

A historical and comparative study in search of a revised *Estate Duty Act* 45 of 1955

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ABSTRACT

Estate duty is a tax levied on the deceased estate based on the value of the property in the estate at the time of death. The *Estate Duty Act* 45 of 1955 has been in operation since 1955 and has become stagnant due to the limited changes. Its unchanging provisions in an ever-changing legal landscape have become in need of reform. Many reviews have been done, including those by the Margo Commission (1987), the Katz Commission (1997) and the Davis Tax Committee (2016), where it was each time concluded that the *Estate Duty Act* should remain but requires an extensive revision.

The repeated call for a revision of the Act and the lack of response to it inspired this study, and the primary research question that it aims to answer is, "Through the use of a historical and comparative study, how can the *Estate Duty Act* be revised to keep up with a changing legal landscape?"

This study reviewed the historical recommendations made in respect of the *Estate Duty Act*, and it was found that apart from the changes to the rate of estate duty, the scope of the primary abatement, and the exclusion of certain property from the estate, many proposals remained unattended to. After an extensive literature review, it was found that a revised *Estate Duty Act* is both desirable and needed regarding the following aspects: the jurisdictional basis on which estate duty is levied; the scope of property included in the estate; the constitutionality of exempting spousal bequests; the meaning and timing of the "accrual" of an inheritance; the rationale behind valuation rules; the lack of certainty regarding the unilateral relief from double estate taxation; the lack of specific anti-avoidance rules and various administrative misalignments that need to be addressed to enhance efficiency in administering an estate. It was further concluded that the issues identified also result in the *Estate Duty Act* not adhering to the canons of taxation (equity, certainty, convenience and cost efficiency), which are the criteria for a good tax system.

This study also reviewed international principles and guidelines for inheritance taxes laid down by the Organisation for Economic Co-operation and Development (OECD). It was found that the OECD's guidance speaks to most of the problem areas identified under the *Estate Duty Act* which serves as a valuable benchmark to make enhancements. The OECD guidance includes limited exemptions in respect of bequests to a charity or a surviving spouse, abatements consisting of real-time values, detailed unilateral relief provisions for double taxation and specific anti-avoidance provisions to combat tax avoidance.

A comparative analysis of the similar transferor-based wealth transfer tax systems in the United Kingdom (UK) and the United States (US) was done in a benchmarking exercise to determine which lessons can be learnt. It was found that the UK's statutory definition of a "resident" and its detailed anti-avoidance rules concerning inheritance tax provides a useful benchmark regarding enhancements for clarity under the *Estate Duty Act*. The US' different treatment of residents and non-residents regarding deductions and exemptions provides useful guidance for consideration of a similar approach in South Africa. Both countries provide an alternative treatment of life policies than in South Africa, more detailed provisions regarding unilateral relief and extensive administrative provisions to enhance voluntary compliance. All of those were considered to enhance certainty and clarity if applied to the *Estate Duty Act*.

In answering the primary research question this study provides recommendations for changes to the *Estate Duty Act* regarding each problem area identified. Each recommendation is designed to promote the objectives of taxation, the "canons of taxation" and to remain aligned with the *Constitution of the Republic of South Africa, 1996*.

Keywords: Deceased estate, estate duty, estate tax, estate tax reforms, inheritance tax, and wealth tax

OPSOMMING

Boedelbelasting is 'n belasting wat op die bestorwe boedel gehef word gebaseer op die waarde van die eiendom in die boedel ten tye van afsterwe. Die *Boedelbelastingwet* 45 van 1955 is sedert 1955 in werking en het gestagneer weens die beperkte veranderinge oor tyd. Die onveranderlike bepalings daarvan in 'n voortdurende veranderende regslandskap het self 'n hervorming nodig. Vele hersienings is gedoen, insluitend die Margo-Kommissie (1987), die Katz-Kommissie (1997) en die "Davis Tax Committee" (2016) waar daar telkens tot die gevolgtrekking gekom is dat die *Boedelbelastingwet* moet bly voortbestaan, maar dat dit 'n uitgebreide hersiening vereis.

Die herhaalde oproep om 'n hersiening van die Wet en die gebrek aan reaksie daarop het hierdie studie geïnspireer en die primêre navorsingsvraag wat dit beoog om te beantwoord, is: "Hoe kan die *Boedelbelastingwet* deur die gebruik van 'n historiese en vergelykende studie hersien word om tred te hou met 'n veranderende regslandskap?"

Hierdie studie het die historiese aanbevelings wat ten opsigte van die *Boedelbelastingwet* gemaak is in oënskou geneem, en daar is gevind dat afgesien van die veranderinge aan die koers van boedelbelasting, die omvang van die primêre verlaging, en die uitsluiting van sekere eiendom uit die boedel, baie voorstelle nie in ag geneem is nie. Na 'n uitgebreide literatuuroorsig is bevind dat 'n hersiene *Boedelbelastingwet* beide wenslik en nodig is ten opsigte van die volgende aspekte: die jurisdiksiegrondslag waarop boedelbelasting gehef word; die omvang van eiendom wat in die boedel ingesluit word; die grondwetlikheid van die vrystelling van bemakings aan 'n gade; die betekenis en tydsberekening van die toevalling van 'n erfenis; die rasionaal agter reëls van waardebepaling; die gebrek aan sekerheid rakende die eensydige verligting van dubbele boedelbelasting, die gebrek aan spesifieke teenvermydingsreëls en verskeie administratiewe wanbelynings wat aangespreek moet word om doeltreffendheid in die bereddering van 'n boedel te verbeter. Daar is verder tot die gevolgtrekking gekom dat kwessies wat geïdentifiseer is ook die *Boedelbelastingwet* insluit wat nie voldoen aan die

beginsels van belasting nie (gelykheid, sekerheid, gerief en koste-effektiwiteit) wat bekend staan as die kriteria vir 'n goeie belastingstelsel.

Hierdie studie het ook internasionale beginsels en riglyne vir erfbelasting wat deur die "Organisation for Economic Co-operation and Development (OECD)" neergelê is, in oënskou geneem en daar is gevind dat die "OECD" se leiding tot die meeste van die probleemareas wat ingevolge die *Boedelbelastingwet* geïdentifiseer is spreek wat as 'n waardevolle maatstaf dien om verbeterings daaraan te maak. Die "OECD" leiding sluit in beperkte vrystellings ten opsigte van bemakings aan 'n liefdadigheidsorganisasie of 'n langselewende gade, aftrekkings wat uit huidige waardes bestaan, gedetailleerde eensydige verligtingsbepalings vir dubbele belasting, en spesifieke anti-vermydingsbepalings om belastingvermyding te bekamp.

'n Vergelykende ontleding van die soortgelyke oordraggewergebaseerde welvaartoordragbelastingstelsels in die Verenigde Koninkryk (VK) en die Verenigde State (VS) is gedoen as maatstafoefening om te bepaal watter lesse daaruit geleer kan word. Daar is gevind dat die VK se statutêre definisie van 'n "inwoner" en sy gedetailleerde teenvermydingsreëls ten opsigte van boedelbelasting 'n nuttige maatstaf vir soortgelyke verbeterings vir duidelikheid onder die *Boedelbelastingwet* bied. Die VS se verskil in hantering van inwoners en nie-inwoners ten opsigte van aftrekkings en vrystellings bied nuttige leiding om 'n soortgelyke benadering vir Suid-Afrika te oorweeg. Beide lande bied 'n alternatiewe behandeling vir lewenspolisse as in Suid-Afrika, meer gedetailleerde bepalinge oor eensydige verligting en uitgebreide administratiewe bepalinge om vrywillige nakoming te verbeter. Hierdie is alles oorweeg om sekerheid en duidelikheid in die toepassing van die *Boedelbelastingwet* te verhoog indien dit toegepas word.

In die beantwoording van die primêre navorsingsvraag maak hierdie studie aanbevelings vir verbeteringe aan die *Boedelbelastingwet* ten opsigte van elke probleemarea wat geïdentifiseer is. Elke aanbeveling is ontwerp om die doelwitte en die beginsels van belasting te bevorder, en om met die *Grondwet van die Republiek van Suid-Afrika*, 1996 in lyn te bly.

Sleutelwoorden: Bestorwe boedel, boedelbelasting, hervorming van boedelbelasting, welvaartbelasting

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LIST OF ABBREVIATIONS

APPG	All-Party Parliamentary Group
CGT	Capital Gains Tax
DTC	Davis Tax Committee
EJIL	European Journal on International Law
EU	European Union
FISA	Fiduciary Institute of Southern Africa
JEFS	Journal of Economic and Financial Sciences
OECD	Organisation for Economic Co-operation and Development
OTS	Office of Tax Simplification
PELJ	Potchefstroom Electronic Law Journal
SABR	Southern African Business Review
SAICA	South African Institute of Chartered Accountants
SAIT	South African Institute of Taxation
SAJAR	South African Journal of Accounting Research
SAJHR	South African Journal on Human Rights
SALJ	South African Law Journal
SAMLJ	South African Mercantile Law Journal
SARS	South African Revenue Service
STELL LR	Stellenbosch Law Review
TSAR	Tydskrif vir die Suid-Afrikaanse Reg
UK	United Kingdom
US	United States

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CHAPTER 1 INTRODUCTION

Abstract

Apart from a general introduction, this chapter contains the problem statement, the research question, hypothesis and methodology that will be used to constructively search for a revised legal framework for estate duty. The primary research question posed by this study is "Through the use of a historical and comparative study, how can the *Estate Duty Act* be revised to keep up with a changing legal landscape?"

1.1 Overview of estate duty in South Africa

The death of a person results in the activation of a number of administrative processes and functions. Included is the finalisation of the deceased person's tax affairs, which does not only include the most well-known tax, called income tax, but also estate duty. Estate duty may often be forgotten or be treated as an afterthought, and this may have a devastating impact if not catered for appropriately.

Estate duty is a tax levied on the transfer of wealth upon death and falls within the category of a wealth transfer tax. Wealth transfer tax charged upon death is found in many tax jurisdictions, takes on different forms and is known by various names such as an "estate tax", an "estate duty"¹ (as mentioned in the South African context), a "succession duty" or an "inheritance tax". Apart from the name, the two main forms include a transferor-based taxation² levied on the deceased estate based

¹ Donations tax is also levied on the transfer of wealth during a person's lifetime instead of at death. Donations tax is governed under Part V of the *Income Tax Act* 58 of 1962 (the *Income Tax Act*). Donations tax is also primarily levied on the transferor of the donation, see s 59 of the *Income Tax Act*.

² This type of tax is referred to as an "estate tax" or "estate duty", except for the United Kingdom where its transferor-based wealth transfer tax is called an "inheritance tax". See Rudnick and Gordon "Taxation of Wealth" 292; Jestle *Inheritance Tax Regimes: A Comparison* 2; Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 410 and OECD *Inheritance Taxation in OECD Countries* 62-64.

on the dutiable value of assets in an estate; or a recipient-based taxation³ levied on the beneficiaries of the estate for the transfers received from the estate.⁴

In the South African context, estate duty is not a novelty. The Cape Colony introduced a succession duty, like inheritance tax, where legatees and heirs of an estate paid a duty on the value of their legacies and inheritances.⁵ At a later stage, a similar succession duty was introduced in Natal and the Orange Free State, while the Transvaal had an estate duty.⁶ These duties levied under pre-Union legislation were repealed when the *Death Duties Act* 29 of 1922 (the *Death Duties Act*) was enacted. The *Death Duties Act* applied nationally in South Africa and provided for both an estate and a succession duty. The *Death Duties Act* was repealed by the *Estate Duty Act* 45 of 1955 (the *Estate Duty Act*), which is currently in effect. The *Estate Duty Act's* basic structure is like the *Death Duties Act* but does not retain the *Death Duties Act's* succession duty provisions. The *Estate Duty Act* increased the estate duty rate to compensate for revenue lost by abolishing the succession duty.⁷

As mentioned, estate duty serves as a wealth transfer tax, and its purpose is to tax the transfer of wealth of the deceased person's property upon death.⁸ Estate duty is levied⁹ on the dutiable amount¹⁰ of the estate of a person that is "ordinarily resident"¹¹ in South Africa. The estate of a person that is "ordinarily resident" in

³ Mostly referred to as an "inheritance tax" or a "succession duty". See Jestle *Inheritance Tax Regimes: A Comparison* 2; Rudnick and Gordon "Taxation of Wealth" 293 and Muller *Wealth Transfer Taxation* 1.

⁴ Roeleveld 2015 *SAJAR* 147; Rudnick and Gordon "Taxation of Wealth" 292; Muller *Wealth Transfer Taxation* 1; Jestle *Inheritance Tax Regimes: A Comparison* 2; Weber-Frisch and Duquenois-Djoua 2014 *ERA Forum* 410 and OECD *Inheritance Taxation in OECD Countries* 62-64.

⁵ Meyerowitz 1986 *The Taxpayer* 61.

⁶ Meyerowitz 1986 *The Taxpayer* 61.

⁷ The First Schedule to the *Death Duties Act* provided for a maximum estate duty rate of 17% and under the Second Schedule to that Act, a maximum succession duty rate of 10%. The *Estate Duty Act* repealed the *Death Duties Act* and increased the estate duty rate to a maximum of 25%.

⁸ Donations tax is also levied on the transfer of wealth during a person's lifetime instead of at death. Donations tax is governed under Part V of the *Income Tax Act* 58 of 1962 (the *Income Tax Act*). Donations tax is also primarily levied on the transferor of the donation, see s 59 of the *Income Tax Act*.

⁹ Section 2 of the *Estate Duty Act*.

¹⁰ "Dutiable amount" is determined under s 4A of the *Estate Duty Act*.

¹¹ The concept of "ordinarily resident" is not defined by the South African tax legislation and is given its meaning by the courts. In *Cohen v Commissioner for Inland Revenue* 1946 AD 174,

South Africa includes the person's worldwide assets, subject to certain exclusions.¹² In the case of a person who is not "ordinarily resident" in South Africa at the date of death, only South African-sourced assets are included in such a person's estate for estate duty purposes.¹³ Certain deductions are allowed¹⁴ to determine the net value of the estate. A further abatement is also available to calculate the dutiable amount of the estate.¹⁵ Effectively, an estate in South Africa will be subject to estate duty if the dutiable amount exceeds R3.5 million.¹⁶ Estate duty is levied at 20% of the dutiable amount of an estate that does not exceed R30 million,¹⁷ and 25% of the dutiable amount of an estate that exceeds R30 million.¹⁸

1.2 Problem statement

1.2.1 Background to the study

The South African Government has been busy with reviews of the South African tax system, including the contentious issue of death taxes (estate duty) and the debate¹⁹ on its relevance in the South African context was considered by each of the Commissions of Enquiry.²⁰ The Government appointed various Commissions of

13 SATC 362 para 371 (the *Cohen* case), Schreiner JA discussed the meaning in *obiter* that a person can only be "ordinarily resident" in one place at a time, and it is the country where a person has his or her most fixed or settled residence. It is also referred to as the country to which a person would return after his or her wanderings, also referred to as a person's real home. The meaning was confirmed in *Commissioner for Inland Revenue v Kuttel* 1992 3 SA 242 (A), 54 SATC 298 (the *Kuttel* case) para 304.

