case of *Commissioner for Inland Revenue v Visser*<sup>48</sup> can be used to explain what accruals of a capital nature are considered to be. The taxpayer in this case had mining options over certain properties for a period of two years. After this period the options were not renewed, and a competitor for the options offered the taxpayer shares in a company (which would buy these options) to not compete for the options again. The taxpayer accepted the offer. The court found that the nature of the amount in dispute is income, as it is the product of his expertise and therefore not an accrual of capital nature.

The court used the tree-and-fruit analogy in this case as a guideline and warned that what could be an income accrual for one person, could be classified as an accrual of a capital nature in the hands of another person. For example, if a lawyer sells his personal vehicle it would be classified as an accrual of a capital nature, while a car dealer's accrual from selling a vehicle would be classified as income. The tax implications of an accrual of a capital nature differs from accruals of an income nature, as will be seen in the discussion of capital gains below.

In addition to the tree-and-fruit analogy used, another test often applied by the courts in recent years is the "profit-making scheme" test. Should the amount accrued be received in pursuance of a profit-making scheme, it would not classify as an accrual of a capital nature, but be included under gross income for tax purposes.<sup>49</sup>

Exempt income that is deducted from gross income is found in Section 10 of the *Income Tax Act*. It is included under gross income, but is then excluded when income is calculated by deduction.<sup>50</sup> It can be divided into two broad categories, namely partial exemptions and absolute exemptions.<sup>51</sup> These include bursaries and scholarships (section 10(1)(q)), certain dividends (section 10(1)(k)), proceeds from insurance policies (section 10(1)(gG), (gH) and (gI)) and a partial exemption on interest received

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<sup>47</sup> Olivier 2012 *De Jure* 172.

<sup>48</sup> *Commissioner for Inland Revenue v Visser* 8 SATC 271.

<sup>49</sup> Olivier 2012 *De Jure* 172.

<sup>50</sup> Musviba date unknown <http://www.sataxguide.co.za/sa-income-tax/>.

<sup>51</sup> De Swardt *et al Silke: South African Income Tax* 6.1.

(section 10(1)(i)), to name a few. For a full discussion of exempt income, refer to Section 10 of the *Income Tax Act*.

Regarding allowable deductions, all natural persons are entitled to deduct a primary rebate on their income tax payable in terms of Section 6 of the *Income Tax Act*. In addition to this, a secondary and a tertiary tax rebate is available to qualifying individuals, namely the 'over 65' and 'over 75' rebates respectively.<sup>52</sup> Section 6A and 6B also entitles natural persons to a tax credit for contributions made to a registered medical scheme.<sup>53</sup>

When exempt income and allowable deductions as discussed above are deducted from gross income, a person is left with taxable income on which the tax liability is calculated on the scales set out in Table 2.2. In the year that a natural person dies, income tax is also levied for the period from the start of the year of assessment to the date of death.<sup>54</sup>

The rate at which a person is taxed is relevant to capital gains tax, since a part of a person's capital gain is taxable at the same rates as income tax, as is discussed below. The correspondence between income tax and capital gains tax is therefore that the taxable capital gains are aggregated with other taxable income and taxed according to the income tax rates.<sup>55</sup>

### **2.3 Capital gains tax**

Capital gains tax is a tax separate from income tax, although it contains a small element of income tax. It is therefore discussed separately for the purposes of this discussion.

Capital gains tax is levied in terms of the Eighth Schedule to the *Income Tax Act*. It applies to most capital assets that are disposed of,<sup>56</sup> and is levied on any asset of a

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<sup>52</sup> De Koker & Williams *Silke on South African Income Tax* 1.2.

<sup>53</sup> Venter *et al 'n Studentebenadering tot Inkomstebelasting* 15.

<sup>54</sup> Venter *et al 'n Studentebenadering tot Inkomstebelasting* 11.

<sup>55</sup> De Koker & Williams *Silke on South African Income Tax* 1.1.

<sup>56</sup> Olivier 2012 *De Jure* 172.

resident of the Republic of South Africa and certain assets of a non-resident, such as immovable property or an interest in immovable property.<sup>57</sup>

Two or three different entities are formed at the death of a natural person, depending on the circumstances surrounding the estate of the deceased.<sup>58</sup> The first of these entities is the relevant tax year, from its start to the date of death. The second entity is the deceased estate. The third possible entity is formed when beneficiaries become liable for capital gains tax. The formation of this third entity depends on how the estate is devolved and may differ between estates, depending on who the beneficiaries are.<sup>59</sup>

When a person dies, they are deemed to have disposed of all their assets, taking into account certain exclusions as set out by Paragraph 40 of the Eighth Schedule to the *Income Tax Act*. Paragraph 40 reads as follows:

40 Disposal to and from deceased estate

(1) A deceased person must be treated as having disposed of his or her assets, other than-

- (a) assets transferred to the surviving spouse of that deceased person as contemplated in paragraph 67(2)(a);
- (b) assets bequeathed to an approved public benefit organization as contemplated in paragraph 62;
- (c) a long-term insurance policy of the deceased which if the proceeds of the policy had been received by or accrued to the deceased, the capital gain or capital loss determined in respect of that disposal would be disregarded in terms of paragraph 55; or
- (d) an interest in a pension, provident or retirement annuity fund in the Republic or a fund, arrangement or instrument situated outside the Republic which provides benefits similar to a pension, provident or retirement annuity fund which if the proceeds thereof had been received by or accrued to the deceased, the capital gain or capital loss determined in respect of the disposal of the interest would have been disregarded in terms of paragraph 54

Furthermore, the definitions of *asset* and *disposal* should receive some attention. They are defined as follows in Paragraph 1 of the Eighth Schedule to the *Income Tax Act*:

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<sup>57</sup> Venter *et al* 'n *Studentebenadering tot Inkomstebelasting* 491.

<sup>58</sup> Abrie *et al Bestorwe Boedels* 258.

<sup>59</sup> Abrie *et al Bestorwe Boedels* 260.

'asset'

includes—

- (a) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and
- (b) a right or interest of whatever nature to or in such property;

'disposal'

means an event, act, forbearance or operation of law envisaged in paragraph 11 or an event, act, forbearance or operation of law which is in terms of this Schedule treated as the disposal of an asset, and 'dispose' must be construed accordingly;

Although the definition of an *asset* states that it includes property of whatever nature, this is only applicable to capital assets that are disposed of or deemed to have been disposed of, and not to assets in general as the definition implies. A deemed disposal is for example when a person's debt is reduced or discharged for no consideration, or a consideration that is lesser than the face value of the debt.<sup>60</sup>

Disposal of an asset can constitute either a capital gain or a capital loss, and each asset is considered on its own when calculating a capital gain or loss.<sup>61</sup> The capital gain or loss is calculated by subtracting the base cost of the asset from the proceeds of the disposal.<sup>62</sup> The base cost is determined either by the expenditure actually incurred in respect of the acquisition and valuation of the asset,<sup>63</sup> or by the appraisal value of the asset on 1 October 2001 (the valuation date) minus any costs incurred in relation to the asset after the valuation date.<sup>64</sup> Thereafter the person's capital gains and losses for the financial year are added together, after which capital gains tax is calculated.

The Eighth Schedule to the *Income Tax Act* makes provision for three different methods to calculate the base cost of an asset acquired before 1 October 2001 and allows the highest of these three values to be used.<sup>65</sup> These methods are the following:<sup>66</sup> 20 per

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<sup>60</sup> Para 12(5)(a) of the Eighth Schedule to the *Income Tax Act*.

<sup>61</sup> Abrie *et al Bestorwe Boedels* 260.

<sup>62</sup> South African Revenue Services 2016 <http://www.sars.gov.za/TaxTypes/CGT/Pages/default.aspx>.

<sup>63</sup> Para 20 of the Eighth Schedule of the *Income Tax Act*.

<sup>64</sup> South African Revenue Service 2016 <http://www.sars.gov.za/TaxTypes/CGT/Pages/default.aspx>.

<sup>65</sup> Abrie *et al Bestorwe Boedels* 261.

cent of the proceeds from disposal of the asset after deducting allowable expenditure,<sup>67</sup> the market value of the asset on the valuation date,<sup>68</sup> and the time-apportionment base cost.<sup>69</sup> For a full discussion on the base cost of an asset, refer to part V of the Eighth Schedule to the *Income Tax Act*.

Paragraph 44 to 61 of the Eighth Schedule to the *Income Tax Act* contains certain exclusions that should be taken into consideration when determining the capital gain or loss of a person. The first of these exclusions being R2 million on disposal of the primary residence, as set out in paragraphs 44 to 61. Personal use assets (paragraph 53) are also exempt from capital gains tax, and include a motor vehicle, household items, furniture, a boat smaller than 10 meters or an aeroplane with an empty weight of not more than 450 kilograms.

Furthermore, any capital gain or loss accruing under a retirement benefit (paragraph 54); long-term insurance proceeds (paragraph 55); the disposal of small business assets and micro-business assets (paragraphs 57 & 57A); compensation for personal injury, illness or defamation (paragraph 59); proceeds from gambling, games and competitions (paragraph 60) and investments in a collective investment portfolio, excluding such investment in property (paragraph 61), fall under these exclusions. For a full discussion of these exclusions, refer to paragraphs 41 to 61 of the Eighth Schedule to the *Income Tax Act*.

