

**Estate planning:
The impact of estate duty and capital gains tax on offshore assets**

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DECLARATION

I Christine Bornman, declare that the mini-dissertation submitted for assessment is my own and is expressed in my own words. Any uses made within it of the works of other authors in any form (e.g. ideas, equations, figures, text, tables, programmes) are properly acknowledged at the point of their use. A full list of the references employed has been included.

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Table of Contents

- 1 INTRODUCTION AND OBJECTIVES OF THE MINI-DISSERTATION..... 1**
- 1.1 INTRODUCTION, BACKGROUND AND MOTIVATION 1
- 1.2 PROBLEM STATEMENT 4
- 1.3 OBJECTIVES OF THE MINI-DISSERTATION..... 4
- 1.4 SCOPE AND LIMITATIONS OF THE TOPIC..... 5
- 1.5 RESEARCH METHODOLOGY 6
- 1.6 OVERVIEW 6

- 2 THE DEVELOPMENT AND FUTURE OF ESTATE DUTY 8**
- 2.1 INTRODUCTION 8
- 2.2 THE HISTORY OF ESTATE DUTY 9
- Table 1 11
- 2.3 THE DEVELOPMENT OF ESTATE DUTY OVER THE YEARS 11
- 2.4 FACTORS IMPACTING ON THE DETERMINATION OF ESTATE DUTY..... 13
- 2.4.1 The different type of marital regimes 13
- 2.4.2 The impact of a will on estate duty 15
- 2.5 THE LATEST CHANGES TO THE ESTATE DUTY ACT 16
- 2.6 THE IMPACT OF ESTATE DUTY IN PRACTICE 18
- 2.6.1 Fairness in taxation..... 19
- 2.6.2 Revenue contribution of estate duty 20
- Table 2 21
- 2.7 CALCULATION OF ESTATE DUTY 23
- Table 3 24
- 2.8 CONCLUSION..... 25

- 3 THE IMPACT OF CGT UPON DEATH 27**
- 3.1 INTRODUCTION 27
- 3.2 THE CGT SYSTEM 27

Contents (continued)

- Table 428
- 3.3 ASSET DISPOSED OF IN A FOREIGN CURRENCY31**
 - Table 533
- 3.4 CGT UPON DEATH34**
 - 3.4.1 Calculation of CGT upon death35**
 - Table 636
 - Table 736
 - 3.4.2 The effect of levying CGT upon death37**
- 3.5 CONCLUSION.....40**

- 4 TAXES UPON DEATH IN SELECTED FOREIGN COUNTRIES41**
 - 4.1 INTRODUCTION41**
 - 4.2 ESTATE DUTY ON OFFSHORE ASSETS42**
 - 4.3 AUSTRALIA43**
 - 4.3.1 Introduction43**
 - 4.3.2 Taxation of deceased estates: estate duty and CGT44**
 - 4.4 CANADA45**
 - 4.4.1 Introduction45**
 - 4.4.2 Taxation46**
 - 4.4.2.1 *Taxation of deceased estates: estate duty*47**
 - 4.4.2.2 *Taxation of deceased estates: CGT*.....47**
 - 4.5 FRANCE48**
 - 4.5.1 Introduction48**
 - 4.5.2 Wealth tax48**
 - 4.5.3 Taxation of deceased estates48**
 - 4.6 GERMANY49**
 - 4.6.1 Introduction49**
 - 4.6.2 Taxation of estates49**
 - 4.7 NEW ZEALAND50**
 - 4.7.1 Introduction50**
 - 4.7.2 Taxation of estates50**

Contents (continued)

4.8	SWITZERLAND	51
4.8.1	Introduction	51
4.8.2	Swiss succession law	51
4.8.3	Taxation	52
4.9	THE UNITED KINGDOM	52
4.9.1	Introduction	52
4.9.2	Taxation upon death	53
4.10	THE UNITED STATES OF AMERICA	53
4.10.1	Introduction	53
4.10.2	Taxation upon death: estate taxes	54
4.10.3	The effect of estate taxes upon USA non-citizens not domiciled	55
4.10.4	CGT in the USA	56
4.11	CONCLUSION	56
5	THE IMPACT OF ESTATE DUTY AND CGT ON OFFSHORE ASSETS UPON DEATH	57
5.1	INTRODUCTION	57
5.2	ASSETS SITUATED OUTSIDE SOUTH AFRICA	59
5.2.1	Introduction	59
5.2.2	Purchasing property offshore	59
5.2.3	Offshore wills	61
5.3	ESTATE DUTY AND CGT LEVIED ON OFFSHORE ASSETS	62
5.3.1	The effect of DTAs and estate tax treaties	63
5.3.2	The impact of estate duty and CGT on offshore assets where neither a DTA nor/and an estate tax treaty exists	63
5.4	CASE STUDIES	66
5.4.1	A global perspective.....	67
5.4.2	From a South African perspective: in the event of a DTA and/or estate tax treaty in place	68
5.4.2.1	<i>South Africa has concluded a DTA and estate tax treaty with the UK.....</i>	<i>69</i>

Contents (continued)

- 5.4.2.2 *South Africa has concluded only a DTA but no estate tax treaty with the government of France*71
- 5.4.2.3 *South Africa has concluded a DTA but no estate tax treaty with Australia*.....72
- 5.5 THE TAXATION OF RESIDENTS WITH OFFSHORE ASSETS UNDER INTERNATIONAL LAW 74
 - 5.5.1 Main theories.....74
 - 5.5.2 The taxation of offshore assets75
- 5.6 THE EFFECT OF ABOLISHING ESTATE DUTY76
 - 5.6.1 Arguments in favour of abolishing estate duty76
 - 5.6.2 Arguments against abolishing estate duty78
- 5.7 CONCLUSION80

- 6 CONCLUSION82
 - 6.1 INTRODUCTION.....82
 - 6.2 THE IMPACT OF THE ABOLITION OF ESTATE DUTY.....84
 - 6.3 TOPICS FOR FURTHER STUDY85

- BIBLIOGRAPHY86

List of tables

Table 1 11
Table 2 21
Table 3 24
Table 4 28
Table 5 33
Table 6 36
Table 7 36

SUMMARY AND KEY TERMS

Death and taxes are unavoidable. In terms of the current legislation both estate duty and capital gains tax (hereinafter referred to as "CGT") are levied upon death. The South African National Treasury is reconsidering taxes on death as estate duty contributes minuscule revenue, and its administration is cumbersome. Worldwide taxation is based on either source or residence. Because of the R3 500 000 exemption from estate duty, only wealthy individuals are generally subject to estate duty. Wealthy individuals make use of the annual R4 000 000 foreign investment capital allowance by owning offshore property.

The aim of this study is to document how death taxes are currently levied on an estate which holds offshore property, given the perception that foreign property is exempt from death duties, and also to consider the impact on taxes payable on offshore property at death if estate duty were to be abolished. These objectives cannot be achieved without a thorough understanding of the development and future of estate duty, the impact of CGT on death, how selected foreign countries levy taxes upon death, and how residents of South Africa are taxed on property situated within foreign countries. When CGT was introduced in 2001 the estate duty rate was reduced and it is likely that, if estate duty is repealed, the rate of CGT will be increased.

In South Africa, residents are taxed on worldwide income and capital gains. The international perspective is that the foreign country has the sovereignty to levy taxes on a person who owns property situated within its boundaries. An estate which holds offshore property may also be subject to estate duty in terms of the tax law of that country which results in double taxation in the hands of the deceased estate. South Africa has concluded international agreements with a number of foreign countries through double tax agreements and estate tax treaties to prevent double taxation.

In terms of the Estate Duty Act, and in some of the treaties, a rebate is allowed in respect of foreign estate taxes paid. However, if estate duty is abolished, the deceased estate may be liable for estate tax in the foreign country where the assets are situated and the deceased estate may not qualify for any rebate in South Africa in respect of foreign taxes paid. Hence, the abolition may have detrimental

consequences on the liquidity requirements, and on the heirs, in cases where offshore property is involved. It is vital that proper estate and tax planning advice is given before a resident acquires offshore property as the tax implications may be enormous. The current impact of estate duty and CGT on a resident who owns offshore assets is that the said taxes will be levied either here in South Africa or in the foreign country. The effect of capital transfer tax on a resident with an offshore asset can never be underestimated.

Key terms

Estate duty / abolish / repeal / revenue contribution / capital gains tax / offshore assets / inheritance tax / capital transfer tax / double tax treaties / foreign countries.

OPSOMMING EN SLEUTELWOORDE

Om te sterf en om belasting te betaal is beide onvermydelik. Ingevolge huidige wetgewing, word beide boedelbelasting en kapitaalwinsbelasting (hierna genoem KWB) met afsterwe gehef. Die Suid-Afrikaanse Nasionale Tesourie heroorweeg belasting gehef met afsterwe, aangesien die inkomste verkry uit boedelbelasting minimaal is en die administrasie daaraan verbonde problematies is. Wêreldwyd word belasting gebaseer op óf bron van inkomste, óf waar gewoon word. Omdat vrystelling van boedelbelasting by afsterwe tot R3 500 000 verskaf word, is dit hoofsaaklik welgestelde individue wat wel boedelbelasting moet betaal. Welgestelde individue maak gebruik van die jaarlikse R4 000 000 buitelandse kapitaaltoelaag deur eienaarskap van eiendomme in die buiteland.

Die doel van hierdie studie is om te dokumenteer hoe belasting met afsterwe gehef word op 'n boedel waarvan buitelandse eiendom deel uitmaak, aangesien die persepsie bestaan dat buitelandse bates nie by die berekening van boedelbelasting en KWB in aggeneem word nie. Die studie fokus voorts op die implikasies vir belasting betaalbaar op buitelandse eiendom na afsterwe, indien boedelbelasting afgeskaf sou word. Hierdie doelwitte kan nie bereik word sonder 'n deeglike begrip van die ontwikkeling en toekoms van boedelbelasting nie, hoe belasting in 'n geselekteerde groep lande met afsterwe gehef word en hoe inwoners van Suid-Afrika, wat in besit van buitelandse bates is, met afsterwe belas word. KWB het in 2001 in werking getreë, waarna die boedelbelastingkoers verlaag is. Indien boedelbelasting afgeskaf word, is daar 'n moontlikheid dat die koers waarteen KWB gehef word, sal verhoog.

In Suid-Afrika word inwoners op hul wêreldwye inkomste en kapitaalwins belas. Die internasionale perspektief is dat enige land die soewereiniteit het om belasting te hef van 'n persoon wat eiendom binne daardie land se grense besit. 'n Boedel waarvan eiendom in die buiteland deel uitmaak, kan dus onderhewig wees aan die heffing van boedelbelasting ingevolge die belastingwet van daardie land. Die gevolg is 'n dubbelbelastingaanslag met betrekking tot die bestorwe boedel. Suid-Afrika het internasionale ooreenkomste gesluit met 'n aantal lande om hierdie tipe dubbelbelastingaanslag uit te skakel.

Ingevolge die Wet op Boedelbelasting asook in sommige internasionale ooreenkomste, is daar 'n korting beskikbaar in die geval waar boedelbelasting in die buiteland betaalbaar is. Indien boedelbelasting egter afgeskaf word, kan die bestorwe boedel aanspreeklik wees vir boedelbelasting in die land waar die bate geleë is. Die bestorwe boedel mag ook nie kwalifiseer vir 'n korting in Suid-Afrika in terme van die belasting wat in die buiteland betaal is nie. Die afskaffing van boedelbelasting kan dus ernstige gevolge vir likiditeitsvereistes en erfgename inhou in die geval waar buitelandse bates betrokke is. Dit is noodsaaklik dat inwoners van Suid-Afrika, voordat hulle buitelandse eiendom bekom, advies rakende belastingimplikasies bekom. Indien buitelandse bates deel van 'n bestorwe boedel uitmaak, word boedelbelasting en KWB tans óf in Suid-Afrika óf in die buiteland gehef. Die gevolge van kapitaaloordragsbelasting vir 'n Suid-Afrikaanse inwoner wat buitelandse bates besit, kan nooit onderskat word nie.

Sleutelwoorde

Boedelbelasting / afskaf / herroep / inkomstebydrae / kapitaalwinsbelasting / buitelandse bates / belasting op erflatings / kapitaaloordragbelasting / dubbelbelastingooreenkomste /

CHAPTER 1

INTRODUCTION AND OBJECTIVES OF THE MINI-DISSERTATION

1.1 INTRODUCTION, BACKGROUND AND MOTIVATION

According to Benjamin Franklin, there are two certainties in life – death and taxes (Gans & Leigh, 2006:1). For a number of years the impact of estate duty has been scrutinised and debated as to whether or not South Africa should abolish estate duty, also widely known as a wealth transfer tax. The reason behind these arguments is that estate duty makes only a minute revenue contribution compared to that of other national taxes (Joffe, 2010:12; Van Vuren, 2010). Wealth transfer taxes were the first major direct taxes to be imposed across the world and the primary rationale appears to have been to raise revenue (Duff, 2005:16). The revenue contribution of wealth transfer taxes in countries like Australia, Canada and New Zealand was insignificant, and that has led to a change in wealth transfer taxes in those countries (Duff, 2005:16). It is also accepted that the administration of estate duty is known to be unwieldy. In the 2010/2011 Budget Tax Proposal (SARS, 2010:25) the impact of taxes upon death was addressed as follows:

“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 upon death will be reviewed.”

Joffe (2010:12) submits that government is considering doing away with estate duty. According to Bird (1991:322) death may still be certain, but death taxes no longer are.

In terms of section 3 of the Estate Duty Act (45/1955) (hereinafter referred to as the “Estate Duty Act”), “the estate of any person shall consist of all property

of that person as at date of his death and of all property which in accordance with this Act is deemed to be property of that person at that date.” It is submitted that estate duty has an impact, not only on assets situated in South Africa, but also on the offshore property of the deceased. Estate duty is levied on the worldwide assets of ordinarily residents, including offshore assets.

Internationally, capital gains tax (hereinafter referred to as “CGT” (also known as capital transfer tax) is considered to be a complex tax that is frequently very difficult to calculate. In the simple sense, CGT in South Africa is calculated as proceeds less base cost (Oliver, 2007:35). However, if the assets being transferred were acquired prior to 1 October 2001, and no valuation was placed on the said assets, then the calculations are no longer so simple, because different methods need to be applied to calculate the amount of CGT payable that relates to the period ownership since the introduction of CGT (paragraphs 26 to 28 of the Eighth Schedule of the Income Tax Act, (58/1962) (hereinafter referred to as the Income Tax Act). In terms of paragraph 40(1) of the Eighth Schedule of the Income Tax Act, it is deemed that, for CGT purposes, a taxpayer has disposed of his assets on death.

In terms of Section 26A of the Income Tax Act, the taxable capital gain as determined in terms of the Eighth Schedule, includes the taxable income of a person for the year of assessment. According to paragraph 2(1)(a) of the Eighth Schedule of the Income Tax Act, the Schedule applies to the disposal of *any* asset of the resident. A deceased estate is also liable for CGT on offshore assets. A deceased estate is therefore liable for both estate duty and CGT, also referred to as death taxes, which gives rise to double taxation.

It is often assumed that offshore assets will not form part of a resident’s estate for estate duty purposes. Therefore it is essential that estate practitioners or financial planners are knowledgeable and gain expertise in the field of offshore planning (Oosthuizen, 2008:20, 25). A resident who owns property or engages in some sort of economic activity in a foreign country is liable for foreign taxation (Albrecht, 1952:145). A “resident” is a South African resident

in terms of section 1 of the Income Tax Act, unless specifically stipulated otherwise.

In terms of section 4(e) of the Estate Duty Act, property situated outside South Africa which is in a resident's personal name, will attract estate duty unless certain exclusions exist: such as, the property was acquired before the deceased became ordinarily resident in South Africa for the first time; or the property was acquired by donation or inheritance from a non-resident after becoming a South African resident for the first time. If the mentioned exclusions of section 4(e) of the Estate Duty Act are not applicable, an offshore asset is, in terms of section 3 of the Estate Duty Act, subject to estate duty.

Residents are taxed on worldwide income and gains from the disposal of world-wide assets, while non-residents are liable for tax on income and capital gains from a South African source (definition of "gross income" section 1 of the Income Tax Act). Most foreign countries such as Australia, Canada, France and New Zealand apply the same principles (Bevan *et al.*, 2010:72; Cadesky *et al.*, 2010:137; Naudin & Tirard, 2010:299; Hart, 2010: 463, 466). If a South African resident holds offshore property, it is likely that the South African resident is subject to tax in the foreign country where the asset is situated.