¹² Section 3 of the *Estate Duty Act* read with s 4(e) of the *Estate Duty Act*.

¹³ Section 3(2)(c)-(h) of the *Estate Duty Act*.

¹⁴ Section 4 of the *Estate Duty Act*.

¹⁵ Section 4A of the *Estate Duty Act*.

¹⁶ Section 4A of the *Estate Duty Act* allows for an abatement of R3.5 million for every estate and any unused portion by the first-dying spouse is transferred to the estate of the second dying spouse to a maximum of R7 million.

¹⁷ Section 2(2) of the *Estate Duty Act* read with para 2(1)(a)(i) of the First Schedule to the *Estate Duty Act*.

¹⁸ Section 2(2) of the *Estate Duty Act* read with para 2(1)(a)(ii) of the First Schedule to the *Estate Duty Act*.

¹⁹ Katz Commission *Fourth Report on Capital Transfer Tax* (the *Fourth Report*) para 5.8; Muller *Wealth Transfer Taxation* 443; Maartens-Dorey *The Survival of Estate Duty* 54; Bornman *The Impact of Estate Duty and Capital Gains Tax* 76-81; Ramson *The Interface between Capital Gain Tax and Estate Duty* 43-44; Hefer *Abolishing Death Taxes in South Africa* 47-48; Roeleveld 2015 *SAJAR* 153; DTC *Second and Final Report on Estate Duty* (the *Final Estate Duty Report*) 33; and DTC *Report of Feasibility of a Wealth Tax in South Africa* (the *Wealth Tax Report*) 68.

²⁰ DTC *First and Interim Report on Estate Duty* (the *First Estate Duty Report*) 25.

Enquiry to investigate the prevailing tax structures, focusing on changing the existing tax regimes.²¹ The most noteworthy of these are the Margo Commission (1987), the Katz Commission (1997) and the Davis Tax Committee (DTC) (2016). Chapter 3 illustrates how these Commissions reviewed the entire South African tax system, including estate duty. More specifically, the terms of reference for the DTC by the Minister of Finance included an enquiry into the tax system's progressivity and the relevance of estate duty to support a more equitable and progressive tax system in South Africa.²²

In 1985, statements were made by the Minister of Finance to the Margo Commission that in the Government's opinion, the *Estate Duty Act* is no longer suitable to the needs of our time.²³ As a follow-up remark in the second reading debate on the *Revenue Laws Amendment Bill*, 1985, the Minister said that as far as estate duty is concerned, it should be clear that the "patient" (estate duty) is terminally ill.²⁴ The finding by the Margo Commission that estate duty should be replaced with a capital transfer tax was anticipated.

The Katz Commission supported the Margo Commission's recommendation for a capital transfer tax but qualified the recommendation on the basis that South Africa already has it in the form of donations tax and estate duty and therefore, instead of replacing estate duty, a reform should be considered through amendments regarding its problem areas.²⁵ The Katz Commission further stated that the repeal of estate duty would raise serious questions about the equitable balance of the tax system in South Africa.²⁶ The Katz Commission made various recommendations to the *Estate Duty Act* that included a need for specific anti-avoidance rules, provisions

²¹ Roeleveld 2015 *SAJAR* 144.

²² DTC *First Estate Duty Report* 25.

²³ Meyerowitz 1985 *The Taxpayer* 54.

²⁴ Meyerowitz 1986 *The Taxpayer* 61.

²⁵ Katz Commission *The Third Interim Report of the Katz Commission of Inquiry into Taxation* (the *Third Report*) 10.

²⁶ Katz Commission *Third Report* 10. It was stated that in the case of any amendment, the question must be asked whether it will raise relatively more revenue than in the present.

dealing with generation-skipping trusts, and a review of the residence-based versus a sourced-based tax system for estate duty purposes.²⁷

The Katz Commission also compared estate duty with an inheritance tax in its pursuit of a capital transfer tax and concluded, in brief, that South Africa should retain its system of estate duty instead of having an inheritance tax.²⁸ This conclusion was based on the availability of human resources at the South African Revenue Service (SARS), to prevent additional complexity to the tax system and to attain vertical and horizontal equity among taxpayers.²⁹

Subsequently, more contemporary studies were done to investigate whether an inheritance tax would be a better system than estate duty for South Africa. In 2010, Muller³⁰ in proposing a framework for wealth taxation in South Africa, and specifically focusing on the interaction between estate duty and donations tax, proposed that the estate duty and donations tax legislation should be combined into a single piece of legislation. It was concluded that a review was required to consider whether estate duty in comparison to an inheritance system is a better fit for South Africa. However, Muller leaned towards an inheritance tax system that was more aligned to international systems.³¹

In 2011, Maartens-Dorey³² investigated the likelihood that estate duty will remain as a wealth tax in South Africa and argued that a wealth tax is required, but arguments were made for an inheritance tax type of system.³³ In 2012, Ger³⁴ also addressed the question of whether it was time for estate duty to be abolished and argued that it is more feasible for South Africa to retain its estate duty regime in

²⁷ Katz Commission *Fourth Report* Chapter 14.

²⁸ Katz Commission *Fourth Report* para 5.8.

²⁹ Katz Commission *Fourth Report* para 5.8.

³⁰ Muller *Wealth Transfer Taxation* 439-443.

³¹ Muller *Wealth Transfer Taxation* 443. See also Bornman *The Impact of Estate Duty and Capital Gains Tax* 76-81 where arguments for and against the abolishment of estate duty were provided.

³² Maartens-Dorey *The Survival of Estate Duty* 54.

³³ Reasons included that an inheritance tax would eliminate the double taxation issue on CGT at death and a beneficiary may be in a better position to pay the inheritance tax due on an unearned benefit.

³⁴ Ger 2012 *De Rebus* 59.

comparison to an inheritance tax, as the latter would require new legislation and systems, and would result in delays in finding solutions to existing problems. Ostler³⁵ stated that extensive changes are required to the *Estate Duty Act*, which would require a review that may be impractical due to the amount of work that it would entail.

In 2013, Hefer³⁶ was of the view that the advantages of death taxes outweigh the detrimental effect thereof and should remain. In 2014, Ramson³⁷ argued that the solution does not lie in introducing a new tax but in amending the estate duty provisions or abolishing it in its entirety. In 2015, Thorpe³⁸ concluded in a study on whether estate duty should be abolished, that it is not economically justifiable to repeal a tax as it results in major changes and existing legislation should be reviewed considering the capacity concerns to administer new taxes. Roeleveld³⁹ made arguments for and against the abolishment of estate duty and made various recommendations to the *Estate Duty Act*. Basson⁴⁰ cautioned against a repeal of the *Estate Duty Act* that applies to a few taxpayers in comparison to the introduction of a new wealth tax that will apply to a broader group of taxpayers.

In 2016, the DTC as the final Commission of Enquiry to date, recommended that estate duty should remain, despite low levels of collection.⁴¹ The DTC considered, regarding estate duty, the four canons of taxation (equity, certainty, convenience and cost efficiency) as defined by Adam Smith as contributors to a good tax system.⁴² The DTC⁴³ was of the view that the estate duty system lacked adherence to the canons of taxation because it is considered inefficient in administering estate duty, inequitable in calculating the estate duty liability based on the marital status

³⁵ Ostler *The Impact of Estate Planning* 3.

³⁶ Hefer *Abolishing Death Taxes in South Africa* 47-48.

³⁷ Ramson *The Interface Between Capital Gain Tax and Estate Duty* 43-44.

³⁸ Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 90.

³⁹ Roeleveld 2015 *SAJAR* 158-159. For example, a review of the definition for an "ordinarily resident" and the scope of a resident for estate duty purposes; the broad provisions of s 16(c) of the *Estate Duty Act* and the rationale behind the valuation rules.

⁴⁰ Basson *Wealth Transfer Taxation in the Absence of Estate Duty* 65.

⁴¹ See para 3.6.2 below for a detailed discussion on the DTC's recommendations.

⁴² Adam Smith Institute *The Condensed Wealth of Nations* 70. See also para 2.4.2 below.

⁴³ DTC *First Estate Duty Report* 32.

and class of assets in the estate, highly complex and time-consuming in applying the legislation. Estate duty is also seen to lack transparency by providing wealthy taxpayers with creative estate planning opportunities and there is no certainty in calculating the estate duty liability. As mentioned, the DTC recommended that estate duty should remain but, in light of the mentioned shortcomings, the DTC recommended a review of the *Estate Duty Act* to establish an effective and equitable package of major abatements in calculating the value of the dutiable estate.⁴⁴ This recommendation is aligned with the OECD's approach in its recent report, *Inheritance Taxation in OECD Countries, 2021 (Inheritance Taxation in OECD Countries)* that instead of repealing an existing wealth transfer tax and introducing a new tax, a reform of the country's existing tax should be considered.⁴⁵

Since the DTC's *Final Estate Duty Report* in 2016, no further reviews have been conducted and apart from *ad hoc* amendments, very few amendments have been made to the *Estate Duty Act* over the years.⁴⁶ A constant that runs through all of the research is that although there may be strong arguments to repeal and replace estate duty, it is recommended to use what exists and improve it rather than to reinvent the wheel. This study was inspired by exactly that: to look at keeping estate duty in an improved manner in place rather than to revisit the same old debate and to try and do away with it.

The major issues raised that remained unattended also appear in the discussion in Chapter 4 on the challenges that are currently experienced under the *Estate Duty Act*.⁴⁷ Furthermore, due to various provisions in the *Estate Duty Act*, whether outdated or insufficient, ongoing delays occur in finalising deceased estates. This

⁴⁴ DTC *Final Estate Duty Report* 5. Regarding the capital transfer tax recommended by previous Commissions, it was recommended that further investigations should be done on the feasibility of a new wealth tax in South Africa and estate duty should be revisited in the interim (see DTC *Final Estate Duty Report* 7 and DTC *Wealth Tax Report* 68).

⁴⁵ OECD *Inheritance Taxation in OECD Countries* 53.

⁴⁶ See for example, the increase in the estate duty rate from 20% (applicable to all dutiable estates below R30 million) to 25% for estates to the extent its dutiable value exceeds R30 million from 1 March 2018; the inclusion of s 3(2)(i) and the deletion of s 3(3)(a)*bis* from 1 January 2009; deletion of deemed property under s 3(3)(c) in 1988 and s 3(3)(cB) in 1993; additions to s 4(q) in 1987; and the deletion of s 4(k), (l), and (n) in 1988 to name a few.

⁴⁷ See also the issues identified in para 1.2.2 below.

study will address these shortcomings outlined by the Commissions in Chapter 3 and further discuss them in Chapter 4 while arguing for a revised legal framework to rewrite the current *Estate Duty Act*.

1.2.2 Motivation

The need for a revised *Estate Duty Act* is indicated in the findings of all the Commissions of Enquiry as well as the research mentioned earlier. The underlying issues identified that informed this need form the basis of this study.⁴⁸ Considering the few changes made to the *Estate Duty Act*, the need for new proposals concerning the *Estate Duty Act* is established in this study. To ignore this dire need would negate all the work previously done in reviewing this topic in the South African tax law regime.

The adherence of the *Estate Duty Act* to the established canons of taxation have been questioned in the sense that it is inefficient, inequitable (when taking into account a person's marital status), complex, and far from a simplified system.⁴⁹ The *Estate Duty Act* has further been considered to lack transparency and to provide no certainty when a deceased person's estate duty liability is calculated.

Chapter 2 explains the canons of taxation and discusses that the canon of equality, in the context of estate duty, is not necessarily determined on a person's ability to pay and since not all taxpayers have the same ability to pay taxes, vertical equity is lacking in which case a person with a greater ability should pay more estate duty.⁵⁰ This is also reflected in the primary abatement that is not adjusted for inflation.⁵¹ Chapter 4 further provides a discussion of the canon of taxation in the context of

⁴⁸ See the discussion below that follows.

⁴⁹ Adam Smith Institute *The Condensed Wealth of Nations* 70 and Lambert 1992 https://cooperative-individualism.org/lambert-ian_some-modern-principles-of-taxation-adam-smith-revisited-1992-jan.htm.

⁵⁰ See para 2.4.2 below.

⁵¹ The primary abatement has not been adjusted since 2007 and remained the same at R3.5 million, which have resulted in many deceased persons becoming subject to estate duty which may not have been the case if the abatement has been adjusted for inflation over the years. See para 4.2.5.2 below.

the *Estate Duty Act* where the lack of compliance deadlines is also considered to undermine the canon of certainty.⁵²

The issues identified over the years in the *Estate Duty Act* that have not yet been addressed by legislation include the following:

- (a) The different meanings of a "resident" under the *Estate Duty Act* and the *Income Tax Act* result in various misalignments.⁵³ Clarity regarding the meaning of an "ordinarily resident" under the *Estate Duty Act* is required by considering a statutory definition instead of relying on case law to make a decision.⁵⁴
- (b) The scope of "property" and "deemed property" under section 3 of the *Estate Duty Act* and specifically considering insurance policies.⁵⁵ Furthermore, the misalignment in the scope of property included in the estate of a non-resident for estate duty purposes if compared with CGT.⁵⁶
- (c) The constitutionality of the different estate duty treatments between a single deceased person and one that is survived by a spouse.⁵⁷
- (d) The deletion of section 4(q) of the *Estate Duty Act* for bequests to a surviving spouse to counter possible estate duty avoidance.⁵⁸
- (e) The unlimited tax relief for a non-resident surviving spouse under the *Estate Duty Act* that is contrary to the limited relief available for CGT purposes.⁵⁹
- (f) The value of the primary abatement under section 4A of the *Estate Duty Act* that has not been adjusted for inflation since 2007, resulting in a wider scope

⁵² See para 4.2.9.2 below.

⁵³ See para 4.2.1.1 below.