In addition to these exclusions, an annual exclusion of R30 000 on capital gains are granted to a natural person and special trusts, while Paragraph 5 raises this exclusion to R300 000 in the year that the person dies.<sup>70</sup> The exclusion of R300 000 is an attempt to provide some relief to the deceased as the deceased is deemed to have disposed of all his assets at the time of his death.<sup>71</sup> These amounts are subject to change when and

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<sup>66</sup> For a full discussion with regard to calculating the base cost of an asset on the methods provided, refer to Abrie *et al Bestorwe Boedels* 261 – 268.

<sup>67</sup> Para 26 of the Eighth Schedule to the *Income Tax Act*.

<sup>68</sup> Para 29 of the Eighth Schedule to the *Income Tax Act*.

<sup>69</sup> Para 30 of the Eighth Schedule to the *Income Tax Act*.

<sup>70</sup> Eighth Schedule to the *Income Tax Act* 58 of 1962.

<sup>71</sup> Abrie *et al Bestorwe Boedels* 273.

if authorities see the need to do so. When calculating a person's capital gain or capital loss, this amount should be deducted to determine the taxable amount.

In terms of Paragraph 67, no capital gains tax is levied on assets transferred to the surviving spouse. These capital gains are postponed until the death of the surviving spouse, and capital gains tax is then calculated from the date that the first deceased acquired the assets, which can be disadvantageous to the surviving spouse.<sup>72</sup>

After the net capital gain of a deceased estate has been determined, the taxable amount must be calculated. This is done by using the prescribed inclusion rate, which is currently set at 33,3% for natural persons and special trusts.<sup>73</sup>

## **2.4 The Davis Tax Committee**

In 2013, the Minister of Finance announced that capital taxes (including capital gains tax, donations tax and estate duty) would be reviewed by the Davis Tax Committee.<sup>74</sup> Depending on their proposals, double taxation brought about by estate duty and capital gains tax might be affected. These proposals must therefore be considered.

There are various possible reasons why these taxes should be reviewed, such as the potential of double taxation, the small turnover produced by estate duty, and the difficulty to administrate estate duty.<sup>75</sup> According to Jacobs<sup>76</sup>, the amendment of estate duty in recent years (with the Section 4A reduction being raised throughout from R1 million in 1988 to R3.5 million in 2007)<sup>77</sup> opened up the possibility that estate duty may be revoked when taking the capital gains tax that was introduced in 2001 into account.<sup>78</sup>

Speculation by writers further opened up this possibility, saying that the administration of estate duty and the possible ways to avoid it by using trusts and estate planning

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<sup>72</sup> Jones 2008 *Personal Finance Newsletter* 3.

<sup>73</sup> SARS 2016 Inclusion Rate <http://www.sars.gov.za/TaxTypes/CGT/Proceeds/Calc-Tax-Capital/Pages/Inclusion-rate.aspx>.

<sup>74</sup> The Davis Committee 2013 <http://www.taxcom.org.za/>.

<sup>75</sup> Warmbak 2010 *TAXTalk* 12.

<sup>76</sup> Warmbak 2010 *TAXTalk* 12.

<sup>77</sup> *Taxation Laws Second Amendment Act* 8 of 2007.

<sup>78</sup> Van Gijsen 2015 <http://www.moneyweb.co.za/moneyweb-opinion/soapbox/ras-and-estate-duty-rather-abolish-estate-duty-altogether/>.

techniques makes it insufficient.<sup>79</sup> These authors regard capital gains tax as a superior tax that should replace estate duty in its entirety. Considering that the average house price was around R1 million in 2008 already, having a few more assets worth something could easily surpass the current rebate of R3.5 million (R7 million where the rollover discussed above is used).<sup>80</sup> Their view is submitted to be correct.

During 2011, the Minister of Finance made the following statement:<sup>81</sup>

Both estate duty and capital gains tax are payable upon death, which is perceived as giving rise to double taxation. The estate duty raises limited revenue and is cumbersome to administer. Moreover, its efficacy is questionable: many wealthy individuals escape estate duty liability through trusts and other means. Taxes on death will be reviewed.

This spurred the speculations that estate duty may be abolished and coming from the Minister of Finance himself, this statement justifies these speculations.

In July 2015, the Davis Tax Committee released the First Interim Report on Estate Duty.<sup>82</sup> This report notes that estate duty only contributes to about 0,1% of total tax collections due to a decline in estate duty collections over the past 20 years, partly because of the 'generous allowances' in the South African estate duty system.<sup>83</sup> The report acknowledges the shortcomings of the present estate duty system and discusses a few options to overcome these shortfalls. The options are to repeal the *Estate Duty Act* completely (moving away from death as a taxable event), amending the *Estate Duty Act* to increase its efficiency or replacing the estate duty system with a new form of wealth taxation.<sup>84</sup>

Rather than moving away from estate duty as part of capital taxes (the others including donations tax and capital gains tax) and contrary to speculation or the statement of the Minister of Finance in 2011, it seems that the Davis Committee moved towards amending the *Estate Duty Act* to increase its efficiency.<sup>85</sup> Some of the recommendations

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<sup>79</sup> Jacobs 2012 *Tax Break Newsletter* 4.

<sup>80</sup> Jones 2008 *Personal Finance Newsletter* 3.

<sup>81</sup> South African Revenue Service *Budget 2010/2011 Tax Proposals* 25.

<sup>82</sup> The Davis Committee 2015 <http://www.taxcom.org.za/docs/>.

<sup>83</sup> The Davis Committee *First Interim Report on Estate Duty* 5.

<sup>84</sup> The Davis Committee *First Interim Report on Estate Duty* 6.

<sup>85</sup> The Davis Committee *First Interim Report on Estate Duty* 25 – 58.

the committee proposes is to repeal the provisions of Section 7 and 25B of the *Income Tax Act* in so far they apply to trusts resident in South Africa, and taxing trusts as a separate entity.<sup>86</sup> The reason for this is the fact that capital taxes can be avoided by transferring assets into a trust on an interest-free loan account.

In April 2016, the Davis Tax Committee released their Second and final report on Estate Duty. In the report, the Committee is of the opinion that the Section 4(q) abatement of the *Estate Duty Act* in respect of estate duty should be withdrawn and replaced with a primary abatement on the grounds that it discriminates against taxpayers who are not married.<sup>87</sup> Furthermore, they suggest that the primary rebate provided by Section 4A(1) of the *Estate Duty Act* be increased significantly, the Section 4A(2) roll-over between spouses be removed and the rate at which estate duty is levied be increased from 20% to 25% for estates exceeding R30 million.<sup>88</sup>

The basis on which the section 4(q) deduction in terms of the *Estate Duty Act* should be withdrawn and replaced with a single all-compassing primary rebate is twofold: first because of the privilege it provides to persons in any form of marital status, and second the disadvantage suffered by persons without marital status, such as single parents or families supported by relatives or friends.<sup>89</sup>

The Committee proposed in their First Interim Report that the rebate provided by section 4A(1) of the *Estate Duty Act* be increased from the current R3,5 million to R6 million by November 2015, and in the Second Interim Report that it be increased to as much as R7,5 million, taking into account their other recommendations.<sup>90</sup> Current low interest rates is recognized as one of the grounds on which this recommendation is made, and the fact that a middle class person's estate can easily exceed R3 million with a primary residence and a few personal effects.<sup>91</sup>

The second recommendation of the Committee is that the rebate provided by section 4A(1) of the *Estate Duty Act* be increased to 15 million, while simultaneously doing

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<sup>86</sup> The Davis Committee *First Interim Report on Estate Duty* 7.

<sup>87</sup> The Davis Committee *Second Interim Report on Estate Duty* 5.

<sup>88</sup> The Davis Committee *Second Interim Report on Estate Duty* 5.

<sup>89</sup> The Davis Committee *Second Interim Report on Estate Duty* 13 – 14.

<sup>90</sup> The Davis Committee *Second Interim Report on Estate Duty* 14 – 15.

<sup>91</sup> The Davis Committee *Second Interim Report on Estate Duty* 15.

away with the section 4A(2) rebate between spouses.<sup>92</sup> Furthermore, the report suggests introducing a progressive rate at which estate duty is levied, being 20% for estates with a net worth of more than R15 million and 25% for estates with a net worth of more than R30 million.<sup>93</sup> The proposed result will be that estate duty only be levied upon high net worth individuals, irrespective of their marital status, and that these individuals bear a larger burden in the interest of South Africa and its future.<sup>94</sup>

## **2.5 Double Taxation**

The occurrence of double taxation has been thoroughly discussed by various writers on an international level. To establish what exactly double taxation constitutes for the purposes of this study, this section considers some of these writers' definitions of double taxation from their perspectives and areas of application.

Baker<sup>95</sup> defines double taxation as follows in his discussion of the influence of double tax treaties on the economy between countries:

Double taxation is the levying of taxes on the same income (or capital) of the same taxpayer in the same period across two jurisdictions.