The topic of estate planning, but more specifically international estate planning, may conjure up notions of the very wealthy shifting assets to other locations via offshore trusts. A wealthy person is likely to have an interest, for example, in the form of immovable property outside South Africa that is subject to the tax laws of the foreign country in which it is held, resulting in the need for professional and adequate tax advice (Jones, P.M., 2006:1).

Estate practitioners and tax advisors should consider the amount of estate duty and CGT payable on death to avoid insolvency of an estate as there might not be sufficient cash available to pay these taxes (Swanepoel, 2008:1). It is submitted that failing to compile a comprehensive estate plan may have

detrimental consequences for the deceased estate and on the benefits to which the heirs are entitled.

Even though the National Treasury is reconsidering taxes upon death, the impact of estate duty and CGT on a deceased estate which holds an offshore asset should not be neglected, as these taxes may be payable on death. The study makes use of case studies and applies the double tax agreements (hereinafter referred to as “DTAs”) and/or double death duty agreements (hereinafter referred to as “estate tax treaties”) to a person with immovable property in a foreign country, determining which country may claim estate duty and CGT, if any.

1.2 PROBLEM STATEMENT

In the light of the discussion thus far, the following research question is stated to address the problem being investigated:

What is the current impact of estate duty and CGT on offshore assets and the potential impact should estate duty be abolished?

1.3 OBJECTIVES OF THE MINI-DISSERTATION

To address the problem statement (chapter 1.2), the following objectives are formulated to answer the research question:

The main objective is to consider the impact of current taxes payable by the deceased estate which holds an offshore asset and to determine what the potential impact could be if estate duty was to be abolished. This main objective is reached through the following secondary objectives:

- summarising the development and future of estate duty (chapter 2);
- summarising the impact of CGT on death (chapter 3);

- analysing how selected foreign countries levy taxes upon death and how non-residents of the country are taxed on the property situated within the foreign country (chapter 4);
- analysing the current impact of estate duty and CGT on offshore assets (chapter 5); and
- analysing the potential impact of the abolition of estate duty on offshore assets (chapter 6).

1.4 SCOPE AND LIMITATIONS OF THE TOPIC

The scope of the topic is to provide an answer to the stated problem. In order to provide an answer, the history of, and latest changes to, the Estate Duty Act are addressed. It is also essential to give attention to the revenue contribution of estate duty as well as to the arguments of those who advocate abolishing estate duty and of those who are against its abolition. Discontinuing it may affect taxes payable on death. The impact of CGT on death is examined as it is deemed for CGT purposes, that the deceased has disposed of his assets on his death. Due to the scope of this topic only CGT payable on death is addressed. The different methods of calculating the base cost of an asset are only touched on as this is an issue beyond the scope of this study. Estate duty and CGT are the taxes that are examined in the study as they affect the estate at death.

This study examines death taxes or similar taxes imposed by selected foreign countries and investigates why certain foreign countries have abolished death taxes. Attention is also given to DTAs and estate tax treaties and their effect. Case studies are based on selected foreign countries with which South Africa has concluded DTAs and/or estate tax treaties as well as countries where such agreements do not exist. Attention is not given to the requirements of section 4(e) of the Estate Duty Act when using the case studies for the purpose of illustration.

This study does not address estate planning tools or techniques such as local trusts, offshore trusts, but does address the need for offshore wills. Discussion

of different types of investments and their tax benefits falls outside the scope of this study. A further limitation is that offshore assets held only by individuals are considered and “offshore assets” refer specifically to immovable property. It focuses on the impact of estate duty and CGT on a deceased estate that holds an offshore asset.

Against this background, the development and prospects of estate duty are dealt with in chapter 2.

1.5 RESEARCH METHODOLOGY

The research relied to a great extent on a literature review of journals, articles, legislation, internet sources, legal opinions, text books, DTAs and estate tax treaties. Practical issues examined included calculations in terms of the application of laws and case studies. Taxes levied upon death in foreign countries in terms of their legislation are also considered.

1.6 OVERVIEW

To achieve the objectives the dissertation will present the topic in the following chapters:

Chapter 2: The development and future of estate duty

This chapter serves to give a basic overview of the levying of estate duty and evaluating its prospects. The current impact of estate duty is addressed in this chapter.

Chapter 3: The impact of CGT upon death

CGT was introduced in order to provide equity in the tax system. This chapter provides an explanation as to what impact CGT has on a deceased estate.

Chapter 4: Taxes upon death in selected foreign countries

Most foreign countries tax non-residents on a source-based system of taxation. This chapter examines the situation in some of the OECD countries which levy estate duty and/or similar taxes.

Chapter 5: The impact of estate duty and CGT on offshore assets upon death.

This chapter examines the effect of DTAs and estate tax treaties as foreign countries have the jurisdiction to tax a person who owns property situated in the foreign country. It addresses the impact estate duty and CGT have on offshore assets and focuses on arguments in favour of abolishing estate duty and arguments against its abolition.

Chapter 6: Conclusion

In the overall conclusion the impact of estate duty and CGT on offshore assets and the potential impact of the abolition of estate duty are addressed.

CHAPTER 2

THE DEVELOPMENT AND FUTURE OF ESTATE DUTY

2.1 INTRODUCTION

The unanswered question remains as the concern about the potential death duties and CGT payable by a deceased estate that holds an offshore asset. The current situation, with reference to the 2010/2011 Budget Tax Proposal, is that both estate duty and CGT are levied on a resident's deceased estate which constitutes double taxation – hence, taxation upon death are being reconsidered. According to Joffe (2010:12), the South African National Treasury might abolish estate duty. To reach a conclusion for the main and the secondary objectives (chapter 1.3), it is necessary to examine the development and future of estate duty to determine the impact of estate duty on a deceased estate.

The efficacy of levying estate duty has been scrutinised over the past few years as clients have comprehensive estate planning tools in place, like trusts, which minimise estate duty payable (SARS, 2010:25). The primary rationale of the imposing wealth transfer taxes appears to have been to raise revenue (chapter 1.1). However, the revenue contribution of estate duty is not viable and its efficiency has been questioned as the taxpayers to whom this tax applies often use estate practitioners to help them achieve financial benefit and other estate goals. Comprehensive estate planning includes, amongst other things, advice regarding insurance and investment products and how to minimise estate duty payable upon death (Abrie *et al.*, 2003:16). In fact, often one of the primary objectives of estate planning is to minimise estate duty, thereby ensuring that no estate duty or very little estate duty is payable by the deceased estate (Davis *et al.*, 1998:1-5, 2-5).

Estate duty is levied on the net worldwide assets of a person who died on or after 1 April 1955 and is levied in accordance with the Estate Duty Act. The Minister of Finance's announcement that the National Treasury is

reconsidering taxes upon death led to uncertainty as to what the impact of the abolition of estate duty would be on a resident with an offshore asset.

To determine the impact estate duty has on the estate of a South African resident, this chapter examines the history of estate duty, the development of estate duty over the years, factors impacting on estate duty and, in illustration of the discussion, practical examples of levying estate duty.

2.2 THE HISTORY OF ESTATE DUTY

Death duties were first imposed in South Africa in 1864 when the Successions Duty Act (5/1864) was placed on the Statute book (Kahn, 1946:81). The imposition of death duties was justified by the “social obligation” or the “benefit and privilege” theory. The theory is based on the idea that the state provides protection for property as well as law and order, while a person builds up his financial reserves. The state allows freedom of bequest and therefore an heir or legatee can benefit from a deceased estate. Since the entire system of private property and the ability to pass the property on death to heirs or legatees is subject to a state-supported institution, there is justification for levying a tax that would compensate for the services it provided while the estate was being developed (Kahn, 1946:87).

According to Kahn (1946:88) “[t]he influence of death duties on capital accumulation was not much more unfavourable than other taxes, and this slight disadvantage was more than counterbalanced by its social effects”.

It is also submitted that death duties are payable wholly “out of capital” and, according to Kahn (1946:87), it may be concluded that “[i]t is fallacious to distinguish it (Estate Duty) from the Income Tax, as coming out of the nation’s capital. Although the duty comes out of the capital of individual estates, it is provided out of the national income no less than the Income Tax; both forms of tax alike prevent a certain amount of new capital from coming into being, the ultimate effect depending very largely on the direction of Government expenditure”.

Thus, estate duty, previously known as succession duty, is a form of capital transfer tax. The term 'capital transfer tax' refers to a taxation of wealth (Katz Commission, 1997). The Cape first imposed succession and inheritance tax in 1864. Two types of death duties were levied:

- estate duty - which was levied on the entire deceased estate; and
- succession duty - which was levied only on portions of the estate that were transmitted to the heirs and legatees (Kahn, 1946:81).

At the end of the nineteenth century, succession and inheritance tax was the more common form of death duty, and the Cape imposed only this type. Transvaal levied estate duty, while the Cape, Natal and Orange Free State levied succession duty. The four provinces levied death duties at different rates. There was no justification for levying these different rates and therefore a Union-wide measure was introduced which was called the Death Duties Act (29/1922) (hereinafter referred to as the "Death Duties Act"). The Death Duties Act came into force in 1922 and dealt with all death duties payable in South Africa in its entirety. In 1922 the rates ranged from 0,5% on the first £2 000, to 17% on amounts exceeding £1 000 000. The abatement was raised from £1 000 in 1922 to £15 000 in 1934 (Kahn,1946:85).

Table 1

Estate duty and succession duty contribution to revenue: 1925-1944 (Kahn, 1946:93).

Year ending 31 March	Total number of estates dealt with	Net dutiable amount of all estates £	Net dutiable amounts of estates over £75 000 in value £	Total estate duty £	Total succession duty £
1925	8 010	10 522 474	505 381	290 425	252 838
1933	9 389	12 968 212	1 548 467	427 411	236 024
1943	14 428	26 733 345	3 279 350	886 531	544 410
1944	13 222	29 911 826	3 477 792	2 218 781	662 468

On 1 April 1955 the Death Duties Act was repealed and replaced by the Estate Duty Act.

2.3 THE DEVELOPMENT OF ESTATE DUTY OVER THE YEARS

When enforcement of the Estate Duty Act began in 1955, estate duty rates ranged from 10% on the first R50 000 to 35% of the portion in excess of R400 000 on the dutiable estate. An estate also qualified for estate duty threshold abatements. The abatements were used to alleviate an estate from any estate duty liability. If a deceased was survived by a spouse and/or children the estate qualified for personal abatements (Silke & Stein, 1984:1, 18).

From 1 April 1986 deceased estates were subject to estate duty at a rate of 10% on the first R100 000 and 3% for every additional R100 000 of the estate value which amounted to 35% of the values in excess of R800 000 (Olivier & Van den Berg, 1991:41; Victor & King, 2008:291). On 16 March 1988 it was announced that all personal abatements were being abolished and replaced with a single abatement amount of R1 000 000. Estate duty was then levied at a rate of 15% on the dutiable amount of the estate (Olivier & Van den Berg,

1991:43). On 14 March 1996 the rate of levying estate duty increased to 25%, and on 1 October 2001 it was reduced to 20%. CGT was introduced on 1 October 2001 and the estate duty rate was reduced as a result of the implementation of CGT (Victor & King, 2008:291).

Currently estate duty is levied at a rate of 20% on the dutiable amount of the estate (First Schedule of the Estate Duty Act; Davis *et al.*, 1998:2-5). In 2001 the rebate amount increased from R1 000 000 to R1 500 000, and in 2006 it increased again from R1 500 000 to R2 500 000. Since 2007 the rebate amount in terms of section 4A has been R3 500 000 (section 4A of the Estate Duty Act; Victor & King, 2008:291).

Section 4(2)(2) of the Estate Duty Act reads as follows:

“Estate duty shall be charged upon the dutiable amount of the estate calculated in accordance with the provisions of this Act, and shall be levied at the rate set out in the First Schedule.”

The dutiable amount is “determined by deducting from the net value of the estate, as determined in accordance with section 4, an amount of R3 500 000” (section 4A of the Estate Duty Act).

To determine the net value of an estate, allowable deductions as set out in section 4 of the Estate Duty Act should be deducted from the value of the property and deemed property as set out in section 3 of the Estate Duty Act (section 4 of the Estate Duty Act).

When compiling an estate plan it is of utmost importance to take the type of marital regime of the resident into consideration as the different marital regimes impact the amount of estate duty and CGT payable by the deceased estate.

2.4 FACTORS IMPACTING ON THE DETERMINATION OF ESTATE DUTY

2.4.1 The different type of marital regimes

There are three forms of marital regime in South Africa:

- in community of property;
- out of community of property without accrual; and
- out of community of property with accrual.

All of these different types of marriages have different elements and consequences (Victor & King, 2008:12).

Victor and King (2008:9) submit there are three key elements of any marriage:

- assets held at commencement of the marriage;
- assets that were attained during the marriage; and
- rights and control over the assets.

For instance, on dissolution of a marriage subject to the accrual system, the spouse with no accrual or who has the smaller accrual of the two spouses, acquires a claim against the other spouse or the estate of the other spouse. The claim will be an amount equal to half of the difference between the accrual of the respective estates of the spouses (section 3(1) of the Matrimonial Property Act 88 of 1984) (hereinafter referred to as the "Matrimonial Property Act"). The amount of accrual claim against the deceased estate by the surviving spouse may be deducted in terms of section 4(IA) of the Estate Duty Act. Section 3(cA) of the Estate Duty Act deems the accrual claim as property in the estate of the spouse who has no accrual or who has the smaller accrual.

When spouses are married in community of property "a wife in a marriage in community of property has the same powers with regard to the disposal of the

assets of the joint estate, the contracting of debts which lie against the joint estate, and the management of the joint estate as those which a husband in such a marriage had immediately before the commencement of this Act” (section 14(1) of the Matrimonial Property Act).

When the marriage dissolves due to death, the deceased estate and the surviving spouse are both entitled to a half-share of the joint estate. The liabilities and assets of both spouses form part of the joint estate unless certain assets are specifically excluded. A fiduciary or usufructuary interest does not form part of the joint estate nor do liabilities that arise after the death of the spouse, such as funeral expenses (Stiglingh *et al.*, 2010:909). Section 1 of the Matrimonial Property Act defines a “joint estate” as “the joint estate of a husband and a wife married in community of property.”

These three marital regimes are applicable to a civil union. Section 13(2) of the Civil Union Act (17/2006) (hereinafter referred to as the “Civil Union Act”) reads as follows:

“With the exception of the Marriage Act and the Customary Marriages Act, any reference to – (a) marriage in any other law, including the common law, includes, with such changes as may be required by the context, a civil union; and (b) husband, wife or spouse in any other law, including the common law, includes a civil union partner.”

Due to the scope of the topic as delimited (chapter 1.4) there is no in-depth discussion on the different types of marital regimes and their effect. However, estate practitioners must not lose sight of the impact of the different types of marriages on a deceased estate. The different marital regimes have been set out above as they have an impact on offshore assets since some foreign countries have exclusions on bequests to a surviving spouse.

2.4.2 The impact of a will on estate duty

Many South Africans structure their wills in such a way so as to reduce taxes payable upon death. However, many others neglect to draw up a will, and without a valid will a person's estate will devolve according to the Intestate Succession Act (18/1987) (hereinafter referred to as the "Intestate Succession Act"). This means that the estate will be distributed to the deceased's blood relatives, and it should be noted that the government may also benefit from the estate (Yochum, 2009:7, 8).

As mentioned, the first R3 500 000 of a person's estate is exempt from estate duty, and many residents bequeath the first R3 500 000 of their respective estates to an *inter vivos* trust or testamentary trust and the residue to the surviving spouse. In terms of section 4(q) of the Estate Duty Act all bequests to a spouse are exempt from estate duty. This structure ensures that the total rebate of up to R7 000 000 is thereafter bequeathed to the children (Desmond, 2009:1). By bequeathing, for example, the residue of your estate to your children or to a trust, instead of to the surviving spouse, the bequests are subject to estate duty.

With effect from 1 January 2010 so much of the rebate amount that has not been used as a section 4A rebate will be rolled over to the estate of the surviving spouse. The effect of this is that the surviving spouse may have a rebate of up to R7 000 000 (section 4A(2) of the Estate Duty Act).

Section 4A(2) of the Estate Duty Act reads as follows:

"Where a person was the spouse at the time of death of one or more previously deceased persons, the dutiable amount of the estate of that person shall be determined by deducting from the net value of that estate, as determined in accordance with section 4, an amount equal to the amount specified in subsection (1) – (a) multiplied by two; and (2) reduced by the amount deducted from the net value of the

estate of any of the previously deceased persons in accordance with this section.”