⁵⁴ Whitfield *Taxation Implications Arising from South African Residents* 180-182 and Roeleveld 2015 *SAJAR* 158. See also para 4.2.1 below for a detailed discussion on the challenges regarding the jurisdictional basis under the *Estate Duty Act*.

⁵⁵ Meyerowitz 1982 *The Taxpayer* 83. See paras 4.2.2.2 below.

⁵⁶ See para 4.2.2.1 below.

⁵⁷ DTC *Final Estate Duty Report* 14. See para 4.2.3 below.

⁵⁸ DTC *Final Estate Duty Report* 12-14. See para 4.2.3 below.

⁵⁹ See para 4.2.3.6 below.

of deceased persons becoming subject to estate duty instead of ensuring that the burden of the estate duty liability is limited to the wealthiest of society.⁶⁰

- (g) The rationale behind the different valuation rules under section 5 of the *Estate Duty Act*, especially about the different treatments between listed and unlisted shares,⁶¹ as well as the valuation of limited interests that are terminated that may result in possible estate duty avoidance schemes.⁶²
- (h) The issue of double taxation for cross-border estates and the limited unilateral relief in that regard.⁶³
- (i) The lack of anti-avoidance legislation under the *Estate Duty Act*.⁶⁴
- (j) The lack of a statutory definition of the concept of "accrual" under the *Estate Duty Act*, specifically taking into account the impact of the law of succession on the application of the *Estate Duty Act*.⁶⁵ The timing of the accrual of an inheritance under the law of succession has been debated,⁶⁶ and no clarity is provided under the *Estate Duty Act*.⁶⁷

In addition to the above-mentioned issues under the *Estate Duty Act*, various administrative challenges occur in the administration of a deceased estate. The primary sources of legislation in the context of this study is the *Constitution of the*

⁶⁰ DTC *Final Estate Duty Report* 17-19. See para 4.2.5 below.

⁶¹ Roeleveld 2015 *SAJAR* 158. See para 4.2.6.2 below.

⁶² Roeleveld 2015 *SAJAR* 158. See paras 4.2.6.3 and 4.2.6.4 below.

⁶³ Whitfield *Taxation Implications Arising from South African Residents* 180-182 and Roeleveld 2015 *SAJAR* 159. See para 4.2.7 below.

⁶⁴ Davis and Emslie 2010 *The Taxpayer* 21. See para 4.2.8 below.

⁶⁵ See para 4.2.4 below.

⁶⁶ For example, the question is whether it take place at death or only at a later point in time. See *Greenberg v Estate Greenberg* 1955 3 SA 361 (A) (the *Greenberg* case). The issue was when the legatee acquired the dominium of the property bequeathed. The Court held it does not happen at the date of death, but the legatee acquires a vested right to claim the legacy once the liquidation and distribution account (L & D account) is confirmed by the Master. The issue of accrual has also been discussed in *inter alia* De Waal and Schoeman-Malan *Law of Succession* 8 and De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 53.

⁶⁷ Although for income tax purposes, the concept of accrual has been defined through case law, the issue is whether the same principle can apply to estate duty, taking into account the principles that have been laid down under the law of succession.

Republic of South Africa, 1996 (the *Constitution*) and the *Estate Duty Act*, supplemented by the common law and case law. Estate duty is calculated, levied and administered under the *Estate Duty Act*. Many of the administrative functions not covered under the *Estate Duty Act* are dealt with under the *Tax Administration Act* 28 of 2011 (the *Tax Administration Act*). The impact of other tax legislation must be noted in the administration of a deceased estate, especially the interaction with the *Income Tax Act*, as far as it determines the position of the deceased person up to the date of death and the deceased estate. Any tax debt (income tax and CGT) the deceased person owes at the date of death will influence the estate duty calculation. However, there is a myriad of other legislative provisions relevant to the winding up of a deceased estate, of which those in the *Administration of Estates Act* 66 of 1965 (the *Administration of Estates Act*) are the most important. The *Administration of Estates Act* is "connected" to the *Estate Duty Act* prescribing the process to finalise the estate.⁶⁸

The Master of the High Court (the Master) supervises the administration of a deceased estate and requires specific steps to be taken at certain points in time. When considering the administration of a deceased estate under the supervision of the Master, specific timelines must be adhered to by the executor regarding the advertisement of the estate and the L & D account. Currently, the *Estate Duty Act* does not provide a specific timeline for the submission of the estate duty return to ensure an accurate assessment of the estate duty liability in a timely manner.⁶⁹ The lack of certainty undermines the canons of taxation and may result in delays in submitting claims to an executor or in claims becoming unenforceable as the timeline under the *Estate Duty Act* is not aligned with the timelines under the *Administration of the Estate Act*.⁷⁰ A revision of the timelines under the *Estate Duty*

⁶⁸ See para 4.2.9.1 below.

⁶⁹ See paras 4.2.9.2 to 4.2.9.4 below for detailed discussion on the timeline issues of returns, assessments and payments for estate duty. The same applies to the *Income Tax Act* and the *Tax Administration Act* where no specific timelines for income tax returns are provided for a deceased person or a deceased estate.

⁷⁰ For example, the timelines for the submission of income tax or estate duty returns are not aligned to the submission of claims to ensure it is taken into account in the preparation of the L & D account that the executor must submit to the Master. Section 35 of the *Administration of*

Act may result in greater alignment in the overall administration of a deceased estate process across the applicable legislation instead of working against each other. Therefore, it is suggested that an in-depth study of the *Estate Duty Act* could clear up uncertainties and provide guidance to the circumstances currently faced in the finalisation of deceased estates. The study ultimately proposes a revised legal framework for the *Estate Duty Act*, as the current *Estate Duty Act* has been in operation for over 65 years.

Based on the discussion above, it is submitted that South Africa's *Estate Duty Act* has become stagnant over the years, which motivates for a complete reform thereof. Lessons may be learnt from other countries that have passed the same route before. This study will include a comparative study in respect of the inheritance tax and federal estate tax legislation of the Organisation for Economic Co-operation and Development (OECD) member states, for example, the United Kingdom (UK) and the United States (US), respectively.⁷¹ These two countries are chosen due to the similarity of the UK inheritance tax system and the US federal estate tax system with the South African estate duty system.⁷² Both countries follow a probate system where an executor is appointed to execute the asset distribution of the estate in terms of the provisions of the deceased person's will.⁷³ Both countries (the UK and US) have undergone inheritance or estate tax reforms in the past from which lessons could potentially be learnt. Certain positions that are taken by both countries that differ from the position in South Africa include the scope of property included for inheritance or estate tax purposes, the wider scope of exemptions applicable, the different treatment of a resident compared to a non-resident, the detailed unilateral relief provisions, anti-avoidance rules for inheritance tax, and penalty provisions in the instance of non-compliance by an executor. Many

Estates Act provides that the executor is required to submit the L & D account within six months from the date of appointment.

⁷¹ See Chapter 5 below.

⁷² The similarity stems from the levying of the inheritance or estate taxes in the same respects, for example, the worldwide assets are included in the estate of a resident, whereas non-residents are only taxed on source. An "estate tax", like South Africa's estate duty is levied while providing exemptions and an abatement. Although the UK calls it an "inheritance tax", it operates on the same basis as an estate tax.

⁷³ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 471, 486.

of these positions taken by both countries which are worth considering, are not seen in the South African system. Both countries have an estate duty agreement with South Africa, which is relevant to determine the available relief from double estate taxation.

In addition to the comparative study, recommendations by the OECD in its report on *Inheritance Taxation in OECD Countries* are discussed throughout the study in relation to the specific issues raised to determine its relevance to the South African system for purposes of making recommendations for the *Estate Duty Act*.

In establishing its legal policies, South Africa considers the policies recommended by the OECD. South Africa is not a member of the OECD but follows the *OECD Model Tax Convention on Income and on Capital 2017* (the *OECD Model Tax Convention*), in its negotiations when entering double tax treaties for income tax and CGT.⁷⁴ The *OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts 1983* (the *Estate Tax Model*), provides for a comparable model for estate tax, inheritance and gift taxes.⁷⁵

Despite criticism against the current *Estate Duty Act* to motivate its abolishment, it is still in place and contributes to the *fiscus*.⁷⁶ This study builds on the various academic studies conducted and the final recommendation by the DTC that estate duty should remain, and a review of the *Estate Duty Act* must be done to make it a more "equitable combined estate duty package".⁷⁷

1.2.3 Limitations of the study

This study focuses on the legal framework for estate duty and the aspects to be considered in making recommendations for a revised *Estate Duty Act*. The debate on whether estate duty should be abolished has been raised on numerous

⁷⁴ Du Plessis 2016 *TSAR* 497.

⁷⁵ OECD "Fundamental Principles of Taxation" 36 and the OECD *Estate Tax Model*.

⁷⁶ National Treasury *Statistical Annexure, 2022 Budget Review* 200. See para 2.3.1 below.

⁷⁷ DTC *Final Estate Duty Report* 7.

occasions,⁷⁸ including through each of the Commissions of Enquiry⁷⁹ appointed by the Minister of Finance. The final approach by the Margo and Katz Commission is also reflected in the final recommendations by the DTC that estate duty should remain.⁸⁰ This position is accepted for the study, and the researcher will not focus on the rationale for or against estate duty, which would make the scope too broad. The same applies to the debate on whether South Africa must have an estate duty or an inheritance tax. Instead, the focus of the study will be on what would be required to enhance the existing estate duty system to reform the *Estate Duty Act*.

This study is limited to the taxation of the transfer of property upon death, and not the profit in respect thereof, which are dealt with under capital gains taxes. Even though reference is made to the treatment of CGT to bring alignment across taxes, where relevant, it is not critically assessed.

Although estate duty is regarded as a wealth transfer tax, the continuous debate on whether South Africa should introduce a new wealth tax falls outside the scope of this study. Instead, the study aims to propose amendments to the *Estate Duty Act* to optimise and revise the current wealth transfer tax already in place.

1.2.4 Research question

Since this study proposes a revised legal framework for estate duty through recommendations to the *Estate Duty Act*, the primary research question is: "Through the use of a historical and comparative study, how can the *Estate Duty Act* be revised to keep up with a changing legal landscape?"

⁷⁸ In addition to the studies discussed under para 1.2.1 above, the following studies were also conducted: Bornman *The Impact of Estate Duty and Capital Gains Tax* 76-81 where arguments for and against the abolishment of estate duty was provided; Ramson *The Interface Between Capital Gain Tax and Estate Duty* 43-44, where it was argued that the solution does not lie in introducing a new tax but in amending the estate duty provisions or abolishing it in its entirety, and Hefer *Abolishing Death Taxes in South Africa* 47-48 stated that the advantages of death taxes outweighs the detrimental effect thereof and should remain.

⁷⁹ Katz Commission *Third Report* 10; Katz Commission *Fourth Report* para 5.8; DTC *Final Estate Duty Report* 33 and the DTC *Wealth Tax Report* 68.

⁸⁰ DTC *Final Estate Duty Report* 33 and the DTC *Wealth Tax Report* 68.

In answering the main research question, the following sub-questions will be addressed in the relevant chapters:

- (a) Which recommendations were made by the various Commissions of Enquiry and to what extent are they still relevant to the *Estate Duty Act*?⁸¹
- (b) What are the existing problem areas under the *Estate Duty Act*?⁸²
- (c) What guidance can be sought from the OECD and its established principles on inheritance-related taxes?⁸³
- (d) What lessons can be learned from the UK and US inheritance tax and estate tax systems to assist in making recommendations for a revised *Estate Duty Act*?⁸⁴

1.3 Aims and objectives

1.3.1 Aims

The study aims to provide recommendations for a revised *Estate Duty Act*. To do so, the individual aims include:

- (a) researching the history of the *Estate Duty Act* and recommendations made by previous Commissions of Enquiry in respect of amendments to the *Estate Duty Act*,⁸⁵
- (b) identifying current problem areas under the *Estate Duty Act*; evaluating its adherence to the canons of taxation and investigating the absence of

⁸¹ See Chapter 3 below. No specific research question relates to Chapter 2 that provides a theoretical framework for purposes of the ultimate aim of the study to make recommendations for a revised *Estate Duty Act*.

⁸² See Chapter 4 below.

⁸³ The guidance from the OECD is reflected through the study and not limited to a specific chapter.

⁸⁴ See Chapter 5 below.

⁸⁵ See Chapter 3 below.

administrative provisions concerning estate duty to motivate amendments to the *Estate Duty Act*,⁸⁶

- (c) doing a comparative study by considering the respective inheritance and estate tax legislation of the UK and the US to draw from lessons learnt in this regard;⁸⁷
- (d) considering OECD principles and guidelines and how they may impact the provisions of the *Estate Duty Act*,⁸⁸ and
- (e) drafting recommendations for a revised *Estate Duty Act*.⁸⁹

1.3.2 Objectives

For purposes of this study, the objectives refer to measures the researcher will take to achieve the overall goal and aim of the study. In this regard, the researcher will:

- (a) conduct a historical overview of the South African estate duty law development with specific reference to the relevant legislation. This investigation is essential to place any recommendations into their proper historical context;⁹⁰
- (b) conduct an overview of the historical recommendations⁹¹ by previous Commissions of Enquiry (Margo Commission, Katz Commission and the DTC) regarding the *Estate Duty Act*, and examine the relevance of the recommendations for the present time;
- (c) identify various problem areas under the *Estate Duty Act* and consider clarifications, for example, the meaning of "ordinarily resident" for purposes

⁸⁶ See Chapter 4 below.

⁸⁷ See Chapter 5 below.

⁸⁸ See Chapter 4 below.

⁸⁹ See Chapter 6 below.

⁹⁰ See para 3.2 below.

⁹¹ See paras 3.4 to 3.6 below. These recommendations include a need for specific anti-avoidance provisions under the *Estate Duty Act*, a review of the residence-based versus source-based tax regime for estate duty purposes, the continuance of s 4(q) or an increase in the s 4A abatement.

of applying the *Estate Duty Act* and whether a wider scope of administrative provisions should be provided for in the *Estate Duty Act*,⁹²

- (d) examine the four canons of taxation (equity, certainty, convenience and efficiency) and how they relate to estate duty to determine the extent to which amendments are required to the *Estate Duty Act* to accommodate them;⁹³
- (e) evaluate the OECD recommendations regarding inheritance tax systems to determine their compatibility with the South African system, as well as the OECD principles and how they may impact the provisions of the *Estate Duty Act*;⁹⁴
- (f) conduct a comparative study of the domestic legislation and estate tax reforms in OECD member states (UK and US) to draw from the lessons already learnt by those states. This will also be of great value in determining what the content and extent of the estate duty reform should be and why certain routes may be more successful than others;⁹⁵ and
- (g) draft recommendations for a revised *Estate Duty Act*.⁹⁶

1.4 Premise, assumption, and hypothesis

1.4.1 Premise

If the emphasis is placed on the findings of the Commissions of Enquiry regarding estate duty, then there are strong indicators that a revised *Estate Duty Act* is required. In this regard, the DTC's recommendation provided a preliminary framework that can be built upon. The *Inheritance Taxation in OECD Countries* report by the OECD acknowledges the need for inheritance or estate tax reforms in jurisdictions worldwide and establishes various building blocks and insights for recommendations in an exercise relating to such reform. The stark reality of estate

⁹² See Chapter 4 below.