The occurrence of capital gains tax and estate duty under certain circumstances amounts to double taxation. Double taxation refers the fact that taxes are levied "on the same income (or capital)" on a deceased person's estate from two different starting points, one being a wealth tax, the other apparently an income tax.

In a study considering the possibility of double taxation occurring through property rates or taxes, Wells<sup>96</sup> provides a more general definition of double taxation:

...taxation at one and the same time on the same person or property, or taxation of the same property a second time in the same year - ...

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<sup>92</sup> The Davis Committee *Second Interim Report on Estate Duty* 17.

<sup>93</sup> The Davis Committee *Second Interim Report on Estate Duty* 17 – 18.

<sup>94</sup> The Davis Committee *Second Interim Report on Estate Duty* 18.

<sup>95</sup> Baker 2012 <http://www2.warwick.ac.uk/>.

<sup>96</sup> Wells *The Theory and Practice of Taxation* 438.

When the time at which these taxes are levied is considered with the possibility that capital gains tax and estate duty will be payable on a deceased estate in certain circumstances, the notion of double taxation seems to fit.

Saavedra<sup>97</sup> discusses double taxation with regard to the income of partnerships and concludes that double taxation is defined as follows:

Essentially, double taxation results where a second tax is imposed on something that is already subject to tax.

These definitions and the circumstances under which they were developed or applied can all be considered as a definition for application in this study as the principle on which they are based remains the same. However, are broad and therefore easily applicable to any remote occurrence of double taxation.

Judson<sup>98</sup> points out various different forms and types of double taxation in his discussion of double taxation in the United States. Double taxation in the legal sense, according to him, is when duplicate taxation of the same property right occurs.<sup>99</sup> His focus falls on the same federal and interstate taxes levied in duplication, albeit from a different level of the same governmental authority.

A more narrow approach to what constitutes double taxation can be found by Cooley<sup>100</sup>, who posits that four requirements must be met to constitute an occurrence of double taxation. These are that two separate taxes be levied (i) by the same country, (ii) for the same objective, (iii) within the same period of time (iv), while the object of both of the taxes (being the person or property in relation to which it is levied) must overlap or partially overlap.

Measuring estate duty and capital gains tax in South Africa against these requirements, the following is noteworthy: both of these taxes are levied by the South African Revenue Services in respect of wealth when a person dies and assets have to be transferred out of their deceased estate. These taxes overlap or at least partially

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<sup>97</sup> Saavedra 1981 *Chicago-Kent Law Review* 137.

<sup>98</sup> Judson 1915 *The Annals of the American Academy of Political and Social Science* 105 – 111.

<sup>99</sup> Judson 1915 *The Annals of the American Academy of Political and Social Science* 105.

<sup>100</sup> Cooley *The Law Of Taxation* 223.

overlap with capital gains tax paid out of the deceased estate, while the worth of the assets (on which the deceased possibly made a capital gain) is also taxed in the form of estate duty applicable to the whole estate as discussed above. This situation is summarised and summed up by Ramson as follows:<sup>101</sup>

Simply put, if X buys a holiday house in 2002 for R 500 000 and sells it in 2014 for R 1,5 million, assuming he is taxed at the highest income bracket and that all abatements are exhausted, the proceeds are R 1 million. He will pay CGT at 13,33% of R 1 million. He will then also be liable for estate duty at 20% of R 1,5 million. Therefore, he is taxed on the full amount for the transfer of wealth for estate duty purposes, and on the portion that constituted growth for CGT purposes. Ergo, effectively, he incurs tax twice for the portion of R 1 million. The issue lies in the fact that Estate Duty and CGT affect the same assets.<sup>102</sup>

Judson, with relation to ineffective taxing laws, states the following:<sup>103</sup>

The only remedy for double taxation of this kind in the state taxing laws is in the substitution of an effective taxing system for an ineffective one, thus recognising the fundamental principle in taxation that effectiveness, and not equality, should be the primary aim. As has been well said, an effective system of taxation which cannot be evaded will tend to bring about equality, while a tax levied without regard to effectiveness, though ostensibly equal, may result in the grossest kind of inequality.

Judson's opinion is justified in that the replacement of an ineffective taxing legislation with effective taxing legislation would bear more fruit than revising ineffective taxing legislation. Moreover, effective taxation legislation will bring about equal taxing principles.

Judson, in evaluating taxes levied on national and interstate level, comes to the following conclusion:<sup>104</sup>

Double taxation of the same property to the same owner, whether resulting from a disregard of interstate or international comity, is alike repugnant to economic justice, and is condemned by the universal law of mankind, the *jus gentium* of the civilians, which was said to be common to all nations, because resting on the nature of things, and the general sense of equity which obtains among all men.

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<sup>101</sup> Ramson *The interface between capital gains tax and estate duty and the double tax implications thereof* 25

<sup>102</sup> It should be noted that this calculation is based on the 2013/2014 year of assessment, and the 13.33% referred to, constitutes that effective capital gains tax rate for the year of assessment.

<sup>103</sup> Judson 1915 *The Annals of the American Academy of Political and Social Science* 107.

<sup>104</sup> Judson 1915 *The Annals of the American Academy of Political and Social Science* 111.

Roeleveld<sup>105</sup> considers excluding death as a capital gains tax event or the abolition of estate duty in South Africa, based on the fact that both these taxes are levied on the same assets, for which there is no basis.<sup>106</sup> Capital gains tax was introduced in 2001 in addition to the existing taxes on the transfer of wealth, being estate duty and donations tax.

The statement of the Minister of Finance in 2011 that the levying of capital gains tax and estate duty upon death is perceived as giving rise to double taxation,<sup>107</sup> provides further substance to Roeleveld's argument that there is no basis for levying both these taxes on the same assets.

Roeleveld states that with estate duty and capital gains tax payable on the death of a taxpayer with a taxable estate, the possibility exists that the family unit may be impoverished due to a lack of funds to pay these taxes. Assets would have to be sold to pay the taxes or mortgage loans acquired, which further burdens the family unit or beneficiary in the likely situation where no provision was made for these taxes.<sup>108</sup>

Further reference is made to the situation where the base cost of an asset, as discussed above, cannot be determined, with the effect that there is no base cost to be deducted from the proceeds and the whole of the proceeds is then taxed.<sup>109</sup> Capital gains tax then becomes a tax, like estate duty, on the transfer of wealth, since it is levied on the whole of the asset and not just the increase in its value, while estate duty is also levied on that same amount.

The current rates at which capital gains tax is levied is higher than the level accepted for a capital transfer tax internationally, which should not exceed 15%.<sup>110</sup> There is common ground that this should not be increased, as this will only give rise to schemes and arrangements to avoid the higher tax payable.<sup>111</sup> The same argument is valid for

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<sup>105</sup> Roeleveld 2012 *SAJAR* 143-162.

<sup>106</sup> Roeleveld 2012 *SAJAR* 144.

<sup>107</sup> South African Revenue Service *Budget 2010/2011 Tax Proposals* 25.

<sup>108</sup> Roeleveld 2012 *SAJAR* 150.

<sup>109</sup> Roeleveld 2012 *SAJAR* 150.

<sup>110</sup> Whalley 1974 *Economic Journal* 638.

<sup>111</sup> Roeleveld 2012 *SAJAR* 159; The Katz Committee *Fourth interim report of the commission of inquiry into certain aspects of the tax structure of South Africa – capital transfer tax*.

estate duty as it is currently levied along with capital gains tax, with the Davis Committee's proposal<sup>112</sup> to increase the rate for estates with a value of R30 million or greater to 25%.

Roeleveld refers to the Irish High Court case of *Daly v Revenue Commissioners*<sup>113</sup> in which the judge stated the following:

The objective of the impugned provision must be of sufficient importance to warrant overriding a constitutionally protected right. It must relate to concerns pressing and substantial in a free and democratic society. The means chosen must pass a proportionality test. They must:

- (a) be rationally connected to the objective and not be arbitrary, unfair or based on irrational considerations,
- (b) impair the right as little as possible, and
- (c) be such that their effects on rights are proportional to the objective.

The conclusion is then that although the Constitution of the Republic of South Africa<sup>114</sup> provides in Section 9 of the Bill of Rights that the State may take legislative or other measures to achieve equality, there is no justification or policy decision in retaining estate duty and capital gains tax. It is based on unfair and irrational considerations and can therefore not pass the proportionality test as set out in the abovementioned case. In conclusion, Roeleveld submits the following:<sup>115</sup>

It is submitted that estate duty should be abolished as capital gains tax legislation is far reaching and more beneficial to the *fiscus* in that it is imposed from the moment a scheme or estate plan is conceived in the form of a donation or sale to a beneficiary or trust and imposed again on any future disposals by the recipients of the wealth. Capital gains tax is also covered in most of the 70 double tax treaties entered into by South Africa and these have kept pace with radical changes in domestic legislation, in contrast to the very few and very old estate duty model double tax treaties.

It is apparent that the occurrence of double taxation is unwanted internationally. There should not be any double taxation. In South Africa no other conclusion can be entertained with regard to estate duty and capital gains tax both becoming applicable under certain circumstances. This practice is unwanted and should be remedied.