If a deceased had more than one surviving spouse, the rebate would be apportioned amongst the surviving spouses (Surtees, 2009:4). There are different opinions as to how to interpret the legislation if a deceased spouse has been a surviving spouse more than once. The uncertainty revolves around which unused abatement the executor will be entitled to use when determining the estate duty liability of the deceased. It can be assumed that the words “any of the previously deceased persons” means that any unused rebate of the previously deceased spouses can be used for the abatement for the last dying spouse (Escott-Watson, 2010:F18). The rebate may only be claimed if the executor submits the estate duty return of the first dying spouse (section 4A(5) of the Estate Duty Act). According to section 4A(6) of the Estate Duty Act “where a person and his or her spouse die simultaneously, the person of whom the net value of the estate, determined in accordance with section 4, is the smallest must be deemed for the purposes of this section to have died immediately prior to his or her spouse.”

2.5 THE LATEST CHANGES TO THE ESTATE DUTY ACT

Estate duty (a type of wealth tax) is levied on the estate of a person who is ordinarily resident in the Republic of South Africa as at the date of death (sections 2 and 3 of the Estate Duty Act). Estate duty is payable on the full value of a deceased estate, after deducting the rebate amount, bequests to a spouse, charitable organisations, funeral costs and the value of the liabilities (section 4 of the Estate Duty Act; Jones, S., 2008:3). One can say that estate duty is levied on the net value of the deceased’s assets, which is also called the dutiable amount.

The average person may be of the opinion that there is no need for concern about estate duty if the value of the assets does not reach or exceed R3 500 000. However, one should take the following into consideration: the value of personal property, personal effects, household furniture, motor

vehicles and certain life policies (Jones, S., 2008:3). Inflation has increased the value of the assets which might have the effect that an average person's estate could be subject to estate duty (Dobris, 1984:1221).

Section 3(3)(a) of the Estate Duty Act deems life insurance policies as the property of the deceased. Certain life policies are deemed to be the property of the deceased, but since 1 January 2009, all lump sum payments from pension funds, provident funds and retirement annuities have been exempt from estate duty. According to section 3(2)(i) of the Estate Duty Act, the term "property" does not include "so much of any benefit which is due and payable by, or in consequence of membership or past membership of, any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as defined in the Income Tax Act, on or as a result of the death of the deceased."

As already noted, as from 1 January 2010 the portion of the rebate amount not used as a section 4A rebate will be rolled over to the estate of the surviving spouse. This could have the effect that the surviving spouse may have a rebate of up to R7 000 000 (section 4A(2) of the Estate Duty Act).

One of the popular estate planning tools for saving on estate duty is leaving a usufruct over the assets to the surviving spouse. Giving someone a usufruct over the property entitles that person to use the property which in fact belongs to someone else, the bare dominium holder. The usufructuary has the right to enjoy the fruits and maintain the property but the bare dominium holder cannot dispose of the property without the consent of the usufructuary (Davis *et al.*, 2010:2.3.2.2). On the death of the surviving spouse the usufruct is transferred to a trust for a period of one year and subsequently transferred to the children. It is proposed in the 2009/2010 Budget Tax Proposal (2009:24) that one year usufructuary interest schemes will be closed as this constitutes an anti-avoidance provision to save estate duty.

Thus, a dutiable estate comprises all the property of the deceased as of date of death, plus all deemed property of the deceased as of date of death, less

any deductions allowable in terms of section 4 of the Estate Duty Act, less the abatement amount.

2.6 THE IMPACT OF ESTATE DUTY IN PRACTICE

It is submitted that estate duty was introduced to tax the wealthy and to create fairness in taxation. According to Smith (quoted by Lambert, 1992:2) there are four maxims of taxation and these can be summarised as follows:

- equity;
- certainty;
- convenience; and
- efficiency.

Equity or fairness has been divided into horizontal and vertical equity. “Vertical equity” is defined as follows (National Treasury, 2009:140):

“[a] doctrine in taxation that holds that differently situated taxpayers should be treated differently in terms of income tax provisions – i.e. taxpayers with more income and/or capital should pay more tax.”

According to Tomasek (2001:10) “[e]quity in taxation consists of both horizontal and vertical equity. Horizontal equity demands that individuals in similar economic circumstances should bear a similar tax burden, irrespective of the form the accretion of economic power takes. In other words, taxpayers should bear similar tax burdens, irrespective of whether their income is received in the form of wages, or capital gain. In this context, the exclusion of capital gains from the income tax base fundamentally undermines the horizontal equity of the tax system.”

2.6.1 Fairness in taxation

According to the Katz Commission (1997:5.4), in order to achieve horizontal and vertical equity, capital transfer tax cannot be repealed. If capital transfer tax is repealed such abolition will give rise to serious questions about the tax system and its equitable balance. Essentially, vertical equity means that taxpayers with greater ability to pay taxes should bear a greater burden of taxation (Tomasek, 2001:10). As stated by Frith (2008), except for CGT, estate duty is the only redistribution of wealth generated. Both estate duty and CGT are levied as a tax on the transfer of wealth.

Currently both estate duty and CGT are levied on death which gives rise to double taxation. The intention of estate duty was to tax wealthier residents but, according to Joffe (2010:12), the effectiveness of estate duty as a wealth tax can be questioned, as wealthier residents have structures in place that minimise their estate duty liability. According to Smith (quoted by Lambert, 1992:15) there should not be any double taxation.

On the other hand, Leigh *et al.*, (2006) are of the opinion, with reference to abandoning death duties in Australia, that the abolition of inheritance duties was a mistake from a purely economic rationalist perspective. In their view inheritance taxes are more efficient than most other forms of taxation. Furthermore, they state that “[b]asic public finance dictates that taxation should aim towards equity, efficiency and simplicity. On equity and simplicity grounds, inheritance taxes compared very favourably to other forms of taxation. But what is often not recognised is that inheritance taxes are also an efficient form of revenue-raising.”

Since the granting of the roll-over rebate, it is likely that more clients will bequeath all their assets to the surviving spouse. Since all bequests to a spouse are exempt from estate duty in terms of section 4(q) of the Estate Duty Act, no estate duty will be levied on the estate of the first dying spouse, and the last surviving spouse will qualify for a rebate to the amount of R7 000 000 instead of the R3 500 000. As explained by Desmond (2009:1), instead of

bequeathing the whole estate to the surviving spouse, spouses bequeath the rebate of R3 500 000 to a trust and the residue to the surviving spouse. Structuring a will in such a way will keep some of the asset growth out of the estate of the last-dying spouse.

The following example can be considered (Escott-Watson, 2010:F18):

The husband has a net estate of R7 000 000 and the wife has a net estate of R3 000 000. The husband considered leaving the rebate amount to a testamentary trust and the residue to his spouse but, due to the latest amendments to the Estate Duty Act, he is reconsidering this structure and is uncertain what would be the best option for both of them. He is now considering leaving his entire estate to his wife to enjoy an abatement of R7 000 000. The result of this structure may be that minimal estate duty is payable by the deceased estate of the surviving spouse, but it is likely that there will be a large CGT liability payable by the deceased estate of the surviving spouse.

It may be submitted that the asset growth that is transferred to the surviving spouse should be measured against the rebate amount for which the estate of the surviving spouse would qualify. Furthermore, it is posited that the very reason behind the introduction of estate duty, i.e. equity and specifically vertical equity is not achieved as the very people for whom the tax is meant, have the means to legally avoid paying it.

2.6.2 Revenue contribution of estate duty

With reference to chapter 1.1, one of the arguments in favour of abolishing estate duty is its insignificant contribution to the country's revenue. Since South Africa is a developing country, it is likely that it will follow in the footsteps of other developed countries as far as economic status is concerned. Prior to the abolition of estate duty in Australia in 1979, the estate duty rates were high in Australia. In 1973 the Commonwealth Government collected roughly gift and estate duties of 0,7% of total tax revenues and,

during 1978/1979 tax year, 9% of the total tax revenues. No rates were phased down prior to the abolition. The inheritance tax rates and thresholds had remained largely the same from 1941 to 1979 (Duff, 2005:39; Gans & Leigh, 2006:2).

In Canada the federal wealth transfer taxes contributed not more than 1,7% of the federal tax revenues. (Duff, 2005:39; Gans & Leigh, 2006:2). The Canadian Bar Association (Duff, 2005:21) decried the “excessive amount of property that was tied up for long periods of time in trusts to avoid wealth transfer taxes, concluding that these arrangements frequently restrict the company’s proper development and expansion and may add to production costs.” On this basis and other considerations, it was concluded that “the economic damage” caused by these taxes was “staggering” (Duff, 2005:21). Chapter 4 examines further the taxes upon death in selected foreign countries.

In the 2001/2002 tax year estate duty contributed 0,2% of all national tax revenue of South Africa, and it seems that this has been constant over the years (Tomasek, 2001:3). The following table sets out the different tax instruments and their contribution to national tax revenue.

Table 2

Composition of national tax revenue in percentages (Tomasek, 2001:3)

Tax instrument	Tax year 1983/84	Tax year 1989/90	Tax year 1994/95	Tax year 1999/00 (preliminary actual)	Tax year 2000/01 (revised)	Tax year 2001/02 (revised)
Direct Taxes						
Persons and individuals	30,1	30,9	39,6	42,8	40,7	40,4
Gold Mines	8,9	1,6	1,0	0,1	0,1	0,1
Other mines	1,0	2,8	0,4	0,3	0,4	0,4
Companies (other than mines)	17,1	17,0	10,5	10,2	10,7	10,9

Secondary tax on companies	0,0	0,0	1,1	1,3	1,4	1,4
Tax on retirement funds	0,0	0,0	0,0	2,9	3,0	3,0
Donations tax	0,0	0,0	0,1	0,0	0,0	0,0
Estate duty/inheritance tax	0,5	0,1	0,1	0,2	0,2	0,2
Other	1,7	0,9	1,0	0,3	1,2	1,9
Total Direct Taxes	59,3	53,3	53,9	58,1	57,7	58,3

Van Vuren (2010) submits that estate duty is a type of “wealth or capital tax”. He remarks that “estate duty is in essence a capital transfer tax”. For the 2009/2010 financial tax year, estate duty and donations tax contributed R800 million to the national taxes which is less than 1% of the revenue estimate. Lester (2008:19) is of the opinion that it costs more to *impose* estate duty than to collect the taxes.

When CGT came into operation in 2001, the rate of estate duty was reduced. If estate duty is abolished it is likely that the rate of CGT will increase to compensate for the loss of revenue in the form of estate duty in order to maintain horizontal and vertical equity. As stated by Joffe (2010:12), the new amendments to the Estate Duty Act and the limited revenue contributed by estate duty, gives a clear indication that National Treasury might abolish estate duty. Bird (1991:323) agrees that wealth taxes are fairly unimportant sources of revenue in any country.

Some argue that, despite its deficiencies, wealth tax can, in principle, play an important and useful role. Those who have been against the abolition of estate duty argue that it should be accepted that the idea of revenue-raising is not an important factor to abolish the transfer tax (Dobris, 1984:1232). One of the arguments is that “to levy no death tax is to fail to tax those in the best position to pay tax at a logical and traditional time to levy a tax” (Dobris, 1984:1231). Doing away with death taxes would be regarded as a giveaway

and something must be left in place (Dobris, 1984:1231). Chapter 5 discusses the impact of estate duty and arguments surrounding the abolition of estate duty.

Even if estate duty is abolished due to the minimal revenue impact of estate duty, the growth of the assets will be subject to CGT and, as submitted by Davis *et al.*, (2010:1.2.1), even if estate duty is abolished, the objective of estate planning would practically remain the same. To the contrary, Dobris (1984:1224) maintains that “[a]rguably, repealing transfer taxes wipes out estate planning, thereby reducing the public perception that there is a candy store of tax planning that is reserved for rich people.” However, due to the revenue contribution and latest changes to the Estate Duty Act, it seems that there is uncertainty about the future of estate duty.

As previously stated, estate duty is levied on the worldwide assets of the deceased estate and hence has an impact on offshore assets, which leads to the question as to what impact do estate duty and CGT, namely, death duties, have on offshore assets.

2.7 CALCULATION OF ESTATE DUTY

Based on the discussion in the chapter, the following case study serves as a practical illustration of how estate duty is levied.

Case study 1

Mr X, a South African resident, is married out of community of property without the accrual system. He dies on 17 October 2010 and according to his last will and testament he bequeaths his offshore property to his son and the residue of his estate to his spouse.

Table 3

Estate duty payable by deceased estate

Assets that are taken into account for estate duty and those which are exempt from estate duty	Value of assets for estate duty purposes
Assets (section 3 of the Estate Duty Act)	Value
Primary residence	R3 000 000
Beach house	R1 500 000
Shares in Pty Ltd	R1 200 000
Offshore property in UK (see chapter 5)	R3 000 000
Deemed assets (section 3(2) of the Estate Duty Act)	
Life insurance to estate (no beneficiary nominated)	R2 300 000
Life insurance payable to spouse	R1 000 000
Policy proceeds on deceased's life owned by trust ¹ : Policy proceeds R800 000 less premium plus 6% compound interest	R 730 142
Pension fund (not taken into account)	R0
Gross estate	R12 730 142
Less Liabilities (section 4 of the Estate Duty Act)	
Mortgage bond on residence	R 900 000
Mortgage bond on beach house	R 600 000
Executor's fees ²	R 319 200
Master's fees ³	R 600
Death bed expenses	R 50 000
Income tax	R 50 000
Capital gains tax (see chapter 3 and 5)	R0
Bequests to spouse: Life insurance	R1 000 000
Residue ⁴	R6 810 342
Net estate (gross estate less liabilities and deductions)	R3 000 000
Section 4A abatements	R3 500 000
Dutiable estate	R0
Estate duty payable @ 20%	R0

¹ Assumption: Premiums were paid by the trust for the past 10 years and amount to R5 000 per year. (R800 000 less R69 858)

² Executor's fee is calculated as follows: assets less offshore property plus life insurance payable to estate multiplied by 3,5% + VAT. The assumption is made that the executor is registered for VAT.

³ The maximum Master's fee per estate is R600 (Davis *et al.*, 2010:11.6).

⁴ The section 4(q) inheritance from spouse is calculated as follows: Assets less offshore property less insurance paid to spouse plus life insurance to estate less liabilities and expenses.

Mr X's estate requires liquidity to cover the following costs:

Mortgage bond on residence	R 900 000
Mortgage bond on beach house	R 600 000
Executor's fees	R 319 200
Master's fees	R 600
Death bed expenses	R 50 000
Income tax	R 50 000
Capital gains tax ⁵	R0
Estate duty payable	R0
Cash required	R1 919 800
Cash available	R2 300 000
Cash surplus	R380 200. (In practice the spouse will receive R380 200 instead of the full R2 300 000 in cash)
Possible UK death duties on offshore property (chapter 5).	R600 000 (Any exemptions and deductions should also be taken into account).

2.8 CONCLUSION

Death duties on the transfer of capital at death were imposed mainly to achieve vertical equity. However, it may be argued that estate duty no longer achieves vertical equity due to proper estate planning tools being employed, particularly by wealthier individuals. In addition, it seems that estate duty contributes only a constant 0,1% or 0,2% of the national tax revenue.

The conclusion reached here is that estate duty does not impact vertical equity and revenue contribution significantly (chapter 2.6). However, the impact of estate duty on offshore assets should not be underestimated.

With reference to chapter 1.1, and as explained above, a taxpayer is deemed to have disposed of his assets on death for CGT purposes. And if, as anticipated, estate duty is abolished, it is likely that the rate of levying CGT on death may increase. The impact CGT has on a deceased estate should not be overlooked and it may be accepted that CGT is here to stay.

⁵ See chapter 3 for a more detailed discussion of CGT payable upon death.

Estate practitioners should be careful when advising their clients on the use of an estate planning tool, as a reduction in estate duty does not necessarily mean CGT will also be reduced; in fact, it is likely that CGT may well increase (Victor & King, 2008:332).

The next chapter is therefore dedicated to a discussion on capital gains tax on death.

CHAPTER 3

THE IMPACT OF CGT UPON DEATH

3.1 INTRODUCTION

Even though the amount of CGT payable is a deduction in the deceased estate for estate duty purposes (section 4 of the Estate Duty Act), the impact of CGT upon death should not be overlooked.