⁹³ See Chapter 4 below.

⁹⁴ See Chapter 4 below.

⁹⁵ See Chapter 5 below.

⁹⁶ See Chapter 6 below.

duty being a "neglected tax" in South Africa and suggestions by the Minister of Finance dating back to the late 1980s motivate the need for such a reform.

1.4.2 Assumption

This study is based on the following assumption:

As part hereof, an overview of previous local Commissions of Enquiry and OECD documents will be provided and the recommendations made in those respective reports or documents will be accepted as valid and legally sound. The correctness thereof will not be questioned, but will be evaluated to determine their relevance to make recommendations to the *Estate Duty Act*.

1.4.3 Hypothesis

For purposes of this study, it is accepted that introducing a revised *Estate Duty Act* is both possible and desirable, although the latter no longer seems in dispute. The study will examine and reveal the historical context of estate duty and whether recommendations to the *Estate Duty Act* are required. If the previous recommendations by the Commissions of Enquiry, and more specifically the DTC, are still regarded as relevant and accepted, it will lead to amendments to the *Estate Duty Act*. If the recommendations are deemed appropriate but rejected or irrelevant, no amendments may be required.

If the purpose of a revised *Estate Duty Act* is to provide a vehicle for the efficient treatment of a deceased estate, it should no longer contain outdated provisions compared to OECD principles. The point of departure should be that the outdated provisions should be replaced by provisions fitting for the present times. A proper examination of this aspect will reveal whether this hypothesis is possible.

Suppose the purpose of the revised *Estate Duty Act* is to be all-encompassing, it should be accepted that all the provisions will be included in the ambit of the *Estate Duty Act*, which would include the administrative provisions that are currently found in the *Tax Administration Act*. Where relevant, it will also be examined whether these administrative provisions should be retained in the *Tax Administration Act*.

1.5 Research methodology

The study follows a qualitative methodology. Qualitative research implies that a researcher collects and uses non-numerical data to understand concepts, opinions or experiences. For the purposes of this study, the qualitative method selected is a literature review combined with a comparative study. The literature review will consist of the review of the following resources:

1.5.1 Primary and secondary sources

The researcher analysed the relevant information from existing primary and secondary sources. The primary sources considered for this study include domestic and foreign legislation, tax treaties, policies, and relevant case law. The secondary sources include books, journal articles, reports and other relevant internet sources.

1.5.2 Relevant legislation

The study revolves around a critical analysis of the *Estate Duty Act* to determine its shortcomings and identify any inadequacies in the administration of an estate in order to provide recommendations or clarity.

The *Tax Administration Act* from 2012 contains most if not all of the administrative provisions relating to the various tax Acts, including the *Estate Duty Act*. Those provisions will also be studied to determine whether sufficient justification exists for specific administrative provisions to be reinstated into the *Estate Duty Act*.

The comparative study's focus on foreign domestic law will also evaluate the UK's *Inheritance Act*, 1984 (the *Inheritance Act*) and the US's *Internal Revenue Code*, 1986 (the *Internal Revenue Code*).

1.5.3 Relevant case law

The study will refer to case law that applies to the *Estate Duty Act*, where clarity has been provided regarding the interpretation and rationale behind the provisions contained in the *Estate Duty Act*. The provisions of the common law will be considered to determine to what extent specific provisions should be included for

purpose of clarity in the *Estate Duty Act*. Foreign case law of the UK and US will also be examined.

1.5.4 Relevant reports

The research will refer to various reports published by the Commissions of Enquiry that will form part of the study. These reports include those prepared by the Margo Commission, 1987; the *Third and Fourth Reports* of the Katz Commission, 1997; the *First Estate Duty Report* by the DTC, 2015; the *Final Estate Duty Report* by the DTC, 2016 and the *Inheritance Taxation in OECD Countries* report by the OECD, 2021. A critical analysis of the final recommendations drafted in these reports will influence the final recommendations made in this study (keeping the OECD recommendations in mind) for a revised *Estate Duty Act*.

1.5.5 Historical analysis

The study will use historical analysis to discuss the historical aspect of the estate duty development in South Africa with specific reference to statutes and case law. This examination will place any recommendations regarding the *Estate Duty Act* into its proper historical context.

1.5.6 Comparative study

The study will contain a comparative study of two OECD member states' (the UK and the US) inheritance and estate tax systems.⁹⁷ The functional approach to comparison is followed as the UK's inheritance tax system and US' estate tax system

⁹⁷ The reason why the UK and the US as developed countries were chosen instead of a SADC country is that no estate duty regime is in place among the SADC countries except for Zimbabwe. Furthermore, South Africa is the largest economy and the most advanced in the SADC community. The Zimbabwean Estate Duty Act was introduced after the South African *Estate Duty Act* and contains almost identical provisions to the South African *Estate Duty Act*, except for specific deductions regarding one of the deceased's motor vehicles and the value of deceased's primary residence. The Zimbabwe estate duty system is almost identical to the South African system which therefore did not provide a proper basis for a comparative study – it would be nonsensical to draw a comparison with something that is close to identical to one's own system. See Louw-Vaudran 2018 <https://issafrica.org/iss-today/who-has-the-power-in-sadc> and Carpenter and Mateta "Comparative Analysis of Death Taxes in South Africa and Zimbabwe" 467, 474.

operate on a similar basis to South Africa's estate duty system, facing similar problems although they take different legal measures in dealing with those problems in reaching suitable results. This is observed in the UK that has an "inheritance tax", operates on a similar basis as an "estate tax" where the tax is payable by the executor of the deceased estate. The US has a federal estate tax and some of its States also have an "inheritance tax" that it levies in addition to the federal estate tax. Each State operates its own system, but a uniform system is operated in terms of the "federal estate tax", which is the tax that will form the focus of the comparative study with the US.

Both the UK and the US systems are chosen because, although they are similar to South Africa's estate duty system, they contain more specific and clear provisions assisting with clarity and certainty. The administration of a deceased estate in both the UK and the US is not governed by forced heirship rules but according to the wishes of the deceased person by way of a testament or in the absence of a testament, according to the intestate succession rules of each country.⁹⁸

As part of the comparative study on foreign law (UK and US), such provisions may be considered in drawing conclusions on how they will influence the South African system.⁹⁹ The relevant provisions that are focused on, include the jurisdictional basis applied, the scope of "property" included in an estate, exemptions available, the different treatment between a resident and a non-resident, and the penalties applied.

Regarding the UK, the *Inheritance Act* will be discussed and in particular, the statutory provisions to determine a "resident", specific exemptions and their scope, as well as anti-avoidance rules. The latest reports by the Office of Tax Simplification (OTS)¹⁰⁰ and All-Party Parliamentary Group (APPG)¹⁰¹ on the reform of inheritance

⁹⁸ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 452-487.

⁹⁹ Section 39(1) of the *Constitution*.

¹⁰⁰ OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax*.

¹⁰¹ APPG *Reform of Inheritance Tax*.

tax will also be relevant regarding the recommendations that could be drawn from the UK inheritance tax system.

From the perspective of the US, the study will be focused on its federal estate tax and not on the inheritance tax that may be levied in several of its States. The study will be focused on the *Internal Revenue Code* and historic reforms in the US federal estate tax and the reasoning behind the various changes it has undergone.¹⁰² Provisions regarding exemption threshold, the distinction between residents and non-residents, and compliance aspects will also be focused on to determine if any lessons can be drawn therefrom to make recommendations to the *Estate Duty Act*.¹⁰³

The OECD's comparative method has the object of determining how selected foreign legal systems deal with estate duty/estate tax/inheritance tax to find parallels with the position in South Africa and identify possible improvements to the *Estate Duty Act* in South Africa.

1.6 Chapter layout of the study

Before delving into the current problem areas associated with the *Estate Duty Act*, as part of the introductory chapter or Chapter 2 covering the canons of taxation, it is necessary to recognise that the study has a historical component with identified problem areas arising subsequent to the enactment of the *Estate Duty Act*. Consequently, the study requires a logical chronological approach where the history of the *Estate Duty Act* is first analysed in Chapter 3 before exploring the subsequent transpired problem areas in Chapter 4.

The framework of the study is as follows:

Chapter 2: Objectives and policy considerations of taxation

Chapter 2 provides a theoretical framework in respect of the objectives of taxation,

¹⁰² Thorndik 2016
<http://www.taxhistory.org/thp/readings.nsf/ArtWeb/F6769F770B0FC2898525803700432EE1?OpenDocument>.

¹⁰³ Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 118-128.

the "canons of taxation" that provide the criteria for an effective tax system, as well as a brief discussion of the South African constitutional considerations applicable to taxation. The theoretical framework is required to provide the wider legal context in which recommendations to the *Estate Duty Act* must be made.

Chapter 3: Historical overview and analysis of findings by the Commissions of Enquiry on the *Estate Duty Act*

Chapter 3 contains a brief historical overview of the development of the South African estate duty legislation well as an analysis of the historical recommendations by previous Commissions of Enquiries (Margo Commission, Katz Commission and the DTC) regarding the *Estate Duty Act*. The chapter will examine the relevance of the recommendations made in the past to support or reject the recommendations to the *Estate Duty Act*.

Chapter 4: Problem areas relating to *Estate Duty Act*

Chapter 4 analyses the problem areas experienced under the *Estate Duty Act*, including the absence of efficient administration provisions to determine possible solutions that can be recommended. The adherence of the *Estate Duty Act* to the four canons of taxation is covered to determine the extent to which amendments are required to the *Estate Duty Act* to accommodate them. The OECD's principles and specific recommendations for inheritance taxation are evaluated to determine its relevance to the *Estate Duty Act* and to make possible recommendations.

Chapter 5: Wealth transfer tax systems in the United Kingdom and the United States

Chapter 5 entails a functional comparative study of the inheritance or estate tax systems in the OECD member states (the UK and the US) and their related reforms to draw from the lessons already learnt by those jurisdictions. The Chapter will include a description of the historical development in each jurisdiction regarding its inheritance or estate tax and the current status in each jurisdiction. It will also

identify key factors that could be considered from South Africa's point of view to improve the *Estate Duty Act*.

Chapter 6: Conclusion and recommendations

Chapter 6 produces the results of the study for a revised legal framework for estate duty. The chapter answers the research question and contains conclusions and recommendations for a revised *Estate Duty Act* regarding the problem areas identified.

CHAPTER 2 OBJECTIVES AND POLICY CONSIDERATIONS OF TAXATION

Abstract

In the search for a revised *Estate Duty Act*, any recommendations should aim to promote the objectives of taxation and be founded upon the "canons of taxation". In addition, the impact of the *Constitution* as the supreme law of South Africa, especially considering the Bill of Rights, in respect of a taxpayer's fundamental rights are discussed which forms part of a good and effective tax system. It was found that the *Constitution* influenced the *Estate Duty Act* in redefining the meaning of a "spouse" to stay abreast with the ever-changing legal environment as well as enhancing administrative provisions to simplify the administration of an estate. The influence of transformative constitutionalism is a continuous consideration in the search for a revised *Estate Duty Act* to ensure any proposals remain aligned with the *Constitution*.

2.1 Introduction

The existence of estate duty in South Africa is a reality. Estate duty as a wealth transfer tax arises from a chargeable event on death that imposes a tax liability on the estate of the deceased person. Since the study aims to provide recommendations for a revised *Estate Duty Act*, any proposals should take cognisance of the objectives of taxation and policy considerations based on the "canons of taxation" and alignment with the *Constitution*.¹⁰⁴

As a point of departure, this chapter sets out to provide a theoretical framework regarding these objectives of taxation,¹⁰⁵ the "canons of taxation"¹⁰⁶ as well as a

¹⁰⁴ Muller *Wealth Transfer Taxation* 11.

¹⁰⁵ See para 2.3 below.

¹⁰⁶ The "canons of taxation" were introduced by Adam Smith in 1776. Adam Smith Institution *The Condensed Wealth of Nations* 70. The "canons of taxation" are also referred to by Smith as the "maxims of taxations", but the "canons of taxation" has become a well-known concept. See para 2.4.2 below.

contextual understanding in terms of which the recommendations for a revised *Estate Duty Act* will be provided in Chapter 6.¹⁰⁷

This chapter will first define the concept of a "wealth transfer tax". The objectives of taxation and the "canons of taxation" are outlined to provide the criteria for an effective tax system and specifically a wealth transfer tax system.¹⁰⁸ The chapter will be concluded with a brief discussion of the South African constitutional considerations applicable to taxation and specifically its relevance to the *Estate Duty Act*.

2.2 Wealth transfer tax

A wealth transfer tax is a tax levied on the transfer of wealth *inter vivos* and on transfers at death.¹⁰⁹ A wealth transfer tax can be divided into two categories, namely:

- (a) a transferor-based tax that is levied on the transferor or his or her estate based on the value of the assets in the estate, or the donation made (for example, an estate tax, estate duty, gift tax or donations tax); or
- (b) a recipient-based tax that is levied on the recipient of the inheritance or a gift received (for example, an inheritance tax, succession duty, accession duty, or donations or gift tax).¹¹⁰

¹⁰⁷ This chapter does not answer a specific research question but provides a theoretical framework for the study considering the recommendations made for a revised *Estate Duty Act*.

¹⁰⁸ The "canons of taxation" is universally and domestically accepted as the criteria for the design of a good tax system. See Margo Commission *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa by the Margo Commissioner* (the *Margo Report*) 1.28; Katz Commission *Third Report* 2; Stiglingh *et al Silke: South African Income Tax* 5; Emslie, Davis and Hutton *Income Tax Cases and Materials* 1 and DTC *Wealth Tax Report* 32; Moosa 2016 *The 1996 Constitution and the Tax Administration Act* 15 and OECD *Inheritance Taxation in OECD Countries* 38-42.