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<sup>112</sup> The Davis Committee *Second Interim Report on Estate Duty* 5.

<sup>113</sup> *Daly v Revenue Commissioners* (1995) IEHC 2; [1996] 1 ILRM 122.

<sup>114</sup> Constitution of the Republic of South Africa, 1996.

<sup>115</sup> Roeleveld 2012 *SAJAR* 161 – 162.



## 3 The tax consequences of the death of a person in Australia

### 3.1 Introduction and historic background

Australia is one of a few countries in the world that abolished inheritance taxes prior to or at the time of introducing capital gains tax. The basis for this decision is relevant for the purposes of this study and is subsequently examined.

Inheritance taxes were abolished in the whole of Australia in 1979.<sup>116</sup> Capital Gains Tax was introduced in Australia with effect from 1985 and applies to any taxable asset acquired on or after such date.<sup>117</sup> From 1979 up until the imposition of capital gains tax in 1985, no inheritance tax consequences in relation to the death of a citizen were imposed on Australian citizens.<sup>118</sup> Capital gains tax is considered part of income tax, although it is dealt with as a separate topic under the Australian tax regime.<sup>119</sup>

The reasons for abolition of Inheritance Taxes in Australia is said to be threefold: First, the taxes had a big effect on even modest estates since the rates and rebates were not altered much from their introductory period, unlike the ever present effects of inflation.<sup>120</sup> Second, the value of land soared while farming property still produced low returns, agitating the agricultural community<sup>121</sup> and owners of small businesses.<sup>122</sup> Last, estate taxes were easily negotiable by well-informed persons and were mainly collected from persons who died unexpectedly or who did not manage their affairs with skill.<sup>123</sup> Duff explains that the extent to which taxes was avoided, created public cynicism about it.<sup>124</sup>

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<sup>116</sup> Gans and Leigh 2006 *Topics in Economic Analysis and Policy* 1.

<sup>117</sup> Australian Tax Office 2016 <https://www.ato.gov.au/General/Capital-gains-tax/>.

<sup>118</sup> Gans and Leigh 2006 *Topics in Economic Analysis & Policy* 3.

<sup>119</sup> Australian Tax Office <https://www.ato.gov.au/General/Capital-gains-tax/> 2016.

<sup>120</sup> Gilding *Abolition of Death Duties in Australia: A Comparative Perspective* 2; Pedrick 1981 *Tax Law* 35(1): 113-141.

<sup>121</sup> Pedrick 1981 *Tax Law* 35(1): 113-141.

<sup>122</sup> Thomson 1972 *The Australian Quarterly* 24.

<sup>123</sup> Basson *The Implications of Wealth Transfer Taxation in the Absence of Estate Duty* 38; Pedrick 1981 *Tax Law* 35(1): 113-141.

<sup>124</sup> Duff 2005 *Pittsburgh Tax Review* 109.

In 1976, the State of Queensland first exempted inter-spousal transfers from gift and death duties, and soon thereafter the Premier of the State of Queensland followed up on this decision with a total abolition of death duties and gift duties under the *Queensland Succession and Gift Duties Abolition Act, 1976, No. 93*, which came to force in 1977 in the State of Queensland.<sup>125</sup> The farming community in the state breathed a sigh of relief, as concerns were raised previously about the impact of death taxes on family farms.<sup>126</sup>

Five other Australian states soon followed suit since they regarded this bold move by Queensland as a threat to their competitive position. It created the possibility of losing capital to the state of Queensland through investment there, or citizens even becoming domiciled there.<sup>127</sup> Soon this decision was taken at a Federal level to include the whole of Australia, and by 1980 no more death or gift taxes were payable by an Australian citizen.<sup>128</sup>

Concern was raised about the fact that no tax on capital would be in position should death taxes be abolished in totality as no other arrangements were in place. However, the Government admitted that the Australian system of capital transfer taxation was in a terrible state due to taxes being raised at state and federal level at different rates. As a result, exemptions had been inadequately adjusted to provide for inflation and the possibility of still being able to avoid taxes.<sup>129</sup>

The abolition of death taxes was regarded as a decision made without proper consideration, and was anticipated to return to Australia in later years. There has, however, not been any sign that it would return, although it was under discussion.<sup>130</sup>

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<sup>125</sup> Queensland Succession Duties Acts Amendment Act, 1975 (amending Queensland Succession Duty Act of 1892), [1980] Austl. Est. and Gift Duty Rep. (CCH) 1 15,037.

<sup>126</sup> Pedrick 1981 *Tax Law* 35(1): 113-141.

<sup>127</sup> Pedrick 1981 *Tax Law* 35(1): 113-141.

<sup>128</sup> Duff 2005 *Pittsburgh Tax Review* 111.

<sup>129</sup> Basson *The Implications of Wealth Transfer Taxation in the Absence of Estate Duty* 38.

<sup>130</sup> Gilding *Abolition of Death Duties in Australia* 5.

### 3.2 Capital gains tax provisions of Australia

The Capital Gains Tax provisions in Australia are found in Sections 100-1 to 152-425 of the *Income Tax Assessment Act 1997*.<sup>131</sup> A person's net capital gain is included in their assessable income for the tax year, should there be any net capital gain.<sup>132</sup> The steps in calculating the capital gain can be set out as follows:<sup>133</sup>

- 1) Reduce the capital gains during the income year with the capital losses (if any) during that year;
- 2) Apply any previously unapplied capital losses from earlier income years to reduce the amounts remaining after the first step;
- 3) Reduce the remaining capital gains by the discount percentage;
- 4) Apply any small business concessions that may be applicable to any capital gains;
- 5) Add up the remaining amounts of capital gains after step 4, which is then the net capital gain for the income year.

Income tax in Australia, like in South Africa, is levied at a progressive rate with its own rebates and exclusions. However, for the purpose of this study, only the rates at which it is levied receives attention since it is relevant to capital gains tax. The rates at which income tax is levied in Australia, is set out in the table below:<sup>134</sup>

**Table 3-1: Rates at which income tax is levied in Australia**

<b>Taxable income</b>	<b>Tax on this income</b>
\$0 - \$18 200	Nil
\$18 201 - \$37 000	19c for each \$1 over \$18 200
\$37 001 - \$80 000	\$3 572 plus 32.5c for every \$1 over \$37 000

<sup>131</sup> <https://www.ato.gov.au/law/#Law/browse/Mode> (hereafter the *Income Tax Assessment Act*).

<sup>132</sup> s 102-5 *Income Tax Assessment Act 1997*.

<sup>133</sup> As set out in s 102-5(1) *Income Tax Assessment Act 1997*.

<sup>134</sup> Australian Tax Office *Individual Income Tax Rates* <https://www.ato.gov.au/rates/individual-income-tax-rates/>; applicable from 1 July 2016.

\$80 001 - \$180 000	\$17 547 plus 37c for every \$1 over \$80 000
\$180 001 +	\$54 547 plus 45c for every \$1 over \$180 000

A capital gain tax asset is described as any kind of property or a legal and equitable right that is not property.<sup>135</sup> This includes part of, or an interest in, an asset, goodwill or an interest in it, an interest in an asset of a partnership, or an interest in a partnership that is not covered by the previous section.<sup>136</sup> The definition of what a capital gains tax asset is seems to be wide, but examples of these provisions are also supplied and include land and buildings, shares in a company and units in a unit trust, options, debts owed to a person, a right to enforce a contractual obligation, and foreign currency.<sup>137</sup>

Various events are set out that give rise to Capital Gains Tax consequences, with the most common of these events being the disposal of an asset: should the proceeds of the disposal exceed its base cost, a capital gain will arise, while in the event that the proceeds do not exceed the base cost thereof, a capital loss will arise.<sup>138</sup> Disposal is defined in the *Income Tax Assessment Act* as follows:<sup>139</sup>

You *dispose of* a \*CGT asset if a change of ownership occurs from you to another entity, whether because of some act or event or by operation of law. However, a change of ownership does not occur if you stop being the legal owner of the asset but continue to be its beneficial owner.

The time of the disposal event is when you enter into the contract for the disposal, or in the instance that there is no contract, when the change of ownership occurs.<sup>140</sup>

The general rule on the levying of capitals gains tax is that a disposal of an asset will constitute a capital gain or loss. This is subject to the special rule that in the instance of an asset disposed of by a deceased person directly to a beneficiary or to his legal personal representative is disregarded, up until the beneficiary disposes of the asset

<sup>135</sup> S 108-5(1) *Income Tax Assessment Act* 1997.

<sup>136</sup> S 108-5(2) *Income Tax Assessment Act* 1997.

<sup>137</sup> Note 1 to S 108-5 *Income Tax Assessment Act* 1997.

<sup>138</sup> S 104-5 *Income Tax Assessment Act* 1997.

<sup>139</sup> S 104-10(2) *Income Tax Assessment Act* 1997;  
<https://www.ato.gov.au/law/view/document?DocID=PAC%2F19970038%2F104-10&PiT=99991231235958>.