As explained in chapter 2.6.2, there is a dark cloud hanging over the future of estate duty due to its insignificant revenue contribution. Victor and King (2008:332) submit that a reduction in estate duty does not necessarily mean CGT will be reduced; in fact, it is likely that CGT may increase. It may be accepted that CGT is here to stay. The rate of levying estate duty was reduced when CGT was introduced. If estate duty is abolished in South Africa, it is anticipated that such repeal will have an effect on CGT. With reference to the discussion in chapter 1, a resident is subject to tax on owned worldwide assets, and it is deemed that he has disposed of his assets on death for CGT purposes (paragraphs 2(1)(a) and 40 of the Eighth Schedule of the Income Tax Act).

The objective of this chapter is to consider whether the repeal of estate duty will affect the levying of CGT. In order to achieve this objective, it is necessary to understand the impact of CGT on death.

3.2 THE CGT SYSTEM

South Africa's CGT system is mainly based on the tax systems of Australia and the United Kingdom (hereinafter referred to as the "UK"), and has been influenced by the United States of America (hereinafter referred to as the "USA"), Canada and Ireland (Victor & King, 1998:195). CGT came into effect on 1 October 2001. Prior to this date, any capital gain a person may have made was exempt from tax. The revenue a person may have earned was

subject to income tax but when a person made a gain on the sale of an asset, no tax was levied on the gain. CGT was implemented in South Africa to create fairness in the tax liability of taxpayers (Victor & King, 1998:195).

According to the American experience, capital gains accrue mainly to individuals with a higher income, hence including the capital gains in the taxable income of the individual contributes to the progressivity of the income tax system. This allows the government to widen tax bases and reduce standard tax rates. The international consensus is that the largest portion of CGT revenue can be attributed to wealthier individuals. The top 1% of taxpayers in the USA and Canada produce nearly 60% of the capital gains (Tomasek, 2001:10, 11).

Table 4

Distributions of taxes paid on capital gains in the USA, by income, 1993- in Millions unless otherwise specified (Tomasek, 2001:11)

Income (\$)*	Number of returns	Current year gains	Taxable gains	Tax on gains	Percentage of gains	Percentage of tax
0	0,5	-9 285	240	-62	-6,6	-0,2
1-10,000	2,7	1 393	1 778	154	1,0	0,5
10,000-20,000	2,4	4 292	4 226	558	3,1	1,7
20,000-30,000	2,2	5 303	5 194	786	3,8	2,4
30,000-40,000	2,0	5 584	5 247	941	4,0	2,8
40,000-50,000	1,6	5 234	5 169	1 020	3,7	3,1
50,000-75,000	2,9	12 217	11 664	2 557	8,7	7,7
75,000-100,000	1,4	8 418	7 994	1 842	6,0	5,6
100,000-200,000	1,4	20 173	19 187	4 645	14,4	14,0
200,000 +	0,6	86 509	83 438	20 675	61,9	62,4

Total	17,7	139 837	144 130	33 115	100,0	100,0
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The table makes it clear that the introduction of CGT imposes vertical equity on the income tax system. For other income groups in the \$1-10 000 range, the CGT contribution was 0,5%; the income groups exceeding \$200 000, CGT contributed 62,4%.

The Eighth Schedule was incorporated into the Income Tax Act and paragraph 11 of this Schedule states that the disposal of an asset after 1 October 2001 is an event for CGT. Unless indicated otherwise, all references in this chapter are to the Eighth Schedule of the Income Tax Act and paragraph 2 of the Eighth Schedule.

It is essential when levying CGT that there is a disposal of an asset. A “disposal” is defined in paragraph 11 of the Eighth Schedule as:

“any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset”.

If the deceased owned a property or was a shareholder of a company, such a shareholding and value of the house would be subject to estate duty and constitute an “asset” as defined in paragraph 1 of the Eighth Schedule for CGT purposes.

According to paragraph 1 of the Eighth Schedule, the term “asset” includes –

“(a) property of whatever nature, whether moveable 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;”

CGT is calculated on proceeds less the base cost of the asset. In terms of the Income Tax Act, the capital gain is multiplied by the 25% inclusion rate and then included in taxable income which in turn is subject to the taxpayer’s

marginal tax rate. When the proceeds of an asset exceed the base cost of the asset the amount constitutes a capital gain. However, if the base cost exceeds the proceeds then the amount constitutes a capital loss (paragraphs 3 and 4 of the Eighth Schedule). In determining a capital gain or capital loss of an asset it is essential to accurately determine the value of the proceeds received in respect of the disposal of the asset and base cost of the asset.

If a resident acquired an asset after 1 October 2001, the base cost of the asset will be the purchase price, also called the market value of the asset. Included in the value, but not limited to the base cost of the asset, is the sum of transfer costs, improvements made to the property and transfer duties (paragraph 20 of the Eighth Schedule).

For assets acquired prior to the 1 October 2001 date, taxpayers were given three years to value their assets. The cut-off date for the valuation was 30 September 2004 (paragraph 29(4) of the Eighth Schedule; Jones, S., 2009:4). If the resident acquired the assets prior to this date and never valued the assets, then one of three different methods will be used to calculate the base cost of the asset (paragraph 25 of the Eighth Schedule; Oliver, 2007:42).

Paragraphs 26 to 28 of the Eighth Schedule determine the various valuation date values in different situations. Paragraph 25 sets out how the base cost of an asset is calculated if the asset was acquired prior to 1 October 2001. In terms of paragraph 25 the base cost of the assets is:

- the valuation date value which is calculated according to paragraphs 26 to 28 of the Eighth Schedule; and
- any qualifying expenditure incurred on the assets before and after 1 October 2001 (also called the valuation date value).

The different methods should be taken into consideration if the asset has never been valued. The different methods of calculating CGT is an issue outside of the scope of this study and will not be covered here. In terms of

paragraph 35(1) of the Eighth Schedule “proceeds” from the disposal of an asset by a person are equal to the amount received by or accrued or which is treated as having been received by, or accrued to or in favour of, that person in respect of that disposal.

3.3 ASSET DISPOSED OF IN A FOREIGN CURRENCY

When dealing with assets acquired or disposed of in a foreign currency, it is necessary to determine the capital gain or loss in rands (paragraph 43 of the Eighth Schedule). Paragraph 43 of the Eighth Schedule prescribes the rules for converting the capital gain or loss into rands and prescribes when such conversion into rands should take place and the appropriate exchange rate to be used (McAllister, 2010:545). This particular paragraph deals with two categories of assets:

- foreign equity instruments and an asset which is derived or deemed to have been derived from a South African source (paragraph 43(4) of the Eighth Schedule); and
- Immovable property in a foreign country which is held by a resident, assets of a foreign permanent establishment (hereinafter referred to as “PE”) of a resident and some assets subject to foreign taxation, loans and advances or debts owing to a person in a foreign currency (McAllister, 2010:551).

The assets contemplated in paragraph 43(4) of the Eighth Schedule is outside the scope of this study and this discussion will therefore focus on paragraphs 43(1) and 43(2) of the Eighth Schedule.

Paragraph 43(1) and (2) of the Eighth Schedule deals with the following conditions:

- where the expenditure derived from and proceeds incurred are denominated in the same foreign currency (paragraph 43(1)), and

- where the expenditure derived from and proceeds incurred are denominated in another currency (paragraph 43(2))” (McAllister, 2010:551).

In terms of paragraph 43(1) of the Eighth Schedule the capital gains or capital loss is determined as follows:

- Step 1 is to determine the capital gain or capital loss in foreign currency;
- Step 2 is to convert the foreign currency capital gain or capital loss into rands at the date of disposal by applying the the average exchange rate for the year of assessment in which the asset was disposed of, or by applying the spot rate on the date of the disposal of the asset (McAllister, 2010:552).

Paragraph 43(1) of the Eighth Schedule does not make provision for the currency fluctuation between the date the expenditure is incurred and the date of disposal of the asset. If the rand declines against the particular foreign currency it will benefit a person holding a foreign asset in terms of paragraph 43(1) of the Eight Schedule. The base cost is converted into rands at a lower exchange rate ruling at the date of disposal which results in giving more rands as opposed to a higher rate at the date the expenditure was incurred. If the base cost is high, the capital gain is low. These assets are treated similar to the treatment of controlled foreign companies (hereinafter referred to as “CFCs”) under section 9D(6) of the Income Tax Act in respect of the foreign taxable income being brought back to rands at the average exchange rate during the relevant year of assessment (McAllister, 2010:552).

When either paragraphs 43(1) and 43(4) of the Eighth Schedule apply then paragraph 43(2) of the Eighth Schedule will not apply. Paragraph 43(2) of the Eighth Schedule deals with a situation where the expenditure derived from and proceeds incurred are denominated in another currency (McAllister, 2010:554). For this purpose the two terms have the following meanings:

According to McAllister (2010:554) the term “currency on disposal” refers to the proceeds that have been

- “received or accrued; or
- denominated for purposes of financial reporting of a PE of the person, in any currency.”

The term “currency of expenditure” is the expenditure

- “actually incurred; or
- denominated for purposes of financial reporting of a PE of the person, in another currency (that is, one that differs from the currency of disposal)” (McAllister, 2010:554).

Paragraph 43(2) of the Eighth Schedule will also apply where a resident owns immovable property outside South Africa, i.e. a holiday home or investment property, which is not attributable to a foreign PE. If the currency in which the expenditure was incurred and the currency in which the proceeds were received or accrued differ, then paragraph 43(2) of the Eighth Schedule will apply (McAllister, 2010:556).

Table 5

Translation of proceeds and or expenditure into local currency (paragraph 43(2) of the Eighth Schedule; McAllister, 2010: 556):

Paragraph 43(2)	How proceeds and expenditure are denominated	Translation method
(a)	Expenditure actually incurred in rands, proceeds in another currency.	Translate proceeds into rands at average exchange rate in year of disposal.
(b)	Proceeds received or accrued in rands, expenditure in another currency	Translate paragraph 20 expenditure into rands at average exchange rate in year expenditure incurred or treated as being incurred.
(c)	Neither proceeds nor expenditure in rands.	-Translate paragraph 20 expenditure to currency of disposal at average exchange rate in year in

		<p>which expenditure incurred or treated as being incurred. If currency of disposal did not exist at time of expenditure, use first available exchange rate for that currency of disposal); and</p> <p>-Translate foreign currency capital gain or loss to rands at average exchange rate in year of disposal.</p>
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In terms of paragraph 43(2)(c) of the Eighth Schedule when an asset is acquired in a foreign currency but the disposal takes place in a rand currency then the base cost of the said asset is exposed to the full currency fluctuation. When an asset is acquired and disposed of in different currencies only the currency gain or currency loss is taken into account and the rand currency gain or rand currency loss is ignored (McAllister, 2010:556).

Paragraph 43(5) of the Eighth Schedule applies where “[a] person is treated as having received an amount of proceeds from the disposal of an asset, and the base cost of that asset has been determined in foreign currency”.

Paragraph 43(6) of the Eighth Schedule provides for this situation: that, if the market value has been adopted as the valuation date value of an asset, that market value of the asset should be determined in the currency of expenditure of the asset (McAllister, 2010:566).

A resident is liable for estate duty and CGT on worldwide assets owned. If the deceased estate has fixed offshore property, such property will be subject to CGT (paragraph 2(1)(a) of the Eighth Schedule).

3.4 CGT UPON DEATH

For CGT purposes it is deemed that a person disposed of his assets on his death for an amount received or accrued equal to the market value of the said assets at date of his death and it is regarded that the deceased estate have acquired the assets at a cost equal to the market value on that date (paragraph 40 of the Eighth Schedule).

Therefore, it is deemed that a taxpayer has disposed of his assets on death for CGT purposes. For this study, the focus will be only on CGT payable on death, and the impact of CGT on a deceased estate. An estate of a deceased resident will be liable for CGT with an exclusion on death of R120 000 (paragraph 5(2) of the Eighth Schedule). Paragraph 53(2) of the Eighth Schedule states that assets which are mainly used for purposes other than carrying on a trade should be disregarded when calculating a capital gain or capital loss. These assets are the so-called “personal use” assets. However, certain assets like a primary residence are subject to CGT.

3.4.1 Calculation of CGT upon death

The following case study illustrates the impact of CGT on death.

Case study 2

Mr X, a South African resident, is married out of community of property without the accrual system. He dies on 17 October 2010 and according to his last will and testament he bequeaths his offshore property to his son and the residue of his estate to his spouse.

Table 6

Total capital gain

Asset	Proceeds	Base cost	Exclusion	Gain/Loss
Primary residence	R3 000 000	R1 000 000	R1 500 000 (paragraph 45 of the Eighth Schedule)	R500 000
Beach house	R1 500 000	R500 000	R0	R1 000 000
Shares in Pty Ltd	R1 200 000	R0	R0	R1 200 000
Offshore property	R3 000 000	R1 000 000	R0	R2 000 000
Total gain				R4 700 000

In terms of paragraph 40(1)(a) bequests to a surviving spouse are seen as a “roll-over regime”. The primary residence, beach house and shareholding are transmitted to the surviving spouse and hence no CGT is payable by the deceased estate of Mr X. The deceased estate will be liable for CGT on the offshore property as the property is bequeathed to his son.

Table 7

CGT payable by deceased estate

Total gain	R2 000 000
Less CGT exclusion upon death	R120 000
Less previous losses	R0
Taxable capital gain	R1 880 000
Multiply R1 880 000 with inclusion rate of	R470 000

25%	
Multiply R470 000 with marginal tax rate 40% (assumption)	R188 000
CGT payable on death is	R188 000 (the CGT payable will have an effect on the liquidity requirements)

For purposes of this example, if the inclusion rate is increased, which is likely to happen as explained in chapter 2, for example to 30% (assumption), then the CGT payable on death would be R225 600 which would have an effect on the liquidity requirements.

3.4.2 The effect of levying CGT upon death

If the deceased estate does not have enough liquidity to pay the taxes and debts, the executor will need to sell some of the assets to settle the taxes and debts and such disposal will attract CGT. As stated above, the deceased resident had disposed of his primary residence, beach house, shares in Pty Ltd and offshore property to his estate, and the CGT payable on death is R188 000 as the estate is liable for CGT on the offshore property. As per the calculation in chapter 2 the cash required at death is R1 919 800. The total cash required at death would be R1 919 800 plus R188 000 (CGT payable by estate), which equals R2 107 800. The cash available at death is R2 300 000. The estate therefore has a surplus of R192 200. The estate may also be liable for foreign death duties.

By way of illustration, if the estate has a liquidity shortfall of R400 000, then the executor of the deceased estate will be required to sell some of the assets to settle the debts. It is possible for a final distribution to take place two years or longer after the date of death of the deceased, and, in that period, there might have been a capital growth in the assets. If the executor decides to sell the beach house for which the market value has increased from R1 500 000 R2 000 000, the estate will incur a capital gain of R500 000. The estate

qualifies for the same exemptions and exclusions as the natural person who has passed away, but the estate will not qualify for the R120 000 exemption on the capital gains. It is very important that the executor pays attention to which assets he disposes of in the estate to ensure adequate liquidity in the estate (Victor & King, 2008:315).

In terms of paragraph 41 of the Eighth Schedule, the heir or legatee who would have been entitled to the said asset, had there been no CGT liability, has the option to choose that the said asset be distributed to the heir or legatee in person. Such distribution will be upon the condition that the amount of CGT payable, which exceeds 50% of the net value, be paid by the said heir or legatee within 3 years after the date the executor was granted permission to dispose of the assets of the estate. If the heir or legatee should decide to pay the CGT liability, the tax will be regarded as a debt owing to the estate and the CGT liability will be chargeable under the Income Tax Act which is due by the heir or legatee. Under section 89 of the Income Tax Act, interest will be charged if the heir or legatee fails to pay the CGT liability within the 3 year period (Stein, 2001:10.8, 10.9).

It is also important to note that, when calculating a resident's CGT liability, the marital regime may have an effect on the CGT payable. If the resident is married in community of property and disposes of an asset, the disposal is seen as comprising equal shares for the spouses. If the asset were excluded from the communal estate of the spouses then only the spouse that made the disposal will be liable for CGT (paragraph 14 of the Eighth Schedule).

As stated in chapter 2.5, the estate of the last surviving spouse may have a rebate of R7 000 000 for estate duty purposes. Even if the estate of the last surviving spouse does not pay or pays very little estate duty, the CGT due by the estate of the last surviving spouse may be enormous. As per the calculation in chapter 2.7, R500 000 of the rebate had not been utilised and the surviving spouse would have a rebate amount of R4 000 000.

According to paragraph 40(1) of the Eighth Schedule, the deceased will be deemed to have disposed of all his assets to the deceased estate for proceeds aligned with the market value of those assets at the time of death. Paragraph 40(2) states that the beneficiary shall also be taken to have acquired a transmitted asset at a base cost aligned with the market value of the asset at the time of death. The devolution of assets upon a surviving spouse is seen as a “roll-over regime” (paragraph 40(1)(a) of the Eighth Schedule).