¹⁰⁹ Rudnick and Gordon "Taxation of Wealth" 292-293. See also Arendse and Stack 2018 *JEFS* 207; Katz Commission *Fourth Report* 7.1.6; Sandford 1987 *Fiscal Studies* 16 and OECD *Inheritance Taxation in OECD Countries* 37-38 and Muller *Wealth Transfer Taxation* 25.

¹¹⁰ Rudnick and Gordon "Taxation of Wealth" 292-293. See also Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 410 and OECD *Inheritance Taxation in OECD Countries* 37-38. There are exceptions, as in the case of the UK, where the "inheritance tax" that is levied is a transferor-based tax but operates like an "estate tax" system (see Sandford 1987 *Fiscal Studies* 18 and

As can be seen, wealth transfer tax has been given many names depending on the type of transfer it is levied upon, but for purposes of this study reference will be made to "inheritance tax",¹¹¹ "estate tax"¹¹² or "estate duty".¹¹³

The rate of tax may differ and depends on the rate structure of a country's wealth transfer tax system and can be either a flat¹¹⁴ rate or a progressive¹¹⁵ rate.¹¹⁶ In the case of a recipient-based inheritance tax, the rate of the tax can also differ depending on the relation between the transferor and the beneficiary.¹¹⁷ For example, a spouse may be subject to inheritance tax at 0% in comparison to a child who is subject to 15% and any other relative being subject to 25%.

As mentioned above, South Africa currently levies a transferor-based wealth transfer tax in the form of donations tax on lifetime transfers¹¹⁸ and in the form of estate duty for transfers upon death.¹¹⁹ Taxation (including a tax on the transfer of wealth)

Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 410). See Chapter 5 for more information on the UK inheritance tax.

¹¹¹ The UK refers to an "inheritance tax" although it operates as a transferor-based estate tax (see Sandford 1987 *Fiscal Studies* 18 and Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 410).

¹¹² The US levies a "federal estate tax" that is also a transferor-based tax.

¹¹³ In the South African context, it is called an "estate duty" (s 2(1) of the *Estate Duty Act*).

¹¹⁴ A flat rate refers to a single tax rate that applies across the taxable value regardless of the value of income or assets involved (see Tax Foundation 2023 <https://taxfoundation.org/tax-basics/flat-tax/>).

¹¹⁵ A progressive tax refers to a "tax rate that increases (or progresses) as taxable income increases". The higher a person's income is, the higher is the tax rate applicable and *vice versa*. This usually involves the creation of tax brackets that group taxpayers according to their level of income earned (see Kagan 2023 <https://www.investopedia.com/terms/p/progressivetax.asp>).

¹¹⁶ The UK and US levy a flat rate of 40% and South Africa levies a progressive rate of 20% and 25%. See OECD *Inheritance Taxation in OECD Countries* 83 and para 2(1)(a) of the First Schedule to the *Estate Duty Act*.

¹¹⁷ Rudnick and Gordon "Taxation of Wealth" 293; Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 412 and OECD *Inheritance Taxation in OECD Countries* 83. South Africa does not apply a different tax rate for estate duty based on the relationship between the deceased and the beneficiary, but a specific exemption for a spousal bequest may become applicable that may result in less or no estate duty being payable.

¹¹⁸ Donations tax is a wealth transfer tax levied under the *Income Tax Act*. CGT may also apply to *inter vivos* transfers where property is disposed of, but it is levied on the growth in the value of the asset.

¹¹⁹ CGT under s 9HA of the *Income Tax Act* may also apply to a deemed disposal upon death in the deceased person's hands. Donations tax and estate duty is levied on the transfer of wealth, whereas CGT is more a tax on the appreciation of wealth (see Roeleveld 2015 *SAJAR* 145; Katz Commission *Fourth Report* 7.1.6; Loubser *Impact of the Davis Tax Committee's First Interim Report on Estate Duty* 29 and DTC *Final Estate Duty Report* 20). For purposes of this study the

is relevant to the *fiscus* because of the objective it serves. The following section will discuss the objectives of taxation.

2.3 Objectives of taxation

The objectives of taxation are categorised into two parts: first, to operate as a fiscal tool to fund public expenditure according to the government's priorities, and secondly, taxation is used to assist in dealing with market failures.¹²⁰ The secondary objective can further be explained as utilising taxation to address numerous socio-economic objectives.¹²¹

The National Treasury provided the objectives of the South African tax system in the *Terms of Reference for the South African Tax Review Committee* (2014) and included the following:¹²²

- (a) The primary objective is to raise revenue to fund government expenditures.
- (b) Social objectives that are met through a progressive tax system where revenue is raised to redistribute resources and build a cohesive and inclusive society.
- (c) A tax on production or consumption to internalise negative externalities¹²³ to correct market failures.
- (d) The implementation of certain taxes can influence people's behaviour to prevent unwanted behaviour and encourage desired behaviour.

focus is limited to estate duty that applies to transfers at death. See also Davis, Jooste and Beneke *Estate Planning* 2.1.

¹²⁰ Momoniat *Challenges Facing Tax Policy in South Africa* 17. See also Stiglingh *et al Silke: South African Income Tax* 1; Morse, Williams and Eden *Davies: Principles of Tax Law* 3; Williams *Income Tax in South Africa* 1 and Haupt *Notes on South African Income Tax* 1.

¹²¹ Momoniat *Challenges Facing Tax Policy in South Africa* 17; Muller *Wealth Transfer Taxation* 37; Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 25 and Williams *Income Tax in South Africa* 1.

¹²² National Treasury *Terms of Reference for the South African Tax Review Committee* 4.

¹²³ This includes pollution or consumption of harmful products.

- (e) Taxation can assist economic growth through tax incentives for higher levels of investment.
- (f) Taxation may also influence the international competitiveness of South Africa.

The primary and secondary objectives of taxation identified will be discussed in more detail below.

2.3.1 Revenue to fund public expenditure

Public expenditure is defined as the expenditure that is incurred by the government to meet the collective social wants of the people.¹²⁴ Muller¹²⁵ states that all social policy efforts require expenditure that is financed through loans, administrative fees, government-induced inflation, or charges, or taxation. According to Gash,¹²⁶ revenue is the main need for taxation. The money collected in the process of taxation is spent to finance the public expenditure.¹²⁷ In *Davies: Principle of Tax Law*¹²⁸ it is stated that tax "is a compulsory levy imposed by an organ of government for public purposes".

In South Africa, the actual total (gross) tax revenue collected for the 2021/2022 year of assessment was R1.563 trillion. The non-tax revenue collected amounted to R46.6 billion.¹²⁹ The tax revenue collected is the most significant contributor to the total national income in South Africa.¹³⁰ This position supports the main objective of taxation to generate revenue for public expenditure.¹³¹ However, the contribution of

¹²⁴ Akrani 2011 <https://kalyan-city.blogspot.com/2011/02/what-is-public-expenditure-meaning-and.html> accessed 29 June 2022. See also Matobela *Wealth Tax in South Africa* 4 and Morse, Williams and Eden *Davies: Principles of Tax Law* 3.

¹²⁵ Muller *Wealth Transfer Taxation* 37.

¹²⁶ Gash *A Critical Discussion of the Present Tax System in Kosovo* 14.

¹²⁷ This view is supported in the South African context, see Stiglingh *et al Silke: South African Income Tax* 1 and Steyn, Franzen and Stiglingh 2013 *International Business & Economics Research Journal* 242.

¹²⁸ Morse, Williams and Eden *Davies: Principles of Tax Law* 3.

¹²⁹ National Treasury *Budget Review 2023* Table 3.8 Main Budget Framework 37.

¹³⁰ National Treasury *Budget Review 2023* Table 3.8 Main Budget Framework 37.

¹³¹ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 26.

estate duty to the total gross tax revenue is R3.14 billion for the 2021/2022 period.¹³² The revenue derived from estate duty is not material to the total tax revenue. It can therefore be reasoned that the primary objective of estate duty is either not necessarily to raise revenue for government expenditure or it is failing in its primary objective.¹³³

2.3.2 Socio-economic objectives

Taxation forms part of social and economic policies and can be used to fund social-economic objectives such as reprising, economic growth, and redistribution of wealth and resources.¹³⁴

2.3.2.1 Reprising

Tax systems are designed, based on policy, to influence the economic and social development of a country over time. This includes reprising which refers to the encouragement or discouragement of certain activities. Reprising is achieved through taxation, for example, "sin taxes" are imposed on products such as tobacco and alcohol to decrease the consumption thereof.¹³⁵

Reprising through taxation has been criticised on the principle of non-discrimination that requires the government to be neutral towards all kinds of activities.¹³⁶ However, the counterargument has been that sin taxes assist in the raising of revenue towards the social cost associated with the misuse or abuse of harmful

¹³² National Treasury *Statistical Annexure, 2023 Budget Review* 204. In comparison to the estate duty collection, revenue derived from value-added tax and personal income tax amounted to R390 billion and R553 billion, respectively.

¹³³ Sandford 1987 *Fiscal Studies* 16 (estate duty is not considered the biggest revenue yielder); Williams *Income Tax in South Africa* 7-8 (estate duty is argued to redistribute wealth and equity); Rudnick and Gordon "Taxation of Wealth" 296-299 (wealth transfer taxes are seen as a complement to income tax and assist in redistribution of wealth); DTC *First Estate Duty Report* 5 (estate duty is underperforming regarding its objective to collect revenue) and Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 26 (due to estate duty's low revenue contribution, raising revenue is not considered its primary objective).

¹³⁴ Muller *Wealth Transfer Taxation* 38 and Sandford *Why Tax Systems Differ* 70.

¹³⁵ Gash *A Critical Discussion of the Present Tax System in Kosovo* 16 and Muller *Wealth Transfer Taxation* 41. Reprising may also be used to encourage people to take certain actions, for example, the preferential treatment of tax-free savings accounts to encourage saving.

¹³⁶ Wagner *Death and Taxes* 44.

products, which justifies discriminatory taxation.¹³⁷ The application of international agreements that prohibit discrimination against foreign trade creates obstacles to penalising the use of certain products through taxation. The globalisation of production may also be opted for to overcome such domestic taxation which leads to the view that a policy consideration to control citizens' behaviour by levying certain taxes should be approached with care.¹³⁸

In the context of estate duty, reprising is seen through the deemed inclusion of insurance policies¹³⁹ in an estate that may result in estate planners looking at alternative products like retirement products in which a greater tax benefit lies.¹⁴⁰

2.3.2.2 Economic growth

Economic growth is reliant upon adequate levels of investment in personal savings. Tax policy can be designed to incentivise economic growth and development,¹⁴¹ prevent high inflation rates and unemployment¹⁴² and encourage savings and investments.¹⁴³ This may include, for example, the introduction of lower tax rates or tax incentives.

The effect of tax incentives on levels of saving and investment in South Africa was considered by both the Margo Commission and the Katz Commission. The Margo Commission¹⁴⁴ stated that although taxation can create a favourable climate for investments through tax incentives about certain investments, such incentives would not have a significant effect on personal savings.¹⁴⁵ It was further stated that

¹³⁷ Muller *Wealth Transfer Taxation* 41 and Gash *A Critical Discussion of the Present Tax System in Kosovo* 16. See also para 4.3 below on s 36 of the *Constitution* where a violation of a person's right may be justified under certain circumstances as in the case of "sin taxes".

¹³⁸ Gash *A Critical Discussion of the Present Tax System in Kosovo* 16.

¹³⁹ Section 3(3) of the *Estate Duty Act*.

¹⁴⁰ Section 3(2)(i) read with s 3(3)(e) of the *Estate Duty Act*.

¹⁴¹ Katz Commission *Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (the *First Interim Report*) 1.5.4; Katz Commission *Third Report* 4 and Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 21.

¹⁴² Muller *Wealth Transfer Taxation* 40.

¹⁴³ Chelliah *Report of the Commission of Inquiry into Taxation* 68; Muller *Wealth Transfer Taxation* 40 and Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 21.

¹⁴⁴ Margo Commission *Margo Report* 4.24, 4.40.

¹⁴⁵ In a study by Romm, the link between personal savings and economic growth was analysed and it was found that the more a person can save, the more it will increase such a person's

no justification exists for maintaining fiscal deterrents to save. The Margo Commission favoured the international trends of lower tax rates that apply to all taxpayers instead of implementing specific tax incentives. The Katz Commission supported the proposal.¹⁴⁶ The Katz Commission¹⁴⁷ noted that introducing tax incentives to specifically encourage investments and savings to raise revenue did not make economic sense. The reason provided is that it will result in a redirection of personal savings between the various available investment instruments and vehicles which leads to a higher personal tax rate to finance the incentives. This will effectively reduce the after-tax income amount available from which savings are made.¹⁴⁸

2.3.2.3 Redistribution of wealth and resources

Contemporary tax systems should value their distributive effects to provide all members of society an equal opportunity to pursue their economic dreams according to their means.¹⁴⁹ Meade¹⁵⁰ states that the redistributive effect should be purposive and consist of vertical (between rich and poor) and horizontal (those of equal standing) components. A redistribution of wealth is seen as an opportunity to reduce concentrated wealth and power in the hands of the wealthy society, addressing inequality by raising the socio-economic standards of the poor and reducing political tension caused by the wide disparity of wealth in developing countries.¹⁵¹

capacity to invest in a country's economy which in turn contributes to its economic growth (see Romm 2003 *Journal of Innovation and Entrepreneurship* 29). See also Ribaj and Mexuani 2021 *Journal of Innovation and Entrepreneurship* 10.

¹⁴⁶ Katz Commission *First Interim Report* 15.6.1; Katz Commission *Third Report* 17; Margo Commission *Margo Report* 4.40.

¹⁴⁷ Katz Commission *First Interim Report* 15.6.1 and endorsed in Katz Commission *Third Report* 17.

¹⁴⁸ Katz Commission *Third Report* 34.

¹⁴⁹ Meade *The Structure and Reform of Direct Taxation* 12, 15.

¹⁵⁰ Meade *The Structure and Reform of Direct Taxation* 12.

¹⁵¹ Meade *The Structure and Reform of Direct Taxation* 15-16; OECD *Inheritance Taxation in OECD Countries* 40; Rudnick and Gordon "Taxation of Wealth" 297; Muller *Wealth Transfer Taxation* 38 and Sandford *Why Tax Systems Differ* 70.