<sup>140</sup> S 104-10(3) *Income Tax Assessment Act* 1997.

after receiving transfer thereof.<sup>141</sup> At the death of a taxpayer, his assets pass directly to a beneficiary or pass directly to his legal representative (executor), who may dispose of the assets or pass them on to a beneficiary.<sup>142</sup> In the case that there is no will, an administrator is appointed to wind up the estate of the deceased. The administrator may dispose of any or all of the assets, or pass them to a beneficiary.<sup>143</sup>

Certain exceptions apply to the event of a capital gain or loss. If a person acquired the asset before 20 September 1985, a capital gain or loss may be disregarded when calculating the capital gain or loss in the income year.<sup>144</sup> The person will be deemed to have disposed of such an asset at market value on the date of death of that person, with the result that the beneficiary who receives ownership of the asset does so at a higher base cost.<sup>145</sup> This is different from the South African capital gains tax regime in that the legislation is not applicable retrospectively.

Should a deceased person dispose of an asset to a tax-advantaged entity (such as a charity), a trustee of a complying superannuation entity or a foreign resident, the capital gain or loss will be taken into account in the deceased's final income year.<sup>146</sup> In this case, the time of the disposal is perceived as the moment before passing away.<sup>147</sup> This provision has one exception, namely that if the deceased acquired the asset before 20 September 1985, the capital gain will be disregarded.<sup>148</sup>

Furthermore, a natural person or trust may reduce their capital gain by 50% in the instance that the asset was acquired more than 12 months prior to its disposal.<sup>149</sup> Should the natural person or trust dispose of the asset within 12 months, this 'discount

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<sup>141</sup> Van Jaarsveld J *The Levying of Capital Gains Tax At Death* 26.

<sup>142</sup> Kruger *Everything you ever need to know about capital gains tax – episode 4* <http://www.thetaxwiseblog.com/%20blog/about-capital-gains-tax-episode-4/>.

<sup>143</sup> Van Jaarsveld J *The Levying of Capital Gains Tax At Death* 26.

<sup>144</sup> S 104-15(4) *Income Tax Assessment Act* 1997.

<sup>145</sup> S 128-15 *Income Tax Assessment Act* 1997.

<sup>146</sup> S 104-215(1) *Income Tax Assessment Act* 1997.

<sup>147</sup> S 104-215(3) *Income Tax Assessment Act* 1997.

<sup>148</sup> S 104-215(5) *Income Tax Assessment Act* 1997.

<sup>149</sup> Australian Tax Office 2016 *Working out your capital gain* <https://www.ato.gov.au/General/Capital-gains-tax/Working-out-your-capital-gain-or-loss/Working-out-your-capital-gain/>.

rate', as it is known, is not applicable, and the full net capital gain of that asset is taxable.<sup>150</sup>

Another method of calculating the base cost of the asset, called the 'indexation method', can be used for assets acquired after 20 September 1985 and before 20 September 1999, while the disposal happened after 20 September 1999.<sup>151</sup> Again, the prerequisite of having acquired the asset of at least 12 months before the disposal or capital gain event must be fulfilled to use this method.<sup>152</sup> Under the indexation method, the amount of the cost base, rather than the costs of owning the element, is increased using the Consumer Price Index (CPI) factor for the quarter ending 30 September 1999, which is 68,7.<sup>153</sup>

The principle rule remains that capital gains tax will only be payable in the instance that it is disposed of to a foreign entity or tax-advantaged entity within Australia.<sup>154</sup> Any capital gains tax is deferred until the beneficiary disposes of the asset, and should the beneficiary decide not to dispose of the asset, the rollover will again apply on his or her death.<sup>155</sup> The Australian tax regime is therefore similar to that of South Africa on the face of things, but the deferral that is provided for in the Australian capital gains tax provisions should be taken into account when the two countries are compared.<sup>156</sup>

### **3.3 Conclusion**

In conclusion, capital gains tax will only be levied at the rate at which a person is taxed according to their income in the instance that a deceased person acquired an asset after 20 September 1985 that was bequeathed to a tax-advantaged entity in the final

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<sup>150</sup> S 128-15 *Income Tax Assessment Act* 1997.

<sup>151</sup> S 128-15 *Income Tax Assessment Act* 1997; Australian Tax Office *The indexation method of calculating your capital gain* <https://www.ato.gov.au/General/Capital-gains-tax/In-detail/Calculating-a-capital-gain-or-loss/The-indexation-method-of-calculating-your-capital-gain/>.

<sup>152</sup> Australian Tax Office 2016 *The indexation method of calculating your capital gain* <https://www.ato.gov.au/General/Capital-gains-tax/In-detail/Calculating-a-capital-gain-or-loss/The-indexation-method-of-calculating-your-capital-gain/>.

<sup>153</sup> Australian Tax Office 2015 *The indexation method of calculating your capital gain* <https://www.ato.gov.au/General/Capital-gains-tax/In-detail/Calculating-a-capital-gain-or-loss/The-indexation-method-of-calculating-your-capital-gain/>.

<sup>154</sup> Roeleveld 2012 *SAJAR* 160.

<sup>155</sup> Kinsler 1997 *Pacific Rim Law and Policy Journal* 323.

<sup>156</sup> Van Jaarsveld J *The Levying of Capital Gains Tax At Death* 27.

income year of the deceased, or if the asset was transferred to a resident beneficiary in the instance that the beneficiary sells the asset.

Should the person or deceased estate have acquired the asset more than 12 months prior to the disposal, they are entitled to reduce their capital gain by the discount rate of 50%. In the event that it was acquired after 20 September 1985 and before 20 September 1999, they can make use of the Indexation method to determine their base cost, should they meet the requirements for doing so. This will effectively raise the base cost of the asset, reducing the capital gain on the asset. The highest effective rate at which capital gains tax is levied in Australia is 22.5% (50% of 45%).

This effective rate is much higher compared to the highest effective rate of capital gains tax, being in the region of 13.65% (33.3% of 41%) in South Africa. Taking into account estate duty, the effective rate at which capital transfers on death is then taxed is upwards of 20%,<sup>157</sup> being contrary to the determination that capital transfer taxes should not exceed 15%.<sup>158</sup> Although the Australian capital gains tax position also differs from this international practice, the circumstances under which it applies is much more favourable.<sup>159</sup> The occurrence of double taxation is also excluded because no other capital transfer tax are applicable in Australia.

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<sup>157</sup> With the allowable deductions with regard to estate duty varying between estates, it is difficult to calculate an exact percentage. However, should the effective tax rate as calculated under *5.2.1 Estate duty* on page 35 be used, being 10,54%, this will amount to an effective wealth tax of 24,19%.

<sup>158</sup> Whalley 1974 *Economic Journal* 638.

<sup>159</sup> See *5.3 Tax consequences in Australia* on page 38.

## **4 The tax consequences following a natural person's death in Canada**

### ***4.1 Introduction and historical background***

Canada abolished estate taxes simultaneously with the introduction of capital gains taxes for reasons similar to that of Australia, reasons to which South Africa can possibly relate. The developments with regard to estate taxes and capital gains tax under Canadian tax law are therefore summarized for purposes of this study.

Estate taxes were levied on both a provincial and a federal level up until its abolishment in 1972, while certain abatements were available to citizens of the specific province of Canada within which they were domiciled.<sup>160</sup> 'Economic competition' between several of the provinces and the way in which they provided an abatement on the estate taxes levied by them against the estate taxes levied at a federal level soon caused turmoil regarding abatements provided by provinces in respect of the estate taxes levied by the federal government, while certain provinces even opted to abate as much as 75% of the federal estate taxes.<sup>161</sup>

Capital gains tax was introduced simultaneously with the effective abolition of federal estate taxes in Canada in 1972.<sup>162</sup> The federal government provided three reasons for this decision in 1971, the first of these being the abatement provided in respect of estate taxes at a provincial level in certain of the prairie provinces of Canada.<sup>163</sup> Much like in Australia, farming communities in the prairie provinces pressured the provincial governments into repaying the estate taxes levied by the federal government due to the costs of this on disposition of their farms.<sup>164</sup>

The second reason for this decision was the low revenues received by the federal government from estate taxes.<sup>165</sup> The abatements provided by the provinces took most

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<sup>160</sup> Bird 1978 *Osgoode Hall Law Journal* 135-136.

<sup>161</sup> Maloney 1988 *Ottawa Law Review* 605; Bird 1978 *Osgoode Hall Law Journal* 135-137.

<sup>162</sup> Bird *et al The Tax System in Industrialized Countries, Canada* 57.

<sup>163</sup> Bird 1978 *Osgoode Hall Law Journal* 137.

<sup>164</sup> Maloney 1988 *Ottawa Law Review* 605.