Capital gains or losses will be disregarded in the deceased’s estate and the surviving spouse is to be taken to have acquired the asset at a base cost on the date on which it was acquired by the deceased and to have used it in the same manner as it was used by the deceased. When assets are bequeathed to the surviving spouse the deceased’s estate will not pay CGT on those assets. However, the surviving spouse will be liable for CGT when he or she disposes of the assets during his or her lifetime or at death (paragraph 67 of the Eighth Schedule).

Estate duty is levied on the gross estate less all liabilities of the deceased (section 2(2) of the Estate Duty Act). CGT is levied on the market value on the date of death of the deceased less the base cost of the asset (paragraph 40(1) of the Eighth Schedule; Swanepoel, 2008:1). Since residents are liable for CGT on their worldwide assets, if residents have offshore assets in their personal names and dispose of the assets as a result of death, they will be liable for CGT in South Africa on those offshore assets, irrespective of where the assets are situated (Victor & King, 2008:195).

The deceased estate is liable for estate duty and CGT on the offshore property. The question remains as to what the tax implication will be on the offshore property situated in the foreign country as the foreign country may also impose taxes upon death. To determine the impact of estate duty and CGT on offshore assets, the effect of the DTAs and estate tax treaties, if any, should be considered. Chapter 5 deals with the impact of CGT on offshore assets upon death.

3.5 CONCLUSION

As with estate duty, CGT was largely imposed to create vertical equity in the South African tax system. Similar to estate duty, CGT upon death can be largely avoided by bequeathing all assets to the surviving spouse. However, the CGT implications upon the death of the last surviving spouse may be enormous. In addition the R120 000 rebate in the year of death cannot be passed on to the surviving spouse as is the case with the estate duty rebate. The CGT liability in a deceased estate may have detrimental implications for the heirs of the deceased estate.

While estate duty is payable on the market value of the assets, CGT is payable on the growth of the assets. The greater the growth, the more CGT is payable upon death. The further away we move from 2001, the more impact CGT has on assets. As mentioned in chapter 3.2, the international perception is that the largest portion of CGT revenue is contributed by wealthier individuals.

As explained in chapters 1.1 and 2.1, a resident is subject to tax on worldwide assets which means that a disposal of an offshore asset will be an event for CGT purposes. The question remains as to what impact CGT and estate duty have on a deceased estate which holds an offshore asset. With the discussion offered in chapters 2 and 3, it has been seen that the deceased estate is liable for estate duty and CGT on offshore property. However, the foreign country may also impose taxes on death that may have a negative effect on the deceased estate.

Chapter 4 considers selected countries from the OECD model and gives an explanation of the death duties imposed by the countries. It is essential to examine estate taxes and CGT levied by the selected countries to obtain a better understanding of how these different jurisdictions tax property situated in them.

CHAPTER 4

TAXES UPON DEATH IN SELECTED FOREIGN COUNTRIES

4.1 INTRODUCTION

The main objective of this study is to consider the current impact of estate duty and CGT on offshore assets and the potential effect if estate duty were to be abolished. In order to reach a conclusion on one of the secondary objectives (chapter 1.3) it is necessary to analyse how selected foreign countries levy taxes upon death and how non-residents are taxed on the property situated within the foreign country.

It is fundamental when compiling a comprehensive estate plan to consider offshore planning (Oosthuizen, 2008:25). It is important to pay attention to the taxes payable on death in foreign countries. The tax implications and protection of assets should always be considered but shouldn't be the overriding concern, and the costs of strategies should not exceed the advantages they offer (Abrie *et al.*, 2003:224).

Non-residents of South Africa are taxed on a source-based system of taxation. If a South African resident has an offshore asset, it is likely that the foreign country will tax the South African resident on a source-based system of taxation. Various foreign countries are eager to attract investments and will offer tax concessions to achieve this. A discussion on various types of investments and their tax benefits would not fall within the scope of this study (chapter 1.4).

It was found in Columbia that wealth taxes formed part of all the non-wage personal income taxes which were collected by the country. In 1989 Argentina and Mexico abolished their death taxes (Bird, 1991:324). Conversely, Spain imposes inheritance tax on all assets situated in Spain. The beneficiary or donee is charged tax and no tax is levied on the estate. On 1 January 2008

Spain suspended wealth tax. Residents and non-residents of Spain are subject to CGT at a rate of 18% (Soul, 2010:656).

4.2 ESTATE DUTY ON OFFSHORE ASSETS

As stated in chapter 1.1, a resident is subject to estate duty on his worldwide estate and hence an offshore asset of the deceased will be subject to estate duty, unless the requirements of section 4(e) of the Estate Duty Act are met.

It is submitted that most foreign countries tax non-residents in their country, on a source-based system of taxation. It can be accepted that the general principle of international law is the right to tax which extends to non-residents (Albrecht, 1952:145). When a resident has an interest in a foreign country, for example, fixed property situated in the country, the effect of any DTA and/or estate tax treaty must be considered. This will be discussed in chapter 5.

According to the Estate Duty Review Consultation Document (2004:3) 24 of the 30 Organisation for Economic Co-operation and Development (hereinafter the "OECD") countries levy estate duty or similar taxes. These include Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Japan, Korea, Luxembourg, Netherlands, Norway, Poland, Portugal, Slovakia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States of America. All the European countries listed above impose both an inheritance tax or estate duty and a capital gains tax or net wealth tax. Chapter 4 examines a few OECD countries selected from the list above that impose estate duty and CGT and as well as foreign countries which no longer impose these taxes. It is essential to examine foreign countries and their taxes payable on death, as the scope of this study focuses on offshore assets and the death duties payable on these offshore assets. Since some of these countries still levy estate duty and/or CGT, the uncertainty remains as to what impact estate duty and CGT have on the deceased estate which holds an offshore asset.

This chapter discusses selected OECD countries with which South Africa has concluded DTAs and/or estate tax treaties and these are: France, Germany, Switzerland, the UK and the USA. Attention is also given to Australia where estate tax was abolished in phases from 1977 to 1984, and Canada, which abolished it in 1972. The following foreign countries are selected on the fact that some of the countries still levy death duties and some have revoked death taxes.

4.3 AUSTRALIA

4.3.1 Introduction

The Australian Constitution has its origin in the United States Constitution, and the country is a Commonwealth country. Australia is a confederacy of six states and two federal territories. One must take account of all six states and the two territories to determine the regulating law applicable to the administration of deceased estates and trusts. The common law system is also applicable in Australia, and the common law of trusts and probate is based on the English principles of trust law. Under the common law system, courts construe statutes law and expand judgement law. (Bevan *et al.*, 2010:67).

The Commonwealth Parliament imposes only income tax, and the six states and the two territories have the authority to levy taxes on the type of transactions and the class and nature of properties. Each jurisdiction of state is authorised to regulate the administration of deceased estates and the probating of testamentary structures. The Trustees Acts and Trustee Companies Acts of each state control and regulate the variation, termination and administration of trusts. The Australian taxable period (tax year) commences on 1 July and ends on 30 June (Bevan *et al.*, 2010:67).

4.3.2 Taxation of deceased estates: estate duty and CGT

Sir Joh Bjelke-Petersen (quoted by Muljee, 2007:28-29) abolished inheritance tax in Queensland in 1978 with the intention of encouraging individuals to move to the state. Malcolm Fraser, who was the prime minister at the time, approved the abolition of inheritance tax (Muljee, 2007:28-29). Since 1981 Australian law no longer levies any estate duty, death duties or any gift tax upon death. Estate duty or death duties may still be levied by some of the states and territories, but it is highly unlikely, as estate duty or death duties, in most cases, no longer apply where the deceased has passed away within the last 20 to 23 years. Estate practitioners and tax advisers no longer take estate duty or death duties into consideration when advising Australian residents on estate planning (Bevan *et al.*, 2010:72).

CGT came into effect in Australia in 1985. Australian residents pay CGT on their worldwide assets and Australian non-residents are also liable for CGT when disposing of an asset situated in Australia. According to the CGT system, the net capital gain is included as income of the taxpayer, and therefore inflicts an income tax liability. An individual is liable for CGT on only 50% of the capital gain where the individual has had the asset for more than one year. A company does not get any discounts on its CGT liability. If the individual shares in the gains of a trust, and if the assets were held for longer than a year, they are taxed on 50% of the capital gain (Bevan *et al.*, 2010:71). CGT is not levied on the deceased estate but is due only when the property is sold (Jones, P.M., 2006:6).

Under the Australian tax system, on death of the taxpayer, two tax returns should be filed. One tax return reflects the income tax and capital gains tax of the deceased upon date of death, and the second tax return recognises any revenue of the estate from date of death until the end of the tax year (Bevan *et al.*, 2010:71).

According to the CGT system of Australia, the legal personal representative and legatees/heirs (also known as the beneficiaries) of the deceased estate

have the option to postpone any CGT liability of the deceased on the assets that have been transmitted to them until sale of the assets and these are subject to CGT. If the deceased had pre-CGT assets at date of death, the said assets will be converted into post-CGT assets. The post-CGT assets are deemed to have been acquired by the legal personal representative or the heirs/legatees of the deceased estate at a base cost equal to the market value at date of death of the deceased. An asset is regarded as a pre-CGT asset if the said asset was acquired before 20 September 1985. The pre-CGT assets were exempt from CGT until the asset was sold or transferred to someone else, and at time of disposal the assets become CGT assets which are subject to CGT. By deeming the assets as those of the legal personal representative or heirs/legatees of the deceased estate, the CGT calculation is placed in the hands of the legal personal representative or heirs/legatees when they dispose of the assets (Bevan *et al.*, 2010:72).

Australia remains one of the only developed nations without some form of explicit or *de facto* inheritance tax. When inheritance tax was abolished in Australia, most forms of capital gains were untaxed and capital gains were not realised at death. In the aftermath Australia introduced a separate capital gains tax (Gans & Leigh, 2006:1).

4.4 CANADA

4.4.1 Introduction

All the jurisdictions of Canada except Quebec follow the common law tradition. Canada consists of ten provinces and three territories. According to the constitution of Canada, each provincial jurisdiction deals with laws relating to property, i.e. estates. The common law jurisdictions endorse legislation regarding property, probate of wills, as well as the management and administration of deceased estates (Cadesky *et al.*, 2010:133-134).

Canada is a Commonwealth country. Taxation is inflicted by statute and the federal authority is authorised to inflict taxation in any form within any part of

Canada. Restrictions are placed on the provinces to impose only direct taxations on persons or property. However, members of the First Nations (“Indians”) are not liable for tax imposed by federal or provincial authorities on income earned in reserves, including property which is situated in those reserves, deceased estates and any trusts formed on a reserve (Cadesky *et al.*, 2010:134).

4.4.2 Taxation

Residents of Canada are taxed on their worldwide income. The tax year for individuals and *inter vivos* trusts is a calendar year. Quebec imposes its own tax system separate from these taxes. Canada imposes tax on Canadian-source income of non-residents also (Cadesky *et al.*, 2010:137).

Income, for income tax purposes, includes 50% on capital gains net of capital losses. If it is an active Canadian business, the amount of capital gains exemption on a farm or share is up to CAD 750 000. If a life insurance policy is paid out as a result of death, such proceeds are exempt from tax (Cadesky *et al.*, 2010:137).

An *inter vivos* trust is taxed at the highest personal tax rate, testamentary trusts on graduate tax rates, corporations at a flat rate of 28% (in 2008) and individuals on the personal graduate tax rates, with certain allowable deductions:

- an individual qualifies for a personal exemption;
- if any income is distributed to a beneficiary in terms of a trust, that income may be deductible in the hands of a trust;
- in terms of corporations, inter-corporate-dividends may be deductible; and
- all taxpayers may also qualify for a credit for foreign taxes paid (Cadesky *et al.*, 2010:137).

4.4.2.1 *Taxation of deceased estates: estate duty*

There is no estate duty, succession duty or gift tax levied by the federal government or any of the provinces in Canada. The inheritance tax was abolished in the 1970s (Cadesky *et al.*, 2010:140).

4.4.2.2 *Taxation of deceased estates: CGT*

When a Canadian individual passes away, he is deemed to sell all the property in his name at fair market value. As previously stated, it is deemed that a taxpayer has disposed of his assets on his death for CGT purposes. The CGT is included on the final tax return of the deceased (Cadesky *et al.*, 2010:140).

CGT will not be levied if the property is transferred to a surviving spouse or a spousal trust. A spousal trust is defined as a testamentary trust whereby the spouse is the only income beneficiary on the trust and, while she is still alive, no one except the surviving spouse will be entitled to any capital of the trust. When the surviving spouse dies, CGT will be levied on his/her estate (Cadesky *et al.*, 2010:140).

If there are funds in a registered retirement savings plan, and unless it is bequeathed to the surviving spouse, such funds will be seen as income to be reported in the final tax return. Any insurance proceeds are free of CGT (Cadesky *et al.*, 2010:140).

Canada abolished its inheritance tax in 1970 but it now taxes realised capital gains at death which amount to a *de facto* form of inheritance tax (Gans & Leigh, 2006:1).

4.5 FRANCE

4.5.1 Introduction

French law does not make provision for trusts as ownership attaches to the land and not to the estate, and therefore it is impossible to create a trust under the French law. However, French law does recognise foreign trusts which are governed by other countries. French law does not make provision for the granting of probate or administration letters. According to French law, the deceased estate vests immediately in the heirs upon the death of the deceased (Naudin & Tirard, 2010:299).

Residents (individuals) in France are subject to tax on their worldwide income whereas non-residents are only taxed on their French source income. In the 2009 tax year the rates varied from 0–40%. Individuals are also taxed on certain capital gains such as gains on the sale of buildings, land or shares (Naudin & Tirard, 2010:299).

4.5.2 Wealth tax

French law imposes a wealth tax on all persons where the assets exceed a certain value on 1 January each year. Residents in France will be liable for wealth tax on their worldwide assets whereas non-residents will only be subject to wealth tax on the assets situated in France (Naudin & Tirard, 2010:299).

4.5.3 Taxation of deceased estates

According to French law neither the donor nor the deceased estate is liable for tax, but each beneficiary is liable for the benefit they receive. When either the deceased or the beneficiary is domiciled in France, the taxes payable are due on worldwide assets. If both the deceased and the beneficiary are domiciled outside France, the taxes will only be levied on the French assets. The tax

rates imposed depend on the degree of relationship between the deceased and the beneficiary. The inheritance tax rates are as follows:

- 5% - 40% for a child;
- 35% - 45% for collateral relations; and
- 60% for unrelated beneficiaries (Naudin & Tirard, 2010:299).

4.6 GERMANY

4.6.1 Introduction

Germany is a civil law, democratic-parliamentary republic, consisting of 16 federal states. The law of succession for movable and immovable property rests on nationality and not on residence or domicile. The German law of succession governs the estates of German citizens (Lehmann *et al.*, 2010:305).

4.6.2 Taxation of estates

When property is transferred at death or by gift to a beneficiary, such transfer is subject to inheritance tax and gift tax. The beneficiary or heir of the estate is liable for inheritance tax whereas gift taxes are inflicted upon the donor and donee. The tax rates imposed depend on the relationship between the donor and beneficiary (Lehmann *et al.*, 2010:305).

The tax rates vary between 7% - 30% for gifts to spouses and children, and between 30% - 50% for gifts to non-family members. A spouse qualifies for a tax-free exemption of EUR 500 000 whereas a child qualifies for a tax-free exemption of EUR 400 000. The following exemptions from inheritance tax may apply under certain circumstances:

- EUR256 000 for a spouse; and
- EUR52 000 for a child (Lehmann *et al.*, 2010:306).

If the primary residence is used for ten years after the transfer by the spouse and children, such transfer will be exempt from tax. CGT is levied at a flat rate with a uniform rate of 25% on privately held property (Lehmann *et al.*, 2010:306).

4.7 NEW ZEALAND

4.7.1 Introduction

New Zealand is classified as a constitutional monarchy which includes a democratically elected Parliament. The Income Tax Act, 2007 and the Goods and Services Tax Act, 1985 control and manage the imposition of taxation. Residents of New Zealand are taxed on their worldwide income and non-residents on source income (Hart, 2010: 463, 466).

4.7.2 Taxation of estates

In terms of section 3 of the Estate Duty Abolition Act, estate duty is no longer levied in New Zealand, but under the Estate and Gift Duties Act 1968, gift taxes are levied on any gifts made by an individual who is domiciled in New Zealand. Individuals who are not domiciled in New Zealand are also liable for gift taxes in respect of property situated in New Zealand. There is no wealth tax imposed in New Zealand (Hart, 2010: 469).