Redistribution can be affected by charging higher taxation on the wealthy members of society through progressive tax rates and wealth taxes.¹⁵² In democratic societies, the redistribution of wealth and resources has become an increasingly accepted and important objective of taxation.¹⁵³ From a South African perspective, the view is supported that taxation should be imposed with the purpose to mitigate the inequality between the members of society and to provide equal opportunities.¹⁵⁴

The decision on whether the redistribution of wealth and resources should be an objective of taxation may be driven by political considerations. However, in South Africa where poverty and inequality are extreme problems,¹⁵⁵ the objective of redistribution should be a common goal of tax policy.¹⁵⁶ The levying of a tax to correct or punish perceived injustices is referred to as "confiscatory taxation".¹⁵⁷ Muller¹⁵⁸ states that confiscatory taxation may result in the violation of constitutionally protected property rights. However, De Vos¹⁵⁹ is of the view that if a tax is imposed on the wealthy as a corrective measure for certain groups in society that are disadvantaged by past discrimination, it is considered constitutionally valid and promotes equality.¹⁶⁰ De Vos¹⁶¹ supports confiscatory taxation under such

¹⁵² O'Brien *First Report of the Commission of Taxation* 442; Gash *A Critical Discussion of the Present Tax System in Kosovo* 15 and Muller *Wealth Transfer Taxation* 38.

¹⁵³ O'Brien *First Report of the Commission of Taxation* 101; Rudnick and Gordon "Taxation of Wealth" 296 and Ginsburg 1996 *Transformation* 89-99.

¹⁵⁴ Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 20; Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 26 and Muller *Wealth Transfer Taxation* 38.

¹⁵⁵ De Vos 2011 <https://constitutionallyspeaking.co.za/where-are-you-going-to-stand-my-fellow-white-south-africans/>.

¹⁵⁶ Ginsburg 1996 *Transformation* 89 and OECD *Economic Survey of South Africa 2022* 97-98. The OECD in its report on the economic survey conducted in South Africa in 2022 stated that the inequalities and disparity of wealth can be addressed through estate duty as wealth transfer tax.

¹⁵⁷ Hill 2023 <https://www.smartcapitalmind.com/what-are-confiscatory-taxes.htm>. Roeleveld also stated that a confiscatory effect of taxation is found where the levying of a tax is not linked or has no reasonable connection to a State's objectives and may be considered a deprivation of property (see Roeleveld 2015 *SAJAR* 148).

¹⁵⁸ Muller *Wealth Transfer Taxation* 39.

¹⁵⁹ De Vos 2011 <https://constitutionallyspeaking.co.za/where-are-you-going-to-stand-my-fellow-white-south-africans/>. See also *Minister of Finance v Van Heerden* 2004 6 SA 121 (CC) para 28.

¹⁶⁰ Supported by s 9(2) of the *Constitution* that states "[E]quality includes the full and equal enjoyment of all rights and freedoms. To promote the achievement of equality, legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination may be taken".

¹⁶¹ De Vos 2011 <https://constitutionallyspeaking.co.za/where-are-you-going-to-stand-my-fellow-white-south-africans/> and De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and->

circumstances that will address the inequality of society and achieve the redistribution of wealth. He considers the redistribution of wealth as a reasonable step in addressing inequality through the transmission of intergenerational inheritance that benefits people through no effort of their own¹⁶² in increasing taxation on the wealthy and lessening the burden on the poor.¹⁶³ Roeleveld¹⁶⁴ agrees with De Vos in that a State may impose confiscatory taxation if sufficient reasoning exists. Heystek¹⁶⁵ rejects the view by De Vos that all wealth passed on through generations is accumulated by privilege and states that some are because of hard work. Jonker¹⁶⁶ disagrees with the notion that a person should not receive anything without working for it and therefore criticises the argument that you must earn what you get.

De Vos¹⁶⁷ explains the link between the redistribution of resources and estate duty is that "unchecked transfer of wealth between generations is an injustice in and of itself" and corrective action should be taken. An inheritance that consists of the transfer of wealth allows for intergenerational transmission of inequality and promotes an "equal opportunity society" De Vos promotes two approaches to mitigate the impact of inheritance and the accompanied inequality:¹⁶⁸

inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/. This position is supported by Zebst (see Zebst 2013 <https://www.fanews.co.za/article/tax/16/tax/1016/is-it-time-to-tax-the-wealthy/13195>).

¹⁶² De Vos uses the example of children born to parents who have accumulated wealth and may also have inherited some of the wealth from their parents and therefore passed wealth through privilege without any effort of their own. This view is supported by Victor AJ in *King v De Jager* 2021 4 SA 1 (CC) para 205 where it is stated that the passing of patrimonial capital through inheritance continues. Piketty states that patrimonial capitalism refers to the wealthy who obtains their fortunes through inheritance instead of obtaining it through innovation or entrepreneurship (see Piketty *Capital in the Twenty-First Century* 267-302).

¹⁶³ De Vos 2020 <https://constitutionallyspeaking.co.za/further-thoughts-on-the-disruption-of-the-intergenerational-transfers-of-wealth/>.

¹⁶⁴ Roeleveld 2015 *SAJAR* 148 and s 9(2) of the *Constitution*.

¹⁶⁵ Hesteyk 2020 <https://twitter.com/MagnusHeystek/status/1270732394920923144>.

¹⁶⁶ Jonker 2020 <https://www.africanliberty.org/2020/06/23/the-morality-of-inheritance/>.

¹⁶⁷ De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/>.

¹⁶⁸ De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/>.

- (a) Abolishing the right to inherit (excluding intimate personal belongings or allowing such transfers at a capped amount). Such abolishment does not apply to spouses, partners, and non-adult children.¹⁶⁹
- (b) Alternatively, inheritance tax should be levied on a sliding scale with a top scale at 100%, together with a similar tax on intergenerational donations made before death. The progressive rate attempts to combat inequity between the rich and the poor.¹⁷⁰

Theobald¹⁷¹ states that the 100% inheritance tax proposed by De Vos will not solve the problem of inequity as it does not solely stem from the transfer of wealth but also from intellectual and social capital that families invest in their children. Rose¹⁷² also states, concurring with Davis, that a 100% inheritance tax would not be the answer and would instead be creating another inequity in society.¹⁷³ Gouws¹⁷⁴ argues that such an inheritance tax would destroy tax morale and result in many tax avoidance opportunities and proposes a recipient-based inheritance tax instead of the existing transferor-based estate duty. However, De Vos¹⁷⁵ states that although

¹⁶⁹ For estate duty purposes, this approach contradicts the recommendation by the DTC to delete s 4(q) of the *Estate Duty Act* in its entirety, however, it is in line with international standards of providing preferential treatment to spousal bequests and making an inheritance to a surviving spouse more attractive from a tax perspective. See DTC *Final Estate Duty Report* 21-23 and para 3.6.2.1 of Chapter 3 and OECD *Inheritance Taxation in OECD Countries* 124. In *King v De Jager* 2021 4 SA 1 (CC) para 202, Victor AJ contends that with the commitment to transformative constitutionalism and to enable substantive equality, the Court is required to reconsider the basis of common-law principles such as freedom of testation which "should be recalibrated towards more egalitarian and ubuntu based ends".

¹⁷⁰ The recommendation of a progressive tax rate is aligned with the recommendations by the OECD, in general, to promote vertical equity (see OECD *Inheritance Taxation in OECD Countries* 87-88). Currently, the *Estate Duty Act* only distinguishes between estates with a dutiable amount below R30 million being subject to 20% and those exceeding R30 million and subject to 25%. See s 2(2) of the *Estate Duty Act* read with para 2(1)(a) of the First Schedule to the *Estate Duty Act*.

¹⁷¹ Theobald 2020 <https://www.businesslive.co.za/bd/opinion/columnists/2020-06-15-stuart-theobald-inheritance-tax-proposal-pokes-a-hornets-nest/>.

¹⁷² Rose 2020 <https://www.businesslive.co.za/fm/opinion/editors-note/2020-06-17-rob-rose-inheritance-tax-idea-absurd-say-tax-experts/>.

¹⁷³ An example provided by Rose is that such an increase in revenue may result in the funding of a new airline, implying government would not be using such funds to redistribute wealth but to fund their own initiatives.

¹⁷⁴ Gouws 2020 <https://www.moneyweb.co.za/moneyweb-opinion/an-open-letter-to-professor-pierre-de-vos/>.

¹⁷⁵ De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/>. In response to Gouws' comment on the tax moral De Vos

a recipient-based inheritance tax may be useful, a limitation on the value a child may receive should be introduced. The rationale behind the limitation is drawn from the views of Mill, where the view is taken that such a limitation is in the best interest of children that would provide a motivation to not just live on their parents' wealth but to develop their capacities.¹⁷⁶

Jonker¹⁷⁷ argues that the view by De Vos that the unchecked transfers of wealth between generations are an injustice is flawed as although one can enjoy the fruits of one's hard work, there is nothing wrong to receive something you did not work for as that is exactly what an inheritance is about.¹⁷⁸ Jonker further states that ultimately it should not matter whether one has worked for what one possesses, but rather whether it was obtained peacefully.

In conclusion, the redistribution of wealth as an objective of taxation is important to South Africa as a developing country that still suffers from inequity and a wide disparity between the rich and the poor. De Vos¹⁷⁹ states that the inequity results from the intergenerational transfer of wealth and the continuation of such inheritances continues the inequity. As discussed above, to address the inequity, a redistribution will take effect through his proposals to limit the amount that may be inherited by a child or introduce higher tax rates on wealthier taxpayers to level the playing field between those who have a great estate value in comparison to those with more moderate estate values.¹⁸⁰ As discussed above, the OECD, in general,

states that although the unfairness of tax may impact the tax morale, the trust in government is a more concerning issue and tax avoidance and tax evasion is always a continuous concern regarding wealthy taxpayers.

¹⁷⁶ Mill *Principles of Political Economy* 107. Mill further supports the right of the parent to bequeath but believe that the right of the child to inherit should be limited (see Mill *Principles of Political Economy* 102).

¹⁷⁷ Jonker 2020 <https://www.africanliberty.org/2020/06/23/the-morality-of-inheritance/>.

¹⁷⁸ His view is also supported in *Harper* where the court states that a bequest is "a free gift to which no person has any entitlement" which implies that there did not have to be any effort by the beneficiary to qualify for the inheritance (see *Harper v Crawford* 2017 JDR 1271 (WCC) para 64).

¹⁷⁹ De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/>.

¹⁸⁰ De Vos 2011 <https://constitutionallyspeaking.co.za/where-are-you-going-to-stand-my-fellow-white-south-africans/>; De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/> and De Vos 2020 <https://constitutionallyspeaking.co.za/further-thoughts-on-the-disruption-of-the->

supports progressive tax rates to enhance vertical equity, however, the rates proposed by De Vos are exorbitant whereas the existing estate duty rates do cater for a higher tax rate of estates with a dutiable amount over R30 million. It is further submitted that, on the basis that an inheritance must be received by someone, it should be carefully considered to discredit a beneficiary merely on the basis that they have not worked to earn their inheritance or for the reason the deceased accumulated the wealth. The redistribution of wealth objective and its effect are considered throughout this study for purposes of making recommendations for a revised *Estate Duty Act* in Chapter 6.¹⁸¹

In addition to the objectives of taxation, tax policy considerations are also relevant in designing specific tax provisions. The following section will discuss tax policy considerations that include the "canons of taxation" and constitutional principles that must be considered in making recommendations for a revised *Estate Duty Act*.

2.4 Tax policy considerations

2.4.1 Introduction

Various factors play a role in the design of a tax system, for example, the tax base, the tax rate structure, the incidence of the tax liability, the economic environment, the rate of inflation, the stages of development, the level of employment, political consideration, and the administrative capacity to administer a tax.¹⁸² The aforementioned tax policy considerations should be guided by the essential tax

intergenerational-transfers-of-wealth/. This illustrates how reforms can assist in the redistribution of wealth to address the inequality that exists due to intergenerational transmission of inheritances and to ensure the wealthy pays their fair share.

¹⁸¹ See Chapter 6 below.

¹⁸² Rudnick and Gordon "Taxation of Wealth" 316; Meade *The Structure and Reform of Direct Taxation* 18; Stiglingh *et al Silke: South African Income Tax* 1; Steyn, Franzen and Stiglingh 2013 *International Business & Economics Research Journal* 242; Croome *Taxpayers' Rights in South Africa* 5 and Lambert 1992 https://cooperative-individualism.org/lambert-ian_some-modern-principles-of-taxation-adam-smith-revisited-1992-jan.htm.

principles, also referred to as the "canons of taxation" as discussed in paragraph 2.4.2 below.¹⁸³

These "canons of taxation" cannot be considered in isolation. South Africa, in its pursuit of true democracy, has adopted a *Constitution* that provides for the structure and parameters that any law within its jurisdiction should adhere to.¹⁸⁴ Any tax policy consideration must therefore consider the *Constitution* in the design and reform of its tax legislation and the interpretation thereof. The *Constitution's* role will also be relevant when considering tax policy considerations regarding its objectives of taxation like economic growth and redistribution when deciding on the constitutionality thereof.¹⁸⁵

Tax proposals should be feasible to be effectively administered within institutional processes. This ensures that tax legislation is enacted by the constitutional principles and canons of taxation. The canons of taxation are discussed in paragraph 2.4.2, followed by the South African constitutional principles specifically applicable to the realm of wealth transfer taxation in paragraph 2.4.3 below.

2.4.2 *Canons of taxation*

Smith, a Scottish economist, in his 1776 treatise, "An Inquiry into the Nature and Causes of the Wealth of Nations", defined four criteria of a good tax system that is commonly referred to as the "canons of taxation".¹⁸⁶ The four canons are equity, certainty, convenience and cost efficiency and have in modern terms become accepted known as the "principles of taxation".¹⁸⁷

¹⁸³ Haupt *Notes on South African Income Tax* 2; Stiglingh *et al Silke: South African Income Tax* 1, 5; Kabinga *Principles of Taxation* 5 and Blom *Wealth Taxation from a South African Perspective* 39.

¹⁸⁴ Muller *Wealth Transfer Taxation* 42; Williams *Income Tax in South Africa* 3 and Croome *Taxpayers' Rights in South Africa* 16.

¹⁸⁵ This is done by measuring any proposed amendment to tax legislation against the Bill of Rights, read with its limitation clause under s 36 of the *Constitution* to ensure that a taxpayer's rights are not unfairly discriminated against without justification. See para 2.4.3 below for a discussion of the constitutional principles.

¹⁸⁶ Adam Smith Institute *The Condensed Wealth of Nations* 70.