<sup>165</sup> Bird 1978 *Osgoode Hall Law Journal* 137.

of the federal government's cut out of the collected estate taxes, while their revenue increasingly diminished.<sup>166</sup>

The third and most important reason was to avoid a substantial tax impact arising on the death of a taxpayer due to the newly introduced capital gains tax on death.<sup>167</sup> The abolished death tax, as a direct wealth tax, can therefore be regarded as a wealth tax imposed indirectly through capital gains tax.<sup>168</sup> Estate taxes were still levied in some of Canada's provinces up until 1985 when Quebec was the last province to abandon estate taxes.<sup>169</sup>

Although the possibility of reinstating some sort of inheritance tax was considered by Canada's various tax review committees during 1970–1980, the argument against double taxation by levying an inheritance tax in addition to capital gains tax in Canada was extremely strong, taking into account the capital gains taxes levied by the Canadian government and estate taxes levied by the United States of America on properties owned by Canadian citizens within the United States of America due to the lack of double tax treaties.<sup>170</sup>

#### **4.2 Capital gains tax provisions in Canada**

Capital gains tax is levied, as in South Africa, by Canada's *Income Tax Act*.<sup>171</sup> The deceased is deemed to have, immediately before their death, disposed of all capital assets at a value equal to fair market value of the asset on death.<sup>172</sup> The party acquiring the asset is deemed to have done so at the fair market value at which it was disposed of in the deceased's estate.<sup>173</sup> The taxable capital gain is calculated by deducting the adjusted cost base plus allowable expenses from the proceeds, and thereafter

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<sup>166</sup> Maloney 1988 *Ottawa Law Review* 605.

<sup>167</sup> Benson *Summary of 1971 Tax Reform Legislation* 30.

<sup>168</sup> Bird *et al The Tax System in Industrialized Countries, Canada* 57.

<sup>169</sup> Van Jaarsveld *The Levying of Capital Gains Tax At Death* 23.

<sup>170</sup> Goodman 1995 *Canadian Tax Journal* 1366 – 1371.

<sup>171</sup> *Income Tax Act* R.S.C., 1985, c. 1(5<sup>th</sup> Supp.).

<sup>172</sup> s 70(5)(a) of the *Income Tax Act* (R.S.C., 1985, c. 1(5<sup>th</sup> Supp.)).

<sup>173</sup> s 70(5)(b) of the *Income Tax Act* (R.S.C., 1985, c. 1(5<sup>th</sup> Supp.)).

multiplying the capital gain by 50%, as only 50% of the capital gain is taxed at the progressive income tax rates.<sup>174</sup>

The rates at which income tax is levied for the 2016 year of assessment, is the following:<sup>175</sup>

**Table 4-1: Rates at which income tax is levied in Canada**

<b>Taxable income</b>	<b>Tax on this income</b>
\$0 - \$45 281	Nil
\$45 282 - \$90 562	20,5%
\$90 563 - \$140 387	26%
\$140 388 - \$199 999	29%
\$200 000 +	33%

Should a deceased person have made a capital loss, the capital loss may be deducted from any capital gains in the year of death, or carried back to any of the three years prior to death to reduce any capital gain made in that year, or it can be applied to reduce other taxable income in the year of death of the taxpayer.<sup>176</sup> As with capital gains, the inclusion rate of a capital loss is 50%.<sup>177</sup>

A capital gain made on personal use property, such as furniture, cars and boats can be regarded as exempt from capital gains tax as such a disposal would not trigger any capital gains tax consequences due to personal use assets usually decreasing in value.<sup>178</sup> Similarly, the disposal of a primary residence by the taxpayer or deceased

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<sup>174</sup> Di Verdi 2014 <http://www.moneysense.ca/save/taxes/capital-gains-explained/>.  
<sup>175</sup> Canadian Revenue Agency 2016 "Indexation adjustment for personal income tax and benefit amounts" <http://www.cra-arc.gc.ca/nwsrm/fctshts/2015/m12/fs151208-eng.html>.  
<sup>176</sup> s 38(b) of the Income Tax Act (R.S.C., 1985, c. 1(5<sup>th</sup> Supp.)); Canada Revenue Agency "Net capital losses in the year of death" <http://www.cra-arc.gc.ca/tx/ndvdl/lf-vnts/dth/nt/nt-eng.html>.  
<sup>177</sup> s 38(b) of the Income Tax Act (R.S.C., 1985, c. 1(5<sup>th</sup> Supp.)).  
<sup>178</sup> Canada Revenue Agency "Capital Gains – 2015" <http://www.cra-arc.gc.ca/E/pub/tg/t4037/t4037-e.html#Whatisthe>.

estate would not trigger any capital gains tax as it is, subject to certain provisions, exempt from capital gains tax.<sup>179</sup>

Furthermore, profits made from registered education savings plans, registered retirement income funds and registered retirement savings plans are in certain circumstances exempt from capital gains tax, although these are included in the income tax assessment of its beneficiary.<sup>180</sup> Any property disposed of by way of a charitable gift via a donation or by bequest in a will, may be, where supported by the necessary documentation, claimed to the lowest of the value of the gift or 100% of the deceased net income.<sup>181</sup>

Few allowable deductions in relation to capital gains tax exist under the Canadian capital gains tax regime. The only allowable deductions, referred to as lifetime capital gains exemptions, are found where a capital gain is made from dispositions on farming or fishing property, or dispositions of qualified small business corporation shares.<sup>182</sup>

This lifetime capital gains exemption is fixed at \$824 176, with an additional exemption amount of \$175 824 for qualified farm or fishing property, while 50% of this exemption is allowed as a deduction to capital gains on the asset due to the inclusion rate being 50%.<sup>183</sup> The effective exemption in relation to farm property is therefore \$1 000 000 of the capital gain made thereupon, while the allowable deduction, being 50% of the exemption, is \$500 000 on the taxable 50% of the capital gain.

Provision is made for a rollover in capital gains tax similar to that found under the South African tax regime. In the instance that an asset is transferred from the taxpayer or the deceased's estate to the spouse, surviving spouse or a trust established for the sole benefit of a spouse or surviving spouse, the capital gain is deferred up until the date

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<sup>179</sup> Canada Revenue Agency 2015 "Capital Gains – 2015" <http://www.cra-arc.gc.ca/E/pub/tg/t4037/t4037-e.html#Whatisthe>.

<sup>180</sup> Grant Thornton "Death and your RRSP" <http://www.taxplanningguide.ca/tax-planning-guide/section-2-individuals/death-rrsp/>.

<sup>181</sup> Canada Revenue Agency 2106 "How are gifts claimed for deceased individuals?" <http://www.cra-arc.gc.ca/chrts-gvng/dnrs/svngs/clmng3-eng.html>.

<sup>182</sup> Canada Revenue Agency 2015 "Capital Gains – 2015" <http://www.cra-arc.gc.ca/E/pub/tg/t4037/t4037-e.html#Whatisthe>.

<sup>183</sup> Canadian Revenue Agency 2016 "Indexation adjustment for personal income tax and benefit amounts" <http://www.cra-arc.gc.ca/nwsrm/fctshts/2015/m12/fs151208-eng.html>.

that such a person disposes of the asset while retaining the base cost of the asset when acquired by the donator or deceased, unless the executor of the deceased's estate elects that the rollover will not apply.<sup>184</sup>

### **4.3 Conclusion**

Capital gains tax would therefore be applicable to all capital assets deemed to be disposed of prior to the death of a taxpayer, excluding personal use assets or a primary residence and the possible deductions in relation to farm or fishing property or qualified small business corporation shares, at an inclusion rate of 50% for both capital gains and capital losses.

Any capital losses accrued in the year of death of a taxpayer may be deducted from capital gains in the year of death or three years prior thereto. Although capital gains tax levied in Canada differ marginally from that of South Africa, heirs (excluding spouses) acquire the assets at a tax cost equal to market value, which amounts to the same as the capital gains tax currently levied in South Africa.<sup>185</sup>

The highest effective rate of capital gains tax would be 16.5% (33% of 50%) in Canada compared to the highest effective rate of capital gains tax being in the region of 13,65% (33,3% of 41%) in South Africa, which is levied in addition to estate duty at 20% of the dutiable amount.<sup>186</sup>

Although the effective rate of capital gains tax is lower in South Africa than Canada, it again depends on the specifics of the particular estate. The effective rate at which it is then taxed, is upwards of 20%,<sup>187</sup> being contrary to the determination that capital transfer taxes should not exceed 15%.<sup>188</sup> Again, the Canadian position with regard to capital transfer taxes proves more favourable than the South African position.<sup>189</sup> As capital gains tax is the only capital transfer tax in Canada, there is no possibility of double taxation as with South Africa.

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<sup>184</sup> s 73(1) of the Income Tax Act (R.S.C., 1985, c. 1(5<sup>th</sup> Supp.)).

<sup>185</sup> Roeleveld 2012 *SAJAR* 160.

<sup>186</sup> See *Table 2-1: Calculating the dutiable amount of estate duty* above.

<sup>187</sup> See footnote 157 above.

<sup>188</sup> Whalley 1974 *Economic Journal* 638.

<sup>189</sup> See *5.4 Tax consequences in Canada* on page 39 below.

## **5 Illustration of the different outcomes of Capital Gains Tax consequences on the death of a natural person**

The following example can be used to illustrate the capital gains tax consequences of a natural person's death in South Africa, Australia and Canada as discussed in Chapters 2 to 4. For purposes of this study, the values of the properties and earnings in the example are adjusted to the respective currency of the relevant country for both of the countries' scenario. An exchange rate of \$10/R1 applies, which is in line to the current exchange rate. This brings the effect of the taxes in line with a South African perspective. Accept that the deceased was taxed at the maximum nominal rate in each of the countries.