Usually there is no CGT payable in New Zealand but, in certain circumstances, such as share trading and real estate transactions, CGT can be levied in the form of income tax. Death as well as the transfer of assets to beneficiaries during the deceased's lifetime constitute a disposition of assets and may impose a tax liability (Hart, 2010:469).

4.8 SWITZERLAND

4.8.1 Introduction

The Swiss federation was founded in the 13th century, and a constitutional democracy came into force in 1848 consisting of a federal structure and independent judiciary. Civil law is applicable in Switzerland with the Federal Constitution as the foundation and the statutes being used as essential sources of law (Hausmann & Jarrett, 2010:531).

Tax legislation functions at three levels and each level has the authority to impose taxes payable and tax rates. The three levels are as follows: federal, cantonal and communal. Federal taxes include inheritance and gift taxes. The Swiss law is not cognisant of the term “trust” and therefore, when a Swiss resident does wish to set up a foreign trust and/or when a Swiss resident is appointed as a beneficiary of the trust or when a family immigrates to Switzerland, it is advisable for the resident to obtain a private ruling regarding the tax liabilities (Hausmann & Jarrett, 2010:532).

When a non-resident of Switzerland wishes to acquire residential real estate, they are usually subject to permit requirements. If the non-residents wish to acquire purely commercial real estate no restrictions apply (Hausmann & Jarrett, 2010:532).

4.8.2 Swiss succession law

According to the Succession Law of Switzerland, upon death all the assets and liabilities of the deceased should be transmitted to the heirs, whether they are legal or instituted heirs. In the event of there being more than one heir, the assets should be divided equally among the heirs and they become jointly and severally liable for any liabilities the deceased might have had at time of death. The deceased (testator) has limited preference as to how the assets are to be devolved upon death as Swiss law states that the deceased may not deny forced heirs their portion. The forced heirs are defined as spouses and

descendants. If there are no descendants then the parents of the deceased will be regarded as forced heirs. If residents are foreign citizens they are permitted to choose their national law and that law will be applied on the deceased estate (Hausmann & Jarrett, 2010:532).

4.8.3 Taxation

Federal tax includes inheritance and gift taxes. Residents of Switzerland are not subject to CGT. Each one of the three levels has its own law and imposes taxes. The rates differ from canton to canton and from community to community (Hausmann & Jarrett, 2010:532).

4.9 THE UNITED KINGDOM

4.9.1 Introduction

United Kingdom (UK) law has developed through court decisions and entails common law. There are three legal jurisdictions in the UK - England and Wales, Northern Ireland and Scotland - incorporated in the United Kingdom of Great Britain and Northern Ireland (Archer *et al.*, 2010:577).

The following Acts manage and control the imposition of income tax:

- The Income Tax (Earnings and Pensions) Act 2003 (hereafter "ITEPA");
- The Income Tax (Trading and Other Income) Act 2005 (hereafter "ITTOIA"); and
- The Income Tax Act 2007 (hereafter "ITA").

CGT is also levied on realised capital gains from disposals or deemed disposals of assets. The Inheritance Act, 1984, manages and controls the imposition of inheritance tax. The year of assessment for income tax and CGT is 6 April to 5 April (Archer *et al.*, 2010:577).

4.9.2 Taxation upon death

Inheritance tax is levied when there is a transfer of capital and is calculated on the reduction in value of the deceased's (transferor's) estate. If the transferor retains a benefit it is not seen as an effective capital transfer for inheritance tax purposes (Archer *et al.*, 2010:579).

If a capital transfer tax takes place at death or during the lifetime of an UK-domiciled spouse or civil partners, such capital transfer will not attract inheritance tax. An individual is allowed (while living) to make gifts, free of inheritance tax, on an annual basis of up to £3 000 (Archer *et al.*, 2010:580).

Provided that the donor of the gifts survives by a seven year period, there is no inheritance tax levied on absolute lifetime gifts. However, CGT may be levied or, under certain circumstances, postponed until there is a disposal from the donee (Archer *et al.*, 2010:579-580).

Currently there is a nil-rate band at death of £325 000. Inheritance tax is levied at a rate of 40% on the estate value in excess of £325 000. If the surviving spouse died on or after 9 December 2007, then the portion of the nil-rate band that has not been utilised at the death of the first dying spouse can be transmitted to the nil-rate band of the estate of the last dying spouse (Archer *et al.*, 2010:580).

The personal CGT exemption is currently £10 100. If the deceased's assets are sold to wind up the estate, CGT will be levied at a rate of 18% in excess of £10 100 (Archer *et al.*, 2010:579-580).

4.10 THE UNITED STATES OF AMERICA

4.10.1 Introduction

The United States of America (USA) consists of 50 sovereign states including the District of Columbia, and 15 dependencies. Each state has its own state

law and it should be noted that the treatment of any property affecting trusts and estates differs from state law to state law (Albright *et al.*, 2010:583).

The Uniform Probate Code (hereinafter referred to as the “UPC”) manages, controls and administers the devolution and transfer of property upon death. Eighteen states have already adopted the UPC model. The common law of trusts is governed by the Uniform Trust Code (hereinafter referred to as the “UTC”) and has already been adopted by 20 states (Albright *et al.*, 2010:583). The USA functions under a federal legal system and taxes are imposed at federal and state levels. The state law of each state determines the property rights of the taxpayer (Albright *et al.*, 2010:583).

4.10.2 Taxation upon death: estate taxes

Estate tax is imposed on the transfer of the taxable estate of a deceased person. A USA citizen or domiciliary is subject to federal estate tax on their worldwide estate. For the 2009 tax year an estate qualified for an estate tax credit of \$3 500 000, and the federal estate and gift taxes were levied on sliding scales at a maximum rate of 45%. To calculate the “taxable estate” certain deductions are also allowed. Included in the qualifying deductions are bequests to a spouse who is a USA citizen. In the event of the spouse not being a USA citizen, then such bequests are transmitted to a qualified domestic trust in order to qualify for the marital deduction. If inheritances are transmitted to a qualified domestic trust, estate tax is deferred until the death of the last dying spouse (Albright *et al.*, 2010:588).

The USA, like South Africa, has rebate amounts for which an estate would qualify. Estate tax was repealed in 2010 but the tax will return in 2011 at the 2001 exemption level of \$1 000 000 for deaths occurring in 2011 and thereafter, unless Congress extends the repeal (Estate Duty Review Consultation Document, 2004:4). If the estate is less than the exemptions, no estate tax would be levied; if the estate is in excess of these amounts then only the amount in excess would be liable for estate tax (Albright *et al.*, 2010:588).

4.10.3 The effect of estate tax upon USA non-citizens not domiciled

Non-citizens not domiciled in the USA may be liable for federal estate tax in the USA if they own property situated in the USA. If a non-citizen has USA bank accounts and debt securities, such accounts and securities are not liable for federal estate tax. The federal estate tax rates applicable to USA citizens and residents are the same for non-citizens not domiciled in the USA, but the non-citizens not domiciled qualify only for an estate tax credit of USD 60,000 (Albright *et al.*, 2010:588).

An estate of a non-USA citizen not domiciled may only get a deduction based on the following rules:

- the amount of debts and expenses deductible are based on the value of the property situated in the USA as well as the full value of the deceased's worldwide estate. The deceased's worldwide estate should be revealed to the IRS;
- only bequests to USA corporate charities and foreign non-corporate charities which were utilized wholly in the USA may be deductible; and
- in the event of the surviving spouse being a non-USA citizen then the bequest should be transmitted to a qualified domestic trust in order to qualify for the marital deduction (Albright *et al.*, 2010:588).

If the country of which the non-citizen non-domiciled is a resident has an estate tax treaty with the USA, the estate of the non-citizen may only be subject to federal estate tax in the USA if the assets are associated with a "permanent establishment" situated in the USA. If the country has an estate tax treaty, the estate of the non-citizen non-domiciled may be exempted from federal estate taxes in the USA (Albright *et al.*, 2010:588). South Africa has entered into an estate treaty with the USA (SARS, 1952).

4.10.4 CGT in the USA

For the 2009, 2010 and 2011 tax years, the tax rate on most long-term capital gains on the sale or disposal of a capital asset held for a period of more than one year was 15% (Albright *et al.*, 2010:585).

4.11 CONCLUSION

Developed countries such as France, Germany, Switzerland, the UK and the USA still levy death duties and apply a source-based system of taxation for non-residents. Only Australia and Canada have done away with estate duties.

Non-residents of foreign countries are tax-liable on a source-based system of taxation in that foreign country which may have the effect that the estate of a South African deceased resident is subject to estate duty and/or CGT in the foreign country. Prior to acquiring offshore property, it is essential that a South African resident obtain comprehensive advice on the taxes payable in that country. If a South African resident dies with offshore property in his personal name, the estate may be liable for estate duty and CGT both in the foreign country and in South Africa. However, if a South African resident wishes to acquire property, for example in Australia, which no longer levies death duties, it is still vital that a comprehensive estate plan and tax plan should be assembled before the resident acquires the offshore property. The effect of capital transfer tax on an offshore asset can also never be underestimated.

One of the secondary objectives of this study is to examine the impact of estate duty and CGT specifically on offshore assets. While chapters 2 and 3 considered the general application of estate duty and CGT, chapter 5 will focus specifically on the taxation of offshore property owned by a deceased estate taking into account the tax regimes of selected foreign countries and the impact of the DTAs and estate tax treaties.

CHAPTER 5

THE IMPACT OF ESTATE DUTY AND CGT ON OFFSHORE ASSETS UPON DEATH

5.1 INTRODUCTION

The first chapter of this study referred to the common misperception that offshore assets will not form part of a resident's estate for estate duty purposes (Oosthuizen, 2008:25). Chapters 2 and 3 addressed the development and uncertain future of estate duty and the imperative role CGT plays on death – the impact of estate duty and CGT. Currently in South Africa, both estate duty and CGT are payable on death which leads to double taxation. In light of a resistance to double taxation and the fact that estate duty contributes minuscule amounts of revenue to the national taxes, the National Treasury is reconsidering taxes on death (SARS, 2010:25).

It is essential to address the potential impact the abolition of estate duty may have on taxes payable on death by a deceased estate which holds an offshore asset to determine the real impact of estate duty even though its revenue contribution is not viable (chapter 2.6.2).

Chapter 4 examined the estate duty and CGT regimes of selected OECD countries which still levy estate duty and/or CGT. This chapter focuses on the impact of death duties specifically on offshore assets, taking into account DTAs and estate tax treaties and their effects.

Arguments in favour of abolishing estate duty and arguments against the abolishing of estate duty and the taxation of residents with offshore assets under international law are examined. This chapter also deduces whether the abolition of estate duty affects taxes payable by a deceased estate which holds an offshore asset or not.

With reference to the definition of paragraph 2 of the Eighth Schedule of the Income Tax Act and section 3 of the Estate Duty Act, residents are subject to tax on their worldwide assets, and non-residents are subject to tax on income from a South African source and capital gains on immovable assets in South Africa, or assets attributable to a permanent establishment of that non-resident in South Africa.

It is submitted in the Estate Duty Review Consultation Document (2004:4, 5) that estate duty regimes adopted by other countries normally tie estate duty liability to “place of domicile”. Broadly speaking, a person is domiciled in the country where a permanent home is situated. The term “domiciled” is used widely as the test for estate duty liability because it is much less common or difficult to change “domicile” compared to “residency”. Generally, overseas jurisdictions treat “non-domiciles” and “domiciles” differently, based on their resident-based taxing principle. The estate of a “domiciled” deceased is subject to estate duty on all assets passed on whether situated locally or offshore. Only local assets of a “non-domiciled” deceased are taxed. There can thus be estate duty and CGT consequences if a South African resident owns offshore property.

In the determination of the taxability of income received by a resident from a foreign source or when a non-resident derives income from a source situated within South Africa, the effect of any DTA and estate tax treaty entered into between South Africa and the foreign country, has to be kept in mind (Stiglingh *et al.*, 2010:50). South Africa has concluded DTAs with various countries and has concluded estate tax treaties with the BLS countries (Botswana, Lesotho, Swaziland), Zimbabwe, the UK and the USA.

5.2 ASSETS SITUATED OUTSIDE SOUTH AFRICA

5.2.1 Introduction

Property situated outside South Africa, which is in a resident's personal name, will be subject to estate duty in South Africa except for certain exclusions as stated in section 4(e) of the Estate Duty Act.

The effect of estate tax treaties should be taken into account when determining whether a deceased will be liable for estate duty in South Africa or in the country where the assets are situated. The Administration of Estates Act (66/1965) (hereinafter referred to as the "Administration of Estates Act") is not clear on how to administer offshore assets if the deceased had personally registered offshore assets at the date of death. It appears that the Master of the High Court only deals with local assets, and that offshore assets only reflect on the liquidation and distribution account for estate duty purposes (Victor & King, 2008:264). Uncertainty remains as to what impact estate duty and CGT have on a deceased estate which holds an offshore asset.

5.2.2 Purchasing property offshore

When South African residents consider purchasing a property in a foreign country there are various factors that need to be taken into account. Every natural person who is a South African resident above the age of 18 years is entitled to invest R4 000 000 offshore through their foreign capital allowance provided that their personal tax return is in order with SARS (Frank, 2009). Since 8 November 2010, the once-off limit of R4 000 000 has been changed to an annual limit of R4 000 000 (Wealth Internal Communications, 2010). According to the Wealth Internal Communications (2010) "[i]ndividuals may also, on an application basis, invest in excess of the foreign investment allowance abroad. The category of investments includes, but is not limited to, foreign fixed property. A resident may therefore now apply to acquire, for example, fixed property anywhere in the world even where he has already availed himself of his maximum foreign investment allowance".

According to the South African Reserve Bank (hereinafter referred to as “SARB”), a resident may raise a mortgage on the offshore assets and only the offshore assets may be used as collateral against the bond. Offshore inheritance may also be utilised to purchase offshore assets (Worms, 2009:16-17). If a mortgage is raised on the offshore property the CGT implications of foreign currency rate fluctuations should be kept in mind (Worms, 2009:5).

Any currency gains or losses on the settlement of a debt utilised to purchase immovable property in the offshore country will not be taken into account when calculating the CGT payable. Thus, an offshore mortgage bond will not attract CGT (Worms, 2009:5).

A resident should consult an estate and tax advisor before purchasing offshore property as consideration needs to be given to the structure in which to purchase the asset. The following options should be considered when purchasing offshore property:

- purchasing directly into the personal name of the resident;
- purchasing into an offshore trust; and
- purchasing into an offshore company (Worms, 2009:17).

As explained above, purchasing property in a resident’s personal name may attract estate duty and CGT; although it may look more attractive with respect to administration costs, it may not be the best option to purchase the offshore property in the resident’s personal name. Assets can be transferred to an offshore trust by way of donation or loan account (Worms, 2009:17).

This study does not address estate planning tools such as offshore trusts and offshore companies as it is outside the scope of this study. When a deceased estate holds an offshore asset there may be practical problems when winding up the estate and, as stated, the Administration of Estates Act is silent on the administering of offshore assets in the deceased estate. It is therefore vital to have an offshore will pertaining to the assets situated in the foreign country.

5.2.3 Offshore wills

If the deceased only has a South African will dealing with the deceased's worldwide assets it may delay the administration of the estate and may cause uncertainty as some overseas jurisdictions do not share our legal terminology. It is indispensable to have offshore wills for the assets situated in the foreign country for the following reasons (Oosthuizen, 2008:25):

- some overseas jurisdictions do not have some of our legal terms in their legal systems;
- immovable property may devolve at death in accordance with pre-inheritance laws in some jurisdictions, which have to be taken into account in the wills;
- delays may be experienced if the South African will has to be used, as sealed copies have to be obtained from the Master of the High Court, to enable the executor to start the administration process in other countries; and
- the officials in the foreign country will insist on obtaining the original will (Abrie, 2003:139).

There is often doubt and uncertainty as to the validity of a will executed according to the formalities of one country but which in effect deals with property situated in a foreign country. According to Victor and King (2008:247) “[a]s per an international convention, a will is treated as having been properly executed if it complies with the formalities then in force in the country where it was executed (*lex loci actus*) or if it was executed in accordance with the laws of the country of the testator's domicile (*lex domicilii*) or place of habitual residence or nationality, either at the time of execution or at the time of his death; or if in respect of immovable property it was executed in accordance with the laws of the country where the immovable property was situated”.