¹⁸⁷ Lambert 1992 https://cooperative-individualism.org/lambert-ian_some-modern-principles-of-taxation-adam-smith-revisited-1992-jan.ht; Haupt *Notes on South African Income Tax* 2;

2.4.2.1 The first tax canon: Equity

According to Smith,¹⁸⁸ the tax canon of equity¹⁸⁹ demands that taxpayers ought to contribute towards the *fiscus* in the same proportion they earn remuneration under the protection of the state. Equal treatment of taxpayers is only possible if a method is in place to measure equity and the two different approaches that have been followed to measure equity are the "benefit principle" and the "ability-to-pay principle".¹⁹⁰

2.4.2.1.1 The benefit principle

The benefit principle provides that the taxes payable by a person must correlate with the benefit the person receives from the government.¹⁹¹ The application of this principle links the expenditure and revenue side of the budget and further provides that it ensures the efficient allocation of resources.¹⁹² User charges are based on the benefit principle as a fee is charged for the services rendered, for example, toll fees, admission fees to recreation parks and museums, licence fees as well as tuition and school fees.¹⁹³

¹⁸⁸ Stiglingh *et al Silke: South African Income Tax* 5; Williams *Income Tax in South Africa* 6; Katz Commission *Fourth Report* 1.4-1.8; Margo Commission *Margo Report* 4.42-4.50; Croome *Taxpayers' Rights in South Africa* 6 and Meade *The Structure and Reform of Direct Taxation* 7. Adam Smith Institute *The Condensed Wealth of Nations* 70. This canon is aligned to the objective of taxation to redistribute wealth to address the inequality between the rich and the poor. See para 2.3.2.3 above; De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/> and Rudnick and Gordon "Taxation of Wealth" 297.

¹⁸⁹ Linked to the canon of equity is the fundamental right of equity under s 9 of the *Constitution* that is enjoyed by taxpayers to enjoy equal benefits of the law which are further discussed in the context of fiscal legislation (see para 2.4.3.1 below). See also Vanistendael "Legal Framework for Taxation" 19.

¹⁹⁰ Margo Commission *Margo Report* 4.43; Katz Commission *Third Report* 6.1.4; Muller *Wealth Transfer Taxation* 43, the DTC *Wealth Tax Report* 32-33 and O'Brien *First Report of the Commission of Taxation* 83.

¹⁹¹ Matobela *Wealth Tax in South Africa* 3; Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 29 and O'Brien *First Report of the Commission of Taxation* 83.

¹⁹² O'Brien *First Report of the Commission of Taxation* 83.

¹⁹³ Muller *Wealth Transfer Taxation* 44.

The benefit principle is restricted in its application and does not support the taxation objective of redistribution of resources.¹⁹⁴ The benefits enjoyed by the public cannot always be allocated to specific users in an accepted manner. Some services, for example, education is benefiting the scholar in a direct way as well as the society in an indirect manner through educated members. The allocation of direct and indirect benefits is cumbersome.¹⁹⁵

2.4.2.1.2 The ability-to-pay principle

The ability-to-pay principle has been described as a person's ability to pay tax where such tax is seen as a sacrifice made by taxpayers according to their economic well-being.¹⁹⁶ The ability-to-pay principle consists of two dimensions, namely horizontal equity, and vertical equity.¹⁹⁷ Horizontal equity requires taxpayers with comparable taxable capacity to contribute in similar proportions,¹⁹⁸ whereas vertical equity requires taxpayers with greater taxable capacities to pay more taxes.¹⁹⁹

¹⁹⁴ O'Brien *First Report of the Commission of Taxation* 83 and Carter Commission *Report of the Royal Commission of Taxation (Volume 3)* 3. See also para 2.3.2.3 above for a discussion on the redistribution of wealth and resources as an objective of taxation.

¹⁹⁵ Carter Commission *Report of the Royal Commission of Taxation (Volume 3)* 3.

¹⁹⁶ Matobela *Wealth Tax in South Africa* 2; O'Brien *First Report of the Commission of Taxation* 83-84; Meade *The Structure and Reform of Direct Taxation* 14; Carter Commission *Report of the Royal Commission of Taxation (Volume 3)* 3-5 and Beuhler 1946 *Tax Law Review* 243.

¹⁹⁷ Chauke, Mathebula and Sebola "Reflection on the Ability to Pay Theory of Taxation" 406 and Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 29. See also para 2.3.2.3 above for a discussion on the redistribution of wealth where it transpires the more wealth one has, the more such person should be subject to tax to redistribute wealth between the rich and the poor.

¹⁹⁸ Tomasek *Capital Gains Tax in South Africa* 10; Lambert 1992 https://cooperative-individualism.org/lambert-ian_some-modern-principles-of-taxation-adam-smith-revisited-1992-jan.htm and Margo Commission *Margo Report* 20.9. OECD *Tax and the Economy: A Comparative Assessment of OECD Countries* 18. This means that people in similar circumstances must be treated similarly.

¹⁹⁹ Margo Commission *Margo Report* 4.44 and 20.10. The more a person has, the greater tax burden should be borne by them in comparison to someone who has less. The fundamental right of equality under s 9 of the *Constitution* may impact the principle of vertical equity where all taxpayers are to enjoy equal benefits of the law, however, a limitation may be justified under s 36 of the *Constitution* where the limitation has a redistributive effect (see para 2.4.3.1 below). See also Muller *Wealth Transfer Taxation* 45; OECD *Tax and the Economy: A Comparative Assessment of OECD Countries* 18; Carter Commission *Report of the Royal Commission of Taxation (Volume 3)* 4-5; O'Brien *First Report of the Commission of Taxation* 83; Meade *The Structure and Reform of Direct Taxation* 12 and Morse, Williams and Eden *Davies: Principles of Tax Law* 6.

These concepts will be briefly discussed below:

(a) Horizontal equity

As mentioned above, horizontal equity means that taxpayers with an equal taxable capacity²⁰⁰ should bear equal tax liability. Measurements of taxable capacity and equality among taxpayers are important and may include income, wealth, consumption, or utility.²⁰¹ A detailed discussion on the measurement of equality falls beyond the scope of this study and will therefore only be discussed briefly.

Anderson²⁰² states that taxpayers who earn similar amounts of income are equal and income represents the taxpayer's ability to pay. Income should not be measured on a statutory taxable income basis but on a more comprehensive method, for example, adjusted gross income less investment income plus other tax preference items that were excluded from the adjusted gross income figure. This adjusted income most accurately reflect a taxpayer's ability to pay taxes.²⁰³ Coetzee²⁰⁴ confirms that the suggested approach by Anderson to use a comprehensive income as the criteria for horizontal equity and to take into account the equality of circumstances among taxpayers negates any form of discrimination.²⁰⁵ This implies that a one-breadwinner family will not be treated the same as a two-breadwinner

²⁰⁰ The OECD has also referred to the taxable capacity as the economic position of the taxpayer. See OECD *Tax and the Economy: A Comparative Assessment of OECD Countries* 18. See also Buehler 1946 *Tax Law Review* 243; Carter Commission *Report of the Royal Commission of Taxation (Volume 3)* 5; Rudnick and Gordon "Taxation of Wealth" 297-298; Sandford *Taxing Inheritance and Capital Gains* 11, O'Brien *First Report of the Commission of Taxation* 83-84; Meade *The Structure and Reform of Direct Taxation* 12-14 and Margo Commission *Margo Report* 4.43.

²⁰¹ Coetzee *Horizontal Equity* 45-52 and Rudnick and Gordon "Taxation of Wealth" 297-298.

²⁰² Anderson 1985 *The Accounting Review* 363. Berliant and Strauss defined horizontal equity as "equal treatment of equals and that the position of individuals before and after-tax income should be maintained" (see Berliant and Strauss "Horizontal Equity, Uncertainty and Economic Well-Being" 179-180); Habib states that families with the same standard of living should be treated equally in a system of transfers and taxes (see Habib 1979 *Public Finance Quarterly* 283) and Hettich stating that equal tax treatment should be endured by people in equal economic circumstances (Hettich 1983 *National Tax Journal* 417).

²⁰³ Anderson 1985 *The Accounting Review* 364. Anderson was further of the view that individuals should be divided into equally situated taxpayers to determine the impact of horizontal equity. See also Hettich 1983 *National Tax Journal* 418 and Habib 1979 *Public Finance Quarterly* 294.

²⁰⁴ Coetzee *Horizontal Equity* 46.

²⁰⁵ Coetzee *Horizontal Equity* 46. See also Hettich 1983 *National Tax Journal* 417-418.

family as their comprehensive income would differ as well as their circumstances, eliminating them as equal taxpayers.

The OECD²⁰⁶ is of the view that there should not be a difference in the tax burden of people in equal circumstances, depending on whether they receive transfers through earnings, gifts or inheritances. Wealth transfer taxes, specifically in the form of an inheritance tax is seen to level the playing field between inheritances and earnings from work or savings.²⁰⁷ An inheritance that goes untaxed in comparison to the same amount of income that is subject to tax will not honour the principle of horizontal equity. However, making the inheritance amount also subject to tax, means the inheritance received is reduced due to the tax paid and further encourages the beneficiary to work and does not serve as a disincentive to not work.²⁰⁸ De Vos²⁰⁹ also states that if the inheritance goes untaxed it negatively affects a beneficiary's work ethic due to the greater amount received in comparison to the amount they would have received had it been taxed. De Vos²¹⁰ further argues that in the context of wealth transfer taxes, inheritances can be taxed at a higher rate as it was received without having worked for them. This view is also supported by Sandford²¹¹ who states that an inheritance is a benefit obtained unrelated to merits or efforts. Therefore, taxing transferred wealth results in greater equality of opportunity to the next generation through "levelling the playing field".²¹²

²⁰⁶ OECD *Inheritance Taxation in OECD Countries* 40. An inheritance tax is seen as levelling the playing field between earnings from work or savings and an inheritance on the basis that it is seen as promoting horizontal equity in that people who are in the same circumstances, who receive the same amount of income or assets should be taxed similarly. The tax burden should not be different in similar circumstances.

²⁰⁷ OECD *Inheritance Taxation in OECD Countries* 40; Rudnick and Gordon "Taxation of Wealth" 297-298 and Sandford *Taxing Inheritance and Capital Gains* 11.

²⁰⁸ Rudnick and Gordon "Taxation of Wealth" 300; Sandford *Taxing Inheritance and Capital Gains* 11 and OECD *Inheritance Taxation in OECD Countries* 40.

²⁰⁹ De Vos 2020 <https://constitutionallyspeaking.co.za/further-thoughts-on-the-disruption-of-the-intergenerational-transfers-of-wealth/>.

²¹⁰ De Vos 2020 <https://constitutionallyspeaking.co.za/further-thoughts-on-the-disruption-of-the-intergenerational-transfers-of-wealth/>.

²¹¹ Sandford *Taxing Inheritance and Capital Gains* 11. See also Rudnick and Gordon "Taxation of Wealth" 298.

²¹² Sandford *Taxing Inheritance and Capital Gains* 11. See also Rudnick and Gordon "Taxation of Wealth" 298.

(b) Vertical equity

The principle of vertical equity provides for a mechanism of progressive tax systems to redistribute wealth amongst the less fortunate that is aligned with the secondary objective of taxation to redistribute wealth and resources.²¹³ Coetzee²¹⁴ states that the application of progressive tax rates results in the wealthy contributing more to the government coffers than the less fortunate. This redistribution brought about an equalisation among the different groups of society. De Vos²¹⁵ also states that wealthy taxpayers should be burdened with a higher tax liability to address inequality. He supports the view that progressive tax rates may assist in the redistribution of wealth and resources. Although De Vos' view may be suitable for an ideal world, when considering the current realities in South Africa of a society flawed by corruption and maladministration in the public sector,²¹⁶ as well as poverty and inequality, the higher taxation of wealthy taxpayers may not completely resolve the inequity suffered by society. Furthermore, due to the current challenges referred to, there is little guarantee that the increased taxes collected from the wealthy will be applied to the least privileged of society. Gouws²¹⁷ also warns against such an approach as it may negatively influence tax morale and result in the creation of tax avoidance and tax evasion schemes by wealthy taxpayers.

How vertical equity is applied is a political issue and involves value judgments about the nature of a good society.²¹⁸ Vertical equity influences tax policy, for example through rate structures and the choice of a tax base.²¹⁹ For purposes of this study,

²¹³ Coetzee *Horizontal Equity* 16. See also O'Brien *First Report of the Commission of Taxation* 101-103; Meade *The Structure and Reform of Direct Taxation* 12-16; De Vos 2011 <https://constitutionallyspeaking.co.za/where-are-you-going-to-stand-my-fellow-white-south-africans/>; De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/> and the discussion on the redistribution of wealth in para 2.3.2.3 above.

²¹⁴ Coetzee *Horizontal Equity* 42.

²¹⁵ De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/>. See also Coetzee 1998 *Tax Planning* 89.

²¹⁶ Moosa 2018 *De Jure* 1.

²¹⁷ Gouws 2020 <https://www.moneyweb.co.za/moneyweb-opinion/an-open-letter-to-professor-pierre-de-vos/>.

²¹⁸ Katz Commission *Third Report* 7.1.4.

²¹⁹ Muller *Wealth Transfer Taxation* 49; Sandford *Why Tax Systems Differ* 37 and Coetzee 1998 *Tax Planning* 90.

it will be accepted that vertical equity through some form of progressive taxation is important in the South African context to assist in the redistribution of resources.²²⁰

Castro and Rizzo²²¹ also regard equity as an important canon in achieving the primary objective of taxation in funding public expenditure as taxpayers are likely to understate their income or avoid taxation when they are of the view that the tax system is inequitable. The OECD²²² previously cautioned against promoting vertical equity in that it may hurt the efficiency of a tax system as the use of capital resources and labour are discouraged and tax evasion and avoidance are prompted. De Vos²²³ also states that tax evasion and avoidance are a continuous concern when taxing the wealthy, but it is not only dependent on tax policy but even more so on the trust in the government that impacts taxpayers' tax morale. The OECD,²²⁴ however, in its recent *Report on Inheritance Taxation* stated that the taxing of wealth transfers, particularly at progressive rates may ensure that those who receive more pay more to achieve a great measure of vertical equity.

2.4.2.2 The second tax canon: Certainty and simplicity

Smith's second tax canon provides that a person's tax liability must be certain, and not arbitrary.²²⁵ A taxpayer should be able to find out with certainty the time, manner and amount of payment.²²⁶ The enforcement of tax liability must be done on a consistent and universal basis.²²⁷ Certainty is obtained through the consistent

²²⁰ Muller *Wealth Transfer Taxation* 49 and Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 30. Ingram states that the principle of vertical equity is a mechanism that redistributes the wealth of the rich to the less fortunate and thereby adheres to the second objective of taxation to redistribute wealth and resources.