### ***5.1 Example of the possible composition of an Estate***

Suppose a natural person, X, dies at the age of 60 during the 2016 year of assessment. X was a major male businessperson married out of community of property. The executor of his estate discovers the following assets while tending to the administration the estate:

- (i) A primary residence with a fair market value of R3 million (acquired in 2002 for an amount of R900 000);
- (ii) A motor vehicle used for personal transportation with a fair market value of R400 000 (acquired in 2014 for an amount of R500 000);
- (iii) Furniture and other household items to the value of R400 000;
- (iv) A farming property (no 1) with a fair market value of R8 million (acquired during 2005 for an amount of R3,5 million);
- (v) A second farming property (no 2) with a fair market value of R6 million (acquired in December 2015 for an amount of R3 million);
- (vi) A vacation property with a fair market value of R800 000 (acquired in 2010 for an amount of R1,7 million)

The two farming properties were not used for *bona fide* farming purposes. The deceased had a valid will at the time of death. According to the will of the deceased, there are two beneficiaries: the surviving spouse aged 56 and their only son, aged 30. The will of the deceased stipulates that his assets are to be bequeathed as follows:

- (a) The primary residence to the surviving spouse;
- (b) The furniture and other household items of the deceased to the surviving spouse;
- (c) The vacation property to a specified registered public charity organization;
- (d) The remainder of his estate, to his son.

The deceased had liabilities to the value of R4 million, while funeral expenses amounted to R10 000. Other expenses of the estate include administration costs of R10 000, and valuation costs of R80 000. The son of the deceased decided to sell the second farming property immediately after it was transferred to him for the price of R6,5 million or \$650 000. The son is also taxed at the highest marginal rate for income tax purposes.

## ***5.2 Tax consequences on death in South Africa***

First, the possible estate duty is discussed, after which capital gains or losses and the liability of capital gains tax receive attention.

### *5.2.1 Estate duty*

As discussed in Chapter 2, the gross worth of the estate must first be determined.<sup>190</sup> The gross worth of the estate amounts to R18,6 million, being the sum of all the assets and deemed assets. In terms of Section 4 of the *Estate Duty Act*, the liabilities and expenses of the estate, bequests made to the surviving spouse and bequests made to public welfare organizations should be deducted from the gross worth of the estate to determine the net worth. The net worth of the estate is therefore R10,3 million (R18,6 million – R4 million – R3 million – R400 000 – R800 000 – R100 000).

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<sup>190</sup> See *Table 5-1: Dutiable amount of estate* below.

Next, the primary deduction in terms of section 4A of the *Estate Duty Act* to the value of R3,5 million should be deducted from the net worth of the estate to determine the taxable amount of the estate. The taxable amount is therefore R6,8 million, which is taxed at a flat rate of 20%. These calculations and figures can be set out as follows:

**Table 5-1: Dutiable amount of estate**

Description	Amount
Value of property	R 18 600 000.00
ADD: Value of property deemed as property	R 0
<b>GROSS VALUE OF THE ESTATE</b>	<b>R 18 600 000.00</b>
SUBTRACT: Allowable deductions (S 4 of the Act)	R 8 300 000.00
<b>NET VALUE OF THE ESTATE</b>	<b>R 10 300 000.00</b>
SUBTRACT: Section 4A reduction	R 3 500 000.00
<b>DUTIABLE AMOUNT</b>	<b>R 6 800 000.00</b>
ESTATE DUTY PAYABLE (DUTIABLE AMOUNT x 20%)	R 1 360 000.00

The total amount payable by the estate in respect of estate duty is therefore R1,36 million, which would constitute an effective estate duty rate of 7.31% (based on the gross value of the estate). This effective rate is greatly reduced by the bequests made to the surviving spouse and specified registered public charity organisation, and it is submitted that in absence of these bequests the effective rate would be greater than 11.5%.

### 5.2.2 Capital gains tax consequences

The net capital gain or loss, using the calculations and provisions of the Eighth Schedule to the *Income Tax Act* in respect of each asset, must be calculated. This is done by deducting the base cost, being the purchase price of the assets in this case, from their fair market value.<sup>191</sup> It should then be established if any allowable deductions, exclusions or rollovers are applicable.

<sup>191</sup> Abrie *et al Bestorwe Boedels* 259.

With regard to the primary residence of the deceased, the capital gain would amount to R2,1 million. The primary residence exclusion of R2 million is applicable,<sup>192</sup> and therefore the only capital gain that may be taken into account is R100 000. However, no capital gains tax is levied to transfers made to the surviving spouse due to the rollover provision,<sup>193</sup> and therefore the capital gain on the house is excluded.

Personal use assets are exempt from capital gains tax.<sup>194</sup> The motor vehicle of the deceased and the furniture and household items are therefore excluded in calculating capital gains or losses.

The capital gain on the first farming property amounts to R4,5 million (R8million – R3,5 million), while the capital gain on the second farming property is R3 million (R6 million – R3 million). In respect of the vacation property, a capital loss in the amount of R900 000 is noted (R800 000 – R1,7 million).

The net capital gain of the deceased therefore amounts to R6,6 million (R4,5 million + R3 million – R900 000), to which a further deduction is allowed in the amount of R300 000,<sup>195</sup> with the net taxable capital gains being R6,3 million.

The inclusion rate for natural persons is set at 33,3%.<sup>196</sup> The taxable amount is therefore R2,1 million, taxed at the maximum nominal income tax rate of 41%. The total amount in respect of capital gains tax payable is therefore R861 000. The effective capital gains tax rate levied, in respect of the taxable amount, is 13.36%.

In addition to being liable for the amount of R1,36 million as estate duty, the estate will also be liable for capital gains tax in the amount of R861 000. This brings the total liability owed in respect of wealth taxes to R2 221 000. Calculated against the taxable amount of the estate with regard to estate duty, this amounts to 32.66% in respect of

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<sup>192</sup> Paragraphs 44 to 61 of the Eighth Schedule to the *Income Tax Act* 58 of 1962.

<sup>193</sup> Paragraph 67 of the Eighth Schedule to the *Income Tax Act* 58 of 1962.

<sup>194</sup> Paragraph 53 of the Eighth Schedule to the *Income Tax Act* 58 of 1962.

<sup>195</sup> Paragraph 5 of the Eighth Schedule to the *Income Tax Act* 58 of 1962.

<sup>196</sup> SARS 2016 Inclusion Rates <http://www.sars.gov.za/TaxTypes/CGT/Proceeds/Calc-Tax-Capital/Pages/Inclusion-rate.aspx>

wealth taxes or indirect wealth taxes. Consequently, the individual is taxed a second time on the growth of the assets with capital gains tax, in addition to estate duty.<sup>197</sup>

### **5.3 Tax consequences in Australia**

As discussed in Chapter 3, the only tax liability arising with regard to property on the death of an Australian resident would be capital gains tax, and only in the event that a beneficiary disposes of the asset or it is sold to a tax-advantaged entity.<sup>198</sup> The consequences are explained with application of the currency provided above being \$1/R10.

No capital gains tax is payable on any of the bequests made to the surviving spouse, or the registered public charity organization. No capital gains tax consequences arise for the son of the deceased, except for the property that he decided to sell.

The second farming property is obtained by the beneficiary, the son, at a value equal to the market value of the asset at the on the date it was deemed disposed of by the deceased,<sup>199</sup> in this instance being \$600 000. It was, however, sold for a value of \$650 000, which constitutes a capital gain of \$50 000.

To qualify for the 50% discount on a capital gain, the asset must have been disposed of 12 months after the date of acquiring the property.<sup>200</sup> The whole of the capital gain will therefore be taxable, with the result that the son will pay an amount of 45c on each \$1 received,<sup>201</sup> and would accordingly have a tax liability in the amount of \$22 500 as capital gains taxes. Converted back to South African currency, this liability would be in the amount of R225 000.

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<sup>197</sup> Ger 2012 *Time for estate duty to go?* <http://www.derebus.org.za/time-estate-duty-go/>.

<sup>198</sup> Van Jaarsveld *The Levying of Capital Gains Tax At Death* 25; S 128-15 *Income Tax Assessment Act* 1997.

<sup>199</sup> S 128-15 *Income Tax Assessment Act* 1997.

<sup>200</sup> S 128-15 *Income Tax Assessment Act* 1997.

<sup>201</sup> Australian Tax Office 2016 *Individual Income Tax Rates* <https://www.ato.gov.au/rates/individual-income-tax-rates/>; applicable from 1 July 2016.

## **5.4 Tax consequences in Canada**

Capital gains tax is applicable to all disposals or deemed disposals of capital assets in which a capital gain is recorded.<sup>202</sup> Personal use assets are excluded from capital gains tax provisions,<sup>203</sup> and consequently the motor vehicle of the deceased and the furniture and other household items are excluded from capital gains tax.