The Wills Act (7/1953) (hereafter “Wills Act”) recognises the validity of offshore wills which do not comply with the requirements under section 3*bis* of the Wills Act in accordance with the international laws.

The definition of “internal law” was inserted in section 1 of the Wills Act by Act 43 of 1992 and means: “[t]he law of a state or territory, excluding the rules of the international private law of that state or territory.”

According to Abrie *et al.*, (2003:138) a separate will has to be compiled for each country in which a person has assets, even if all the assets in both countries are bequeathed to the resident’s spouse. The testator should have the autonomy to choose the law to apply. The South African courts and the courts abroad will enforce the legal obligations consequent upon the choice of law to the will. However, this enforcement will be prohibited if such enforcement offends the public morals or constitutes fraud according to its own laws. However, having an offshore will does not affect the estate duty liability of the deceased estate. The deceased estate will be subject to estate duty on the worldwide assets of the resident (Oosthuizen, 2008:25).

5.3 ESTATE DUTY AND CGT LEVIED ON OFFSHORE ASSETS

To structure an estate plan comprehensively one should take the potential estate duty and CGT liability into consideration. It is important to note that an offshore investment will constitute “property” in the resident’s estate for estate duty purposes, as defined in section 3(2) of the Estate Duty Act, unless the exemptions of section 4(e) of the Estate Duty Act apply.

It is also possible that estate duty may arise both in the foreign country where the assets are situated and in South Africa. Hence the deceased estate would be subject to a double estate duty liability. The effect of estate tax treaties should also be taken into account when determining whether a deceased will be liable for estate duty in South Africa or in the country where the assets are situated.

When a resident has an offshore asset cross-border taxation is involved and the impact of DTAs and estate tax treaties should be considered.

5.3.1 The effect of DTAs and estate tax treaties

A DTA is an agreement concluded between South Africa and a foreign country. This agreement stipulates the method of how and in which country the taxpayer will be taxed if falling in the tax net of both contracting states (Victor & King, 2008:189-199). Section 108(1) of the Income Tax Act and section 26 of the Estate Duty Act make provision for the government to enter into an agreement with any other country.

Once the residency status of the taxpayer has been determined the next step is to consider the DTA between South Africa and the foreign country where the assets are held (Stiglingh *et al.*, 2010:552). When a resident enters into a transaction with a foreign country the liability of double taxation may have to be faced.

According to Thersby (2005:6) “[t]ax treaties make provision for the allocation of the primary right to tax the country where the income is sourced and grant relief in the resident country by either exempting the income or crediting the foreign tax paid against the South African tax charge”.

DTAs are either comprehensive or restricted. Each state levies taxes according to its jurisdiction. Tax planners and estate practitioners should consider all the necessary tax implications when the resident owns an offshore asset (Mosupa, 2003: 178, 181).

5.3.2 The impact of estate duty and CGT on offshore assets where neither a DTA nor/and an estate tax treaty exists

A resident is liable for tax on his worldwide assets (chapter 1.1). As previously explained (in chapter 4.1) many foreign countries levy tax on non-residents on a source-based system of taxation. Hence, the resident may be taxed in both

South Africa and the foreign country. The Estate Duty Act and the Income Tax Act make provision for rebates or a deduction in the event of foreign taxes paid.

In terms of section 16(c) of the Estate Duty Act where a deceased estate is subject to estate tax in a foreign country on property situated in the foreign country, such estate tax will be deductible from any estate duty chargeable under the Estate Duty Act. However, the deduction will be limited to the amount of South African estate duty payable in respect of the offshore property. This provision will not alter the terms of any estate tax treaties (Victor and King, 2008:303).

If the deceased resident owned offshore property in a country which has concluded a DTA with South Africa, the relief will be available in terms of the DTA. The rebate in terms of section 16(c) of the Estate Duty Act will not be available (Stiglingh, *et al.*, 2010:906). When a resident pays foreign taxes, like CGT, then section 6quat of the Income Tax Act comes into operation.

In terms of section 6quat of the Income Tax Act, a rebate shall be deducted from the normal tax payable by any resident in whose taxable income reflects any foreign taxes on income. In terms of section 6quat(1)(e) of the Income Tax Act, any taxable capital gain as contemplated in section 26A from a source outside the Republic -which is not deemed to be from a source in the Republic is deductible from the normal tax payable by the resident. Interpretation Note 18, Issue 2 (SARS, 2009) of the Income Tax Act provides that:

“[a] resident can choose the order in which capital gains are reduced by any capital losses and may apply any capital loss or assessed capital loss carried forward from the previous year of assessment firstly against those capital gains on which no foreign tax liability was incurred. Any excess must then be applied against those capital gains derived from a foreign source which have been subject to

foreign tax. The application of capital losses in this way will yield the greatest benefit for the resident.”

The capital gain or capital loss will be derived from a foreign source if the capital gain or capital loss is:

- attributable to a foreign permanent establishment; or
- not attributable to a foreign permanent establishment but the proceeds on disposal are subject to a foreign tax on income.

If the capital gain is from a foreign source which is not deemed to be from a source within South Africa, it will qualify for a rebate in terms of section 6*quat*(1)(e) of the Income Tax Act. In terms of section 6*quat*(1A) of the Income Tax Act the tax credit will be an amount equal to the sum of any foreign taxes on income proved to be payable to the government of the foreign country.

Section 6*quat*(2) of the Income Tax Act states that “[t]he rebate under subsection (1) and the deduction under subsection (1C) shall not be granted in addition to any relief to which the resident is entitled under any agreement between the governments of the Republic and the said other country for the prevention of or relief from double taxation, but may be granted in substitution for the relief to which the resident would be so entitled.”

Section 6*quat*(2) of the Income Tax Act provides that the resident has the option to choose between the relief provided in the DTA and the relief provided in terms of section 6*quat*. The resident is not entitled to claim both the relief provided in the DTA and the relief provided in terms of section 6*quat*. If the resident does not exercise an option, then SARS will apply section 6*quat* according to the Income Tax Interpretation Note 18 (SARS, 2009). In the event of death it is likely that section 6*quat* will be applied and not the DTA.

It is necessary to look at the wording in the DTA as it will determine how the DTA credit method must be applied in certain circumstances. The articles in the DTA can be divided into:

- those that are “subject to” section 6*quat*; and
- those with no reference to section 6*quat* (SARS, 2009:33).

When the wording refers to “subject to” it is clear that the credit must be applied under section 6*quat* and the whole of section 6*quat* will be applicable and not just certain elements of it such as the carry-forward of excess tax credits (SARS, 2009:33).

When the DTAs are silent as to section 6*quat*, then the resident has the option to elect the DTA credit method of relief instead of the section 6*quat* method (SARS, 2009:35).

A resident has the option to choose the order in which capital gains are reduced by any capital losses. Any capital loss from the previous year of assessment may be carried forward against the capital gains on which the foreign tax liability was incurred. The excess must then be applied against the capital gains derived from the foreign source which have been subject to foreign tax. In the event of capital losses and the application thereof may yield a benefit for the resident (SARS, 2009:6, 7).

5.4 CASE STUDIES

Australian law abolished estate tax in phases from 1977 to 1984 (chapter 4.3). The first example will illustrate a USA resident with an offshore asset in Australia. A resident of the USA is used for illustration on the global impact of estate and capital transfer taxes. For illustration purposes a country which no longer levies estate duty and a country which still levies estate duty will be used. The next case study is an illustration where both countries levy estate duty. This method will assist in illustrating the impact of death duties even if estate duty is abolished.

5.4.1 A global perspective

Australia and USA

Australian law will only tax the asset physically located in Australia. Since Australia no longer imposes estate taxes, no estate duty will be levied, however, it will tax the capital gain in the real estate. When the real estate is sold, Australia will levy CGT irrespective of where the owner of the real estate claims residency. CGT is not triggered at death of the deceased, but on the sale of the property by the beneficiaries, which could happen many years into the future. It is essential to determine whether there is a tax treaty that addresses the double taxation issue (Jones, P.M., 2006:7). Australia and the USA signed a treaty that prevents the double taxation of the same property by both countries. The deceased estate would be taxed on its worldwide assets and would also be subject to CGT on the Australian property. The USA would not tax assets deemed to be situated in Australia, and Australia would impose CGT. The treaty determines the location of the assets owned by the decedent depending on the type of assets (Jones, P.M., 2006:8).

USA and UK (Scotland)

The following example illustrates where a resident of the USA owns a house in Scotland.

On the death of a USA resident, his estate was liable for the USA estate tax on his worldwide assets, which included a house in Scotland. Scotland would impose capital transfer tax on all the property situated in Scotland. The result was that the house would be taxed twice. The UK and the USA have entered into an estate tax treaty. The estate tax treaty states that the decedent's domicile country can tax all property except property physically located elsewhere. The deceased estate will thus be liable to pay USA estate tax on all its assets except for the assets situated in Scotland. According to the treaty the contracting country in which the decedent does not reside but in which the decedent owns physical property, can tax the physical property located within

the country. Hence, the UK will impose tax on the house and the USA will tax the rest of the assets which will prevent double taxation (Jones, P.M., 2006:8).

In *Winans v The Attorney General* 1910 A.C. 27, 31 it was held that securities of an American citizen, who was at the time of his death domiciled in the USA, were liable to estate duty in the UK as they were physically situated in the UK. In *Burnet v Brooks* 1933, 288 U.S. 378 it was held that intangible property of a British citizen be subject to federal estate tax in the USA as the securities was physically present in the USA. Hence, the treaties deal with different kind of assets involved and may vary from one agreement to another (Albrecht, 1952:163).

The above examples are only for illustration purposes on a global perspective. To determine the impact of estate duty and CGT on offshore assets it is necessary to examine countries with which South Africa has concluded DTAs and/or estate tax treaties and countries where no agreements have been concluded.

5.4.2 From a South African perspective: in the event of a DTA and/or estate tax treaty in place

The provisions of the DTA or estate tax treaties will apply: the DTA agreement or estate tax treaty sets out the conditions and determines which of the contracting states are permitted to levy tax on the deceased estate. The last will and testament of the deceased also plays a huge part in determining the nature of the assets and the domicile of the testator (Oosthuizen, 2008:27).

Even though South Africa has entered into DTAs and estate tax treaties with various countries, tax often may still be levied in both South Africa and the foreign country (Thersby, 2005:5-6).

Only selected countries as examined in chapter 4.3, 4.5 and 4.9 are used for illustration.

From a South African perspective

The following case studies are based on the example in chapter 2.3.2 and chapter 3.4.1:

Mr X, a South African resident, is married out of community of property without the accrual system. He dies on 17 October 2010 and according to his last will and testament he bequeaths his offshore property to his son and the residue of his estate to his spouse. The focus in this study will be on the offshore property.

5.4.2.1 *South Africa has concluded a DTA and estate tax treaty with the UK*

Case study

The offshore property, an apartment, is situated in the UK. The value of the property is worth R3 000 000.

The levying of estate duty

In terms of the *Convention between the Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estate of deceased persons and on gifts* (SARS, 1978) (hereinafter the “Tax treaty between SA and the UK”) estate duty will be levied in terms of article 6(1) of the tax treaty between SA and the UK on “[i]mmovable property may be taxed in the contracting state in which such property is situated.”

As noted in chapter 4 the UK may levy 40% inheritance tax on the property situated in the UK. In terms of the Estate Duty Act, 20% estate duty will be levied on the same property as the deceased estate is liable for all property or deemed property of the person at time of death.

In terms of section 16(c) of the Estate Duty Act, if the foreign country levies tax at a smaller amount than the amount which is levied in South Africa, the total amount levied in the foreign country will constitute the relief. If, however, the amount levied in the foreign country exceeds the estate duty payable in South Africa, the amount which will qualify for the relief will be equal to the amount of estate duty payable in South Africa. South Africa has entered into an estate tax treaty with the UK and the relief will be available in terms of the DTA and not section 16(c) of the Estate Duty Act.

In terms of article 12 of the Tax treaty between SA and the UK (SARS, 1978) where a contracting state imposes tax on the property, the former contracting state shall allow so much of its tax as is attributable to such property a credit equal to so much of the tax imposed in the other contracting state in connection with the same event as is attributable to such property.

If the UK levies 40% inheritance tax on value of the property situated in the UK and South Africa levies 20% estate duty, the relief will be limited to 20%, as this is the tax rate imposed in terms of South African law, in the deceased estate. In effect, one can say the 20% inheritance tax is levied in the UK and 20% estate duty in South Africa, hence the deceased estate may be subject to 40% estate duty on the offshore property. The deceased estate may be subject to foreign death taxes to the amount of R600 000. However, any exemptions and deductions should be taken into consideration.

The levying of CGT

In terms of the *New Convention between the Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and the Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains* (SARS, 2003) (hereinafter the “DTA between SA and the UK”) CGT will be levied in terms of article 13(5) of the DTA between SA and the UK (SARS, 2003) which deals with “[g]ains from the alienation of any property other than that referred

to in paragraphs 1, 2, 3 and 4 of this Article shall be taxable only in the Contracting State of which the alienator is a resident.”

The deceased estate (in case study above) is liable for CGT only in South Africa on the offshore property. The asset situated in the UK may be subject to CGT in both South Africa and the UK only if the deceased was resident in both contracting states at the time of death (SARS, 2003).

5.4.2.2 *South Africa has concluded only a DTA but no estate tax treaty with the government of France*

As explained in chapter 4.5 inheritance tax is levied in terms of French law on the French source income of non-residents of France. If a South African resident has an apartment or immovable property situated in France and bequeaths the property to a son who is a South African resident, the said resident may be liable for inheritance tax on those assets situated in France. There is no estate tax treaty entered into between South Africa and the country of France.

The levying of estate duty

If the estate of the resident owns an apartment in France to the value of R3 000 000 and the testator bequeaths his offshore property to his son who is a South African resident, the inheritance tax payable by his son will range from 5% - 40% (Naudin & Tirard, 2010:299). For purposes of this example it is assumed the son is at a low tax rate and will be liable for inheritance taxes at a rate of 10%. The son is liable for inheritance taxes in France to the value of R300 000.

In terms of the Estate Duty Act, the apartment in France will be subject to estate duty at a rate of 20%, as for purposes of this example, section 4(e) of the Estate Duty Act is not applicable and a resident is taxed on his worldwide assets. In terms of section 16(c) of the Estate Duty Act, the amount that qualifies for a deduction is limited to the amount of estate duty payable in

South Africa. Broadly, estate duty payable in South Africa on the offshore property amounts to R600 000 although any exemptions and deductions should be taken into account (chapter 2). The amount that qualifies as a deduction in the deceased estate is the full R300 000. However, if no estate duty is payable in South Africa the R300 000 will not qualify as a deduction. This is the amount of inheritance taxes payable by the son. Thus, the deceased estate is subject to estate duty in South Africa at 20% on the value of the offshore property. The beneficiary, and not the deceased estate, is subject to inheritance tax in France. An estate and tax expert should be consulted as the R300 000 is only an estimate amount of inheritance taxes payable on offshore property.

The levying of CGT

The deceased estate will also be liable for CGT on the offshore assets and the DTA has to be consulted.

Article 13(4) of the *Convention between the Government of the Republic of South Africa and the Government of the French Republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital* (SARS, 1995) (hereinafter the “DTA between SA and France) provides that “[g]ains from the alienation of any property, other than that referred to in the preceding paragraphs of this Article, shall be taxable only in the Contracting State of which the alienator is a resident.”

The effect here is that CGT is levied in South Africa on the deceased estate and it would depend on the rand value of the base cost of the property how much CGT would be payable.

5.4.2.3 South Africa has concluded a DTA but no estate tax treaty with Australia

The following example has the same facts but the offshore property is situated in Australia.

The levying of estate duty

If a South African resident has an apartment situated in Australia at the time of death, the estate will not be liable for estate duty in Australia as the Australian law no longer levies estate duty, death duties or gift taxes upon death. The apartment is, however, subject to estate duty in South Africa because it is part of the deceased's worldwide assets.

The levying of CGT

The deceased estate is liable for CGT in South Africa as, according to paragraph 40(1) of the Eighth Schedule of the Income Tax Act, it is deemed that the deceased has disposed of his assets at date of death for CGT purposes. The Australian tax law taxes non-residents of Australia on their Australian source income including capital gains derived by the non-residents (Bevan *et al*, 2010:70).

Therefore, the deceased estate is liable for CGT in both South Africa and Australia. However, the *Agreement between the Republic of South Africa and the Government of Australia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income* (SARS, 1999) (hereafter the "DTA between SA and Australia") and the *Protocol amending the Agreement between the Republic of South Africa and the Government of Australia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income* (SARS, 2008) (hereafter the "Protocol amending the DTA between SA and Australia") should be taken into consideration when determining the taxes payable.