²²¹ Castro and Rizzo 2014 *International Tax and Public Finance* 564-565.

²²² OECD *Tax and the Economy: A Comparative Assessment of OECD Countries* 20.

²²³ De Vos 2020 <https://constitutionallyspeaking.co.za/further-thoughts-on-the-disruption-of-the-intergenerational-transfers-of-wealth/>.

²²⁴ OECD *Inheritance Taxation in OECD Countries* 40.

²²⁵ Adam Smith Institute *The Condensed Wealth of Nations* 70. See also Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 31 and Downer 2016 *Journal of Financial Management and Analysis* 5.

²²⁶ Adam Smith Institute *The Condensed Wealth of Nations* 70. See also Lambert 1992 https://cooperative-individualism.org/lambert-ian_some-modern-principles-of-taxation-adam-smith-revisited-1992-jan.ht; Haupt *Notes on South African Income Tax* 2; Stiglingh *et al Silke: South African Income Tax* 5; Margo Commission *Margo Report* 4.47; Meade *The Structure and Reform of Direct Taxation* 18-19 and Morse, Williams and Eden *Davies: Principles of Tax Law* 7.

²²⁷ Morse, Williams and Eden *Davies: Principles of Tax Law* 7.

application of the law that is certain, clear, and consistent,²²⁸ and the tax authority is held accountable.²²⁹

Certainty goes hand in hand with simplicity, where taxes are simple to understand, collect and administer.²³⁰ It is desired for a taxpayer to determine their tax liability based on the information available instead of making use of advisors to meet basic tax compliance obligations.²³¹ Muller²³² states that the problem with simplicity is that the simpler the rules, the less fair they are, but to make them fairer, they become more complex. Regarding fairness in the context of estate duty, De Vos,²³³ however, takes a different view. He accepts that a wealth transfer tax system will always have a measure of unfairness due to the complexities that run parallel with inheritances in that wealth accumulated during a person's lifetime is taxed when it is transferred at death.²³⁴ He holds that such unfairness can be addressed by accepting that social solidarity is good for society as it reduces disparity. Addressing the effects of inequality is equally important as protecting a person's self-interest. By accepting social solidarity, the belief that an inheritance tax is unfair will be diminished.

²²⁸ Adam Smith Institute *The Condensed Wealth of Nations* 70; Lambert 1992 https://cooperative-individualism.org/lambert-ian_some-modern-principles-of-taxation-adam-smith-revisited-1992-jan.ht; Haupt *Notes on South African Income Tax* 2 and Stiglingh *et al Silke: South African Income Tax* 5. The rule of law principle also adds to the canon of certainty that provides that no one is above the law; the *Constitution* is the supreme law and all other laws must adhere to its framework.

²²⁹ O'Brien *First Report of the Commission of Taxation* 85.

²³⁰ Margo Commission *Margo Report* 4.47. See also Adam Smith Institute *The Condensed Wealth of Nations* 70; Meade *The Structure and Reform of Direct Taxation* 18-20; O'Brien *First Report of the Commission of Taxation* 85 and Steyn and Stiglingh "The Complexity of Tax Simplification: Experiences from South Africa" 162-164.

²³¹ O'Brien *First Report of the Commission of Taxation* 85. O'Brien states that the uncertainty about what is due, when it is due and how it must be calculated due to complex provisions lead to high compliance costs that defeat the canon of simplicity. A desired quality of a tax system is that it should be simple and straightforward, the administrative costs to collect the tax and the taxpayer's compliance cost should be minimal.

²³² Muller *Wealth Transfer Taxation* 51 and O'Brien *First Report of the Commission of Taxation* 85.

²³³ De Vos 2020 <https://constitutionallyspeaking.co.za/further-thoughts-on-the-disruption-of-the-intergenerational-transfers-of-wealth/>.

²³⁴ For example, under testamentary succession, assets are distributed based on a testator's wishes and may be considered unfair by certain beneficiaries. In the tax context, understanding the rationale why certain assets and bequests made to certain beneficiaries receive more preferential treatment in comparison to others will mitigate the perceived unfairness.

2.4.2.3 The third tax canon: Convenience

Smith's third tax canon provides that tax should be levied at a time and in a manner convenient to the taxpayer, which may imply a levying in cash rather than in kind.²³⁵ It furthermore provides that when a tax is levied, it should consider a taxpayer's liquidity. In the instance that a tax is levied on the value of unrealised assets, it requires a valuation for assets that may lead to inconsistencies and tax avoidance through different valuations being applied.²³⁶ This is observed in the valuation of assets for estate duty purposes where the general rule is a valuation based on the fair market value of the asset at the date of death, subject to exceptions.²³⁷

2.4.2.4 The fourth tax canon: Effectiveness and efficiency in collection

The collection of a tax refers to the transfer of resources from the private sector to the public sector. Smith's fourth tax canon requires that revenue collection must be cost-effective.²³⁸ This implies that the cost to collect tax should not be a disproportionately high percentage of the revenue yield, but rather as low as possible to prevent the situation where most of the revenue collected is spent on the collection thereof.²³⁹

2.4.2.5 Conclusion to the canons of taxation

The tax canons of equity, certainty, simplicity, convenience, efficiency, and effectiveness are seen as the cornerstones of a good, fair and acceptable tax system.²⁴⁰ They are internationally as well as domestically recognised as the "canons

²³⁵ Adam Smith Institute *The Condensed Wealth of Nations* 70; Haupt *Notes on South African Income Tax* 2; Stiglingh *et al Silke: South African Income Tax* 5 and Kabinga *Principles of Taxation* 5.

²³⁶ Muller *Wealth Transfer Taxation* 51.

²³⁷ See s 5 of the *Estate Duty Act*.

²³⁸ Adam Smith Institute *The Condensed Wealth of Nations* 70; Haupt *Notes on South African Income Tax* 2; Stiglingh *et al Silke: South African Income Tax* 5; Kabinga *Principles of Taxation* 5 and Muller *Wealth Transfer Taxation* 52.

²³⁹ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 31; Margo Commission *Margo Report* 4.49 and Downer 2016 *Journal of Financial Management and Analysis* 6.

²⁴⁰ Adam Smith Institute *The Condensed Wealth of Nations* 70 and Muller *Wealth Transfer Taxation* 45-54.

of taxation" and serve as the ideal objectives of tax policy.²⁴¹ An analysis of the adherence of the *Estate Duty Act* to the tax principles is done in Chapter 4.

The following section discusses the constitutional principles and how it impacts wealth transfer taxation when designing tax policy or interpreting legislation.

2.4.3 Constitutional principles

2.4.3.1 The Constitution

During the pre-1994 regime, in the absence of a Bill of Rights, taxpayers were not able to challenge fiscal legislation or the revenue authorities' powers in a court of law.²⁴² The first *Constitution of the Republic of South Africa* 200 of 1993 (the *Interim Constitution*) came into force on 27 April 1994 and rectified the situation of "taxation without representation" by redefining public values and introducing a Bill of Rights that includes a person's right to equality, privacy, property and access to information.²⁴³ The *Third Interim Katz Commission Report* which was published later that year confirmed that South Africa is entering an era where taxation is no longer seen as a tool of oppression but a legitimate instrument to achieve national and democratic objectives.²⁴⁴

In 1996, the *Constitution* replaced the *Interim Constitution*.²⁴⁵ The Bill of Rights is set out in Chapter 2 of the *Constitution*, similar to that contained in Chapter 3 of the *Interim Constitution*.²⁴⁶ The *Constitution* provides that South Africa is one, sovereign, democratic state founded on values including, human dignity, equality,

²⁴¹ Moosa *The 1996 Constitution and the Tax Administration Act* 15. See also Margo Commission *Margo Report* 1.28; Stiglingh *et al Silke: South African Income Tax* 5; Emslie, Davis and Hutton *Income Tax Cases and Materials* 1 and the DTC *Wealth Tax Report* 32 as authority that the "canons of taxation" is accepted in the South African context. See also para 2.4.2 above.

²⁴² Croome 2008 *Taxpayers' Rights in South Africa* 8 (subject to certain exceptions on common-law grounds).

²⁴³ Chapter 2 of the *Constitution*. See also Muller *Wealth Transfer Taxation* 57.

²⁴⁴ Katz Commission *Third Report* 1.4.2(b). Article 29(6) of the *African Charter on Human and Peoples Rights* that was signed and ratified by South Africa on 9 July 1996, an individual is "obliged to pay taxes imposed by law in the interest of the society." See also Moosa *The 1996 Constitution and the Tax Administration Act* 7.

²⁴⁵ The *Constitution* was promulgated on 18 December 1996 and implemented on 4 February 1997.

²⁴⁶ The fundamental rights are laid down in ss 9 to 35 of Chapter 2 of the *Constitution*.

the advancement of human rights and freedoms, non-racialism, non-sexism, supremacy of the *Constitution* and the rule of law.²⁴⁷ The principle of "supremacy of the Constitution" provides that any legislation should first abide by the provisions of the *Constitution* and any legislation in conflict with the *Constitution* may be declared unconstitutional if so challenged, in which case it will be considered null and void.²⁴⁸

Regarding taxation, the *Constitution* does not specifically confer on the State the power to impose a tax, such power can be implied through the general grant of legislative and executive authority,²⁴⁹ together with the accompanied limitations.²⁵⁰ The relevant tax legislation²⁵¹ provides the basis on which the government's taxing power is granted.²⁵² However, such taxing power is not unlimited but may be subject to limitations under the Bill of Rights that apply to all legislation, including fiscal legislation.²⁵³

To determine the scope of any fundamental rights set out in the Bill of Rights, section 39(1) of the *Constitution* is important as it lays down the rules that must be

²⁴⁷ Section 1(a)-(c) of the *Constitution*. The "rule of law" principle also provides that if a taxpayer does not pay a tax that is lawfully imposed it is considered unlawful and not adhering to the values of a democratic society (Moosa *The 1996 Constitution and the Tax Administration Act* 7).

²⁴⁸ Section 2 of the *Constitution*; Chaskalson, Marcus and Bishop "Constitutional Litigation" 3-2, 3-3; Moosa 2018 *De Jure* 12; *Pharmaceutical Manufacturers Association of South Africa: In re Ex Parte President of the Republic of South Africa* 2000 2 SA 674 (CC) para 44 and Dendy 2009 *De Rebus* 60.

²⁴⁹ Section 213 of the *Constitution* requires national taxes to be paid to the National Revenue Fund to finance the government's budget which enables the government to fund the basic needs of society and to fund human rights. See also ss 227-229 of the *Constitution*; Steyn and Stiglingh "The Complexity of Tax Simplification: Experiences from South Africa" 161 and James and Alley 2002 *Journal of Finance and Management in Public Services* 27-28.

²⁵⁰ Moosa is of the view that the duty to pay tax arises from the constitutional entitlements under s 3(2) of the *Constitution* that states: "All citizens are (a) equally entitled to the rights, privileges and benefits of citizenship; and (b) equally subject to the duties and responsibilities of citizenship" (see Moosa *The 1996 Constitution and the Tax Administration Act* 78-79).

²⁵¹ Including the *Income Tax Act*, the *Value-Added Tax Act*, the *Transfer Duty Act* and the *Estate Duty Act*.

²⁵² The *Constitution's* impact on the tax regime includes the setting of taxing powers and establishing public administration guidelines. See also Vanistendael "Legal Framework for Taxation" 16.

²⁵³ Sections 8(1), 39(2) of the *Constitution* read with s 36 of the *Constitution*. See also Chaskalson, Marcus and Bishop "Constitutional Litigation" 3-7; Moosa 2018 *De Jure* 12; Moosa *The 1996 Constitution and the Tax Administration Act* 52 and Goldswain 2017 *SABR* 56-57.

followed by the judiciary²⁵⁴ when interpreting the Bill of Rights or legislation.²⁵⁵ Section 39(1) of the *Constitution* provides that when the Bill of Rights is interpreted it must first promote the values of an open and democratic society based on human dignity, equality and freedom.²⁵⁶ Secondly, the courts must consider international law²⁵⁷ to ensure alignment as far as possible and thirdly, may also consider foreign law.²⁵⁸ Section 39(2) of the *Constitution* provides that any interpretation followed "must promote the spirit, purport and objects of the Bill of Rights".²⁵⁹ This principle is further supported by section 233 of the *Constitution* which requires a court to prefer a reasonable interpretation of legislation that is consistent with international law as opposed to an interpretation that is inconsistent with international law.²⁶⁰ Dugard²⁶¹ states that great care is taken to ensure that the Bill of Rights complies

²⁵⁴ This refers to the courts, tribunals and forums that are required to interpret the fundamental rights in making its decisions.

²⁵⁵ Section 39(1)(a), (b) and s 39(2) are mandatory through the use of the word "must".

²⁵⁶ Section 39(1)(a) of the *Constitution*. The mandatory requirement means legislation must promote the spirit of the Bill of Rights in a democratic society, and it is noted by Currie and De Waal that such a society is not present in South Africa but is more of an ideal society (see Currie and De Waal *The Bill of Rights Handbook* 146).

²⁵⁷ Section 39(1)(b) of the *Constitution*. The mandatory requirement is only that international law must be considered and does not require international law to be applied. See also Strydom and Hopkins "International Law" 30-1 where international law is defined as "that body of law which binds or regulates states in terms of their relationships with other states", and Vanistendael "Legal Framework for Taxation" 31.

²⁵⁸ Section 39(1)(c) of the *Constitution*. For purposes of this study, a comparative study of foreign law is done in Chapter 5. Foreign law consists of the statutes and case law of other countries (see Du Bois and Visser 2003 *Transnational Law & Contemporary Problems* 645; Foster 2010 *University of San Francisco Law Review* 80 and Croome *Taxpayers' Rights in South Africa* 24).

²⁵⁹ The wording of s 39(2) of the *Constitution* stating "[When] interpreting any legislation..." implies that it does not differentiate between fiscal and non-fiscal legislation but applies to all legislation uniformly. In *Investigating Directorate: SEO v Hyundai Motor Distributors* 2001 1 SA 545 (CC) para 21, Langa DP held that according to section 39(2) of the *Constitution* all legislation "must be interpreted through the prism of the Bill of Rights". See also Moosa *The 1996 Constitution and the Tax