The primary residence is excluded for two reasons. The first is that provision is made for a rollover, and all capital gains on bequests to the surviving spouse is deferred until the surviving spouse disposes thereof, unless the surviving spouse or executor of the estate elects that the rollover will not apply.<sup>204</sup>

Would the election have been made to not have the rollover apply, the possible capital gain would have been \$210 000, of which 50% is taxable according to the inclusion rates. With the maximum rate of tax levied at 33% on the taxable \$105 000, the tax liability would be \$34 650 on the asset. However, a primary residence is, subject to conditions, exempt from capital gains tax,<sup>205</sup> and accordingly the surviving spouse will still have no capital gains tax liability, even if she chose not have the rollover apply.

The vacation property bequeathed to the registered public charity organization has no capital gains tax implications. It does, however, provide a deduction to the deceased's estate, which may be claimed against the capital gain made to the lowest value of the gift itself or 100% of the income tax for the year of assessment.<sup>206</sup> The lowest amount of \$70 000 or 100% of his income tax liability can therefore be claimed against the final return of the deceased. 50% of the capital loss (being \$45 000) may also be claimed against the capital gains of the deceased estate, or if there should be no capital gains in the final year of assessment, in up to three previous years of assessment.<sup>207</sup>

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<sup>202</sup> s 70(5)(a) of the Income Tax Act (R.S.C., 1985, c. 1(5<sup>th</sup> Supp.)).

<sup>203</sup> Canada Revenue Agency 2015 <http://www.cra-arc.gc.ca/E/pub/tg/t4037/t4037-e.html#Whatisthe>.

<sup>204</sup> s 73(1) of the Income Tax Act (R.S.C., 1985, c. 1(5<sup>th</sup> Supp.)).

<sup>205</sup> Canada Revenue Agency 2015 <http://www.cra-arc.gc.ca/E/pub/tg/t4037/t4037-e.html#Whatisthe>.

<sup>206</sup> Canada Revenue Agency 2015 "How are charitable gifts claimed for deceased persons" <http://www.cra-arc.gc.ca/chrts-gvng/dnrs/svngs/clmng3-eng.html>

<sup>207</sup> s 38(b) of the Income Tax Act (R.S.C., 1985, c. 1(5<sup>th</sup> Supp.)).

Capital gains tax is payable with regard to both farming properties bequeathed to the son of the deceased. The capital gain in respect of the first farming property would be \$450 000, and the capital gain in respect of the second farming property \$300 000.

However, both capital gains are subject to the lifetime capital gains exemption in the amount of \$1 000 000,<sup>208</sup> and consequently no capital gains tax is payable because the capital gains of farms do not exceed the once-off exempt amount of \$1 000 000. As a result, the estate does not have any capital gains tax liabilities.

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<sup>208</sup> Canadian Revenue Agency 2016 "Indexation adjustment for personal income tax and benefit amounts" <http://www.cra-arc.gc.ca/nwsrm/fctshts/2015/m12/fs151208-eng.html>.

## 6 CONCLUSION

Having researched the areas of taxation, double taxation is found where two separate taxes are levied by the same authority for the same objective within the same period of time, while the object of the taxes overlap or partially overlap.<sup>209</sup> Estate duty and capital gains tax may be applicable to the estate of a deceased person under certain circumstances. Where this occurs, it is considered unfair double taxation, as an estate tax targeting wealth is levied simultaneously with capital gains tax, which indirectly targets wealth via an income tax levied.<sup>210</sup> Accordingly, estate duty can overlap in many ways with capital gains tax.<sup>211</sup> Ramson argues that the liability in respect to capital gains tax would decrease the dutiable amount of the estate as a debt owing by the deceased, but that this does not itself detract from the fact that there is still double taxation on a portion of the assets.<sup>212</sup> This argument is submitted to be correct.

In the event that capital gains tax is not considered to be a direct wealth tax, it cannot be considered anything else than an indirect wealth tax.<sup>213</sup> There is no basis for levying both estate duty and capital gains tax.<sup>214</sup> In addition, these taxes are levied at a rate considered to be too high, without proper remedy to taxpayers in the form of proper deductions and abatements.<sup>215</sup>

Both Canada and Australia abolished inheritance taxes partly because of the adverse impact of these taxes on agricultural communities, after which capital gains tax regimes substituted the inheritance tax systems.<sup>216</sup> South Africa is the only country in the world to levy both capital gains tax and estate duty on death.<sup>217</sup> The geographical composition of the Republic of South Africa tends to favour agricultural activities, much like that of Australia or Canada and in certain aspects possibly more. Consequently, the tax regime

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<sup>209</sup> Cooley *The Law Of Taxation* 223.

<sup>210</sup> Bird *et al The Tax System in Industrialized Countries, Canada* 57.

<sup>211</sup> Ramson *The interface between capital gains tax and estate duty and the double tax implications thereof* 20.

<sup>212</sup> Ramson *The interface between capital gains tax and estate duty and the double tax implications thereof* 20.

<sup>213</sup> Bird *et al The Tax System in Industrialized Countries, Canada* 57.

<sup>214</sup> Roeleveld 2012 *SAJAR* 144.

<sup>215</sup> Roeleveld 2012 *SAJAR* 159.

<sup>216</sup> Maloney 1988 *Ottawa Law Review* 605.

<sup>217</sup> Ger 2012 *Time for estate duty to go?* <http://www.derebus.org.za/time-estate-duty-go/>.

currently applicable to South Africa with regard to the tax implications on death of a person prompts consideration of the grounds upon which inheritance taxes similar to estate duty in South Africa were abolished in countries such as Australia and Canada.

The Davis Tax Committee contradicts itself – should capital gains tax not be a wealth tax of any kind, it would not be necessary to reduce the rate at which a pure wealth tax (being estate duty) is levied. Furthermore, the “onerous consequences” for taxpayers on death supports the submission that capital gains tax amounts to an indirect wealth tax, as capital gains tax constitutes an indirect wealth tax in its current form.

By proposing that Estate Duty should be levied at a rate of 25% for estates with a net worth of R30 million or more,<sup>218</sup> the implications of a double wealth tax is further extended, and this can cause further difficulty for persons or their financial planners. They have to ensure that their estate will have enough cash to provide for taxes etc., without selling any of the assets and incurring further capital gains tax consequences. As pointed out, this may open up the possibility of schemes or arrangements to avoid the tax.<sup>219</sup> Increasing the efficiency of estate duty as proposed by the Davis Tax Committee may provide some relief to the current situation and occurrence of double taxation, but will not eliminate its occurrence.

The argument for vertical equity, meaning that taxpayers with greater ability to pay taxes should bear a greater burden of taxation,<sup>220</sup> may suffice in the abovementioned proposals, but the occurrence of double taxation as discussed does not constitute a fair taxation policy and should therefore not be relied upon in retaining both capital gains tax and estate duty by the Davis Committee.

The submission of the Davis Committee<sup>221</sup> that capital gains tax is not a wealth tax can only be regarded as a mere opinion, as this research provides a strong argument to the contrary. Speculation that the Davis Committee may move away from estate duty and focus on capital gains tax as a wealth tax was to the surprise of many countered,<sup>222</sup> with

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<sup>218</sup> The Davis Committee *Second Interim Report on Estate Duty* 17 – 18.

<sup>219</sup> Roeleveld 2012 *SAJAR* 159.

<sup>220</sup> Tomasek *Capital Gains Tax in South Africa* <http://www.ftomasek.com/NationalTreasury.pdf>.

<sup>221</sup> The Davis Committee *Second Interim Report on Estate Duty* 20.

<sup>222</sup> See 2.4 *The Davis Tax Committee* on page 15 above.

the Davis Committee's focus falling on amending the act to increase its efficiency.<sup>223</sup> Although the recommendations made in their Second and Final Report on Estate Duty<sup>224</sup> seem to aim at providing better protection to taxpayers and estates, it does not exterminate the occurrence of double taxation, but merely tones it down to occur only in estates with a value exceeding the proposed rebates, therefore offering a limited solution.

The conclusion of Judson clearly shows that double taxation is considered 'repugnant' to both legal and economic justice, and an occurrence that is condemned internationally.<sup>225</sup> No other conclusion is possible – even given the South African background and the argument for vertical equity – than that a different approach should be considered to ensure legal and economic justice in taxation. One such approach would be to amend the current system and to replace it with a system levying these taxes from one single origin.<sup>226</sup>

This research showed by way of a simple comparison of the differences in tax regimes between Australia, Canada and South Africa that both Canada and Australia have a better approach to wealth taxes, and it is clear from the illustrated comparison that the taxes levied within South Africa is unfair and puts the taxpayer in a tight spot, should he or she own taxable assets. It is therefore submitted that estate duty should be abolished. If not abolished, legislation should provide ample measures to eliminate the current occurrence of double taxation in certain circumstances. One possible way to achieve this would be to provide for a rebate equal to the amount of capital gains tax payable on estate duty.

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<sup>223</sup> The Davis Committee *First Interim Report on Estate Duty* 25 – 58.

<sup>224</sup> The Davis Committee *Second Interim Report on Estate Duty* 5 – 9.

<sup>225</sup> Judson *The Extent and Evils of Double Taxation in the United States* 111.

<sup>226</sup> De Villiers *'n Ondersoek na die afskaffing van boedelbelasting* 41.

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