Article 13(5) of the Protocol amending the DTA between SA and Australia (SARS, 2008) states that "[g]ains of a capital nature from the alienation of any property, other than that referred to in the preceding paragraphs shall be taxable only in the Contracting State of which the alienator is a resident."

The deceased estate will be liable for CGT in South Africa on the offshore property. Australian law does not levy CGT on the deceased estate, however, if the property is sold CGT will be payable under the Australian law (Jones, P.M., 2006:6).

5.5. THE TAXATION OF RESIDENTS WITH OFFSHORE ASSETS UNDER INTERNATIONAL LAW

The general aspect of international law is one of sovereignty. The fundamental question remains as to which country may levy tax and what may be levied. The main theories have been advanced:

- the contractual theory; and
- the theory of sovereignty (Albrecht, 1952:145).

5.5.1 Main theories

The “contractual theory”

The right to tax residents and non-residents may be affected by DTAs and/or estate tax treaties concluded between two states. The treaties are designed to prevent double taxation and to avoid unfair discrimination. When a resident purchases property offshore, it may be argued that the resident has voluntarily purchased the property in the foreign country, and therefore it may be said to have made an implicit agreement with the foreign country to pay its taxes (Albrecht, 1952:146). In truth, the two countries have concluded the agreement and the taxpayer must pay the taxes.

The “theory of sovereignty”

The right to tax non-residents is influenced by the contractual right which is justified in international law as an attribute of sovereignty. “The right of the State to levy taxes constitutes an inherent part of its sovereignty” (Albrecht, 1952:147).

The impact of the right of foreign countries to impose taxes on a taxpayer who owns assets situated in the foreign country, is illustrated in the case studies.

5.5.2 The taxation of offshore assets

Taxation of persons depends on “residency”. If a resident of a country has offshore property or interest belonging to him in a foreign country, then that foreign country may levy tax on the resident. It may be stated that every enforceable tax must necessarily be within the jurisdiction of the taxing state (Albrecht, 1952:153). However, jurisdiction is limited by custom and law to an area which falls short of the full sway of this power. This generally refers to jurisdictional immunities which are established within the normal jurisdiction of the taxing state. In such cases the subject of taxation rests within the power of the taxing state (Albrecht, 1952:153).

If a South African resident has offshore property, the foreign country has jurisdiction over the property and may enforce tax against the property and South Africa also has the authority to tax the resident.

According to Albrecht (1952:155) “[a]ll persons having a fixed residence in a foreign country are subject to the taxation imposed by the supreme power of the State in the same manner and to the same extent as the native subjects unless they can show some special cause of exemption”.

International agreements, such as DTAs and estate tax treaties, confirm and regulate the right to impose taxes. Usually, the treaties make provision that taxes not specifically allocated should be imposed by the state where the taxpayer resides or is domiciled (Albrecht, 1952:159).

In accordance with international law it is common practice to tax the property of non-residents. The right to tax the property may be limited to the country where the property is situated. The treaties provide whether assets should be taxed in the country where the assets are situated or in the country where the taxpayer is a resident (Albrecht, 1952:160). Careful consideration should also

be given to the kind of assets situated in the foreign country. It is to be noted (chapter 1.4) that this study focuses only on immovable property.

5.6 THE EFFECT OF ABOLISHING ESTATE DUTY

According Bird (1991:322) the revenue importance of net wealth taxes and capital transfers is diminishing on a global basis (Bird, 1991:322) and hence, the impact of estate duty to be scrutinised. The 2010/2011 Budget Tax Proposal (SARS, 2010:25) calls for a reform of taxes upon death. Dobris (1984:1216) submits that estate tax has lost its bite and the time has come to reconsider it. To address the fundamental question of what effect the abolition of estate duty will have on the impact of death duties on offshore assets, the following is examined: first, the arguments in favour and against abolishing estate duty, and second, the justification under international law of the right to tax non-residents.

5.6.1 Arguments in favour of abolishing estate duty

There are meaningful arguments in favour of abolishing estate taxes and it is due to its minuscule revenue impact. The global view, and with specific reference to the views in the USA, is as follows:

- the revenue contribution of estate tax is not viable (Dobris, 1984:1217);
- estate tax does not adequately vindicate any of the social policies it is supposed to. Many people are of the opinion that the purpose of estate tax is to break up concentrations of wealth and to achieve more equitable distribution of resources. Those who advocate abolishing estate duty state that transfer tax does not break up concentrations of wealth and does not function in a significant way to redistribute wealth to enhance the quality of life for those individuals with less wealth (Dobris, 1984:1218);

- estate tax is inefficient. The estate tax is costly, both directly and indirectly. With reference to the direct costs, estate tax includes both the cost of the constant reform and complying with the tax. “Constant reform” means as long the tax is in operation alterations and transformations will take place. Inflation has increased over the years with the result that the value of the property has increased. Hence the average or middle-class taxpayer might be liable for estate duty. Arguably, one of the indirect costs relating to estate tax is the liquidity requirements that the estate tax forces on the estate which may cause inefficient reallocation of resources to pay the duties (Dobris, 1984:1220, 1221);
- one of the arguments in favour of the abolition of estate tax is that death tax disheartens savings and encourages consumption which interferes with capital formation. Dobris (1984:1223) disagrees and submits that estate tax does not play a huge role in savings or consumption. Dobris further submits that the “notion that *you can't take it with you* which may or may not lead to increased consumption, is not ultimately tax-based.” Contrary to Dobris’ opinion, the following has been argued:

“of course, prohibitively high inheritance tax rates generate no revenue; they simply force the individual to consume his income during his life” (Muljee, 2007:17).

However, the abolition of estate duty might reduce the use of trusts. Dobris (1984:1223) suggests that “many trusts are created only to avoid estate tax, and that the trustees invest conservatively”;

- it is argued that estate tax creates severe liquidity requirements for the descendants of the deceased. Since a deceased estate should have enough liquidity to pay the taxes on death, it is necessary that enough liquidity is provided for via insurance or other liquid assets, and as a result of such liquidity requirements it redirects capital from the

decedent's chosen area which instigates an economic deformation (Dobris, 1984:1226). The money could be used in a more sufficient manner rather than providing liquidity; and

- some of the requirements of a tax system are equity, efficiency and administrability. In abolishing estate tax there is equity as people are treated in the same way. Efficiency is created as there is no interference with investment decisions or any preference for different wealth transmissions – one form above the other form. There is no delay in transferring wealth assets to the descendants of the deceased. Levying estate tax causes a delay in the winding up of the estate and distributing of assets to the descendants. The delay, as a result of settling the duties, removes property from active investments while the estate is being wound up. And if estate tax is repealed there is no tax to administer (Dobris, 1984:1226).

The impact of estate duty can be summarised as follows: estate duty contributes minuscule revenue towards national taxes and due to the levying of estate duty, it discourages saving and encourages consumption. Most people transfer their wealth to a trust and, by abolishing estate duty it may reduce the use of estate planning tools, like trusts. The function of estate duty is insignificant as far as redistributing wealth is concerned, neither does it enhance quality of life. Levying estate duty results in delays in the administration process which has a negative effect on active investments and the beneficiaries of the estate. It is also essential to provide enough liquidity to pay the estate duty otherwise the executor may have to sell certain assets to pay the tax.

5.6.2 Arguments against abolishing estate duty

There are substantial arguments in favour of not abolishing estate duty and it may as well be submitted that, according to these arguments, estate duty still has a significant role to play. The arguments in favour of not abolishing estate duty are as follows:

- even though the revenue contribution of estate tax is not viable, a modest source of revenue is not to be “thrown away” only on the basis that it does not raise a significant amount of revenue: there must exist other convincing reasons for abolition. It is argued that a tax that appears to be working, even if it raises minute revenue from wealthier people who do not care to have proper estate planning tools in place, is just what is needed in the society (Dobris, 1984:1227);
- estate tax raises a fair distribution of tax burden by raising revenue from wealthy people. Death and taxes are inevitable and so is the transfer of property. For as long as it only affects wealthy people it does not interfere with the welfare of the descendants of the deceased (Dobris, 1984:1228);
- it is essential to keep estate tax as it is a tax on capital and there is no reason to abolish estate tax. The correct allocation of a tax burden requires that the wealthy be taxed and a repeal of a tax that applies only to the wealthy is intrinsically reprehensible and, in the end, ends up shifting more of the tax burden to the less wealthy (Dobris, 1984:1229);
- the marital deduction offers protection to the surviving spouse (Dobris, 1984:1229);
- estate tax is a delayed tax and only payable on death. It allows persons to increase their savings for their own consumption as the tax is not levied until death (Dobris, 1984:1230); and
- if estate tax is abolished it will be regarded as a giveaway and as favouring the wealthy (Dobris, 1984:1230);

The above arguments can be summarised as follows: even though the estate duty contribution is not viable it does raise some revenue. By repealing estate duty there is no fairness in equity as estate duty was imposed to create

fairness in taxation by taxing the wealthy. Bequests to a surviving spouse are exempt from estate duty and by levying estate duty it serves as a protection to the surviving spouse as it is likely that the first dying spouse will bequeath all or most of their assets to their spouse. Abolishing estate duty will be regarded as a “give away” and favouring the wealthy. If estate duty is abolished some other kind of tax should be increased to compensate for the loss of revenue and to avoid a “give away”.

Most people value the perception that they are free from estate taxes and generally the perception is that offshore assets are free from estate duty (Oosthuizen, 2008:26).

5.7 CONCLUSION

When a resident acquires offshore property it is sensible to have an offshore will pertaining to the property situated in the foreign country. The offshore will will not affect the estate duty liability of a deceased estate. The offshore will helps with the administering of the estate to prevent delays and confusion regarding the legal terms of the different countries (chapter 5.2.3).

Since the once-off limit of R4 000 000 has been changed to an annual limit of R4 000 000, it can be expected that more wealthy residents will use this “relaxation” to invest offshore. Estate and tax practitioners should gain more knowledge and expertise on offshore planning as offshore investments form part of the resident’s estate for estate duty purposes (chapter 5.2.2).

People value the perception that offshore assets are excluded from estate duty and CGT but this is not necessarily the case (Oosthuizen, 2008:25). It may be submitted that the international perspective is that countries have the jurisdiction to impose tax on property situated in the country. Persons with offshore property in a foreign country are liable to tax imposed by the foreign country (chapter 5.1)

South Africa levies estate duty and it cannot necessarily be assumed that an offshore asset will be exempt from estate duty. Section 3 of the Estate Duty Act provides that an estate of any person shall consist of all property and all deemed property of that person at the date of death. Hence, it is essential to look at death duties levied in foreign countries and any DTAs and estate tax treaties concluded between South Africa and the selected country where the asset is held to determine the impact of estate duty and CGT on offshore assets.

The property may be liable for these death duties in South Africa and in the country where the property is situated. The DTAs and estate tax treaties determine which country may levy the tax. The international view is that estate duty and CGT impact offshore assets and are also influenced by the international agreements. Whether South Africa levies estate duty or not, offshore assets may be liable for estate duty in the foreign country. Estate duty impacts international agreements, CGT rates and the Estate Duty Act. By abolishing estate duty it may not have an enormous affect on the liquidity requirements as liquidity is needed to pay any CGT. However, such abolition will affect any international agreements and the Estate Duty Act as there may not be any relief for foreign taxes paid.

CHAPTER 6

CONCLUSION

6.1 INTRODUCTION

National Treasury is re-thinking the usefulness of levying estate duty due to its minuscule revenue contribution, which leads to the problem statement regarding the current impact of estate duty and CGT on offshore assets and the potential impact should estate duty be abolished (chapter 1).

Whether National Treasury will abolish estate duty is yet to be seen. As was mentioned earlier, South Africa generally follows the direction of developing countries and, as explained in the Estate Duty Review Document, 24 of the 30 OECD countries impose estate duty or similar taxes (chapter 2).

Currently, a South African deceased estate is liable for estate duty and CGT which arguably leads to double taxation. Smith is of the opinion there should be no double taxation (chapter 2.6.1). Estate duty's contribution to South Africa's total revenue is minimal, and it is argued that it costs more to administer and collect the taxes. It is submitted that estate duty no longer brings vertical equity into the tax regime and faces extinction (chapter 2).

When CGT was introduced in 2001, the rate of estate duty was reduced from 25% to 20%. CGT is also known as a tax on the transfer of capital. The further we move away from 2001 the more impact CGT has on a deceased estate. A person is deemed to have disposed of his assets on death, thus the deceased estate is liable for CGT which requires liquidity. One of the arguments in favour of abolishing estate duty is the liquidity requirements to pay the tax. If the National Treasury repeals estate duty, it is likely that the rate of CGT will increase which will also affect the liquidity requirements to pay the taxes (chapter 1.1). Currently, the estate duty exemption is R3 500 000 and the CGT exemption upon death is R120 000 (section 4A of the Estate Duty Act and paragraph 5 of the Eighth Schedule of the Income Tax Act). Whether the

CGT exemption will increase has not been addressed and the future of taxes upon death is still to be determined. If estate duty is abolished, the effect such abolition may have on CGT is still undetermined, but it is suspected that the abolition will likely influence the rate of CGT.

Currently, estate duty and CGT are levied on a deceased's worldwide assets (chapter 1.1). Hence, these death duties are levied on offshore assets and not only on assets situated in South Africa. Most individuals are of the opinion that offshore property is not subject to estate duty or CGT. Internationally, countries tax non-residents on a source-based system of taxation, hence, the foreign country in which a South African resident owns property may tax the property situated in the said country either by levying CGT on death or estate duty of both. In the worst case scenario, a South African resident can therefore be subjected to quadruple taxation: estate duty and CGT in South Africa as well as estate duty and CGT in the foreign country.

Fortunately the impact of these taxes is, to a certain extent, negated by the DTAs and estate tax treaties as well as domestic provisions against double taxation contained in section 6quat of the Income Tax Act which provides for a rebate of foreign taxes if a resident has paid foreign taxes and in terms of section 16(c) of the Estate Duty Act, foreign estate taxes may be deducted in the estate for estate duty purposes (chapter 5.3.1). If a resident purchases property in a foreign country, it may be argued that there is voluntary acceptance of needing to pay the taxes levied by the foreign country. One of the arguments in favour of abolishing estate duty is that the administration is cumbersome (chapter 1.1). However, whether or not estate duty is levied there will still be administration costs and effort to wind up the estate. The Administration of Estates Act is vague on the administering of offshore assets, and offshore assets only reflect on the liquidation and distribution account for estate duty purposes.

6.2 THE IMPACT OF THE ABOLITION OF ESTATE DUTY

Based on the study, the impact of the abolition of estate duty on offshore assets can be summarised as follows:

- It is submitted that, if National Treasury abolishes estate duty in South Africa, such an action may also have an enormous effect on estate tax treaties. It is likely that the estate tax treaties will also have to be repealed. If estate duty and the estate tax treaties are repealed, and a deceased estate holds offshore property, for example in the UK, then the deceased estate is liable to pay inheritance tax at 40% to the UK government for the property situated in the UK. The effect may be that there is no relief available for the deceased estate in respect of foreign taxes payable, as there is no longer estate duty payable in terms of the South African law and no estate tax treaty in place to provide for such relief.
- It also raises the question as to what impact the abolition may have on the Estate Duty Act and if the relief in terms of section 16(c) of the Estate Duty Act will still be available in respect of foreign taxes payable by the deceased estate. It may be submitted that there will be no relief available for the foreign taxes payable by the deceased estate as there is no estate duty liability to set the relief off against, which will have the effect that the estate would need liquidity to pay these foreign taxes and in foreign currency.
- Even though not applicable only to offshore assets, the removal of estate duty may impact on the CGT rate and National Treasury will also have to consider the amount allowed as a CGT rebate in the year of death, which currently stands at R120 000.

The impact of estate taxes levied on a resident who owns offshore property can be severe and the same applies to CGT. Irrespective of where a South African resident wishes to acquire property, it is still vital that a comprehensive estate plan and tax plan should be assembled before the resident acquires

the offshore property. The effect of capital transfer tax on an offshore asset can also never be underestimated. It is submitted that this statement remains true even if estate duty is abolished.

6.3 TOPICS FOR FURTHER STUDY

To give a better understanding of assets in an individual's name versus assets in an offshore trust or offshore company, the use of international estate planning techniques such as offshore trusts and offshore companies could be examined. The proposed study should compare taxes payable on death of an individual with the fees and taxes payable by the trust and company.

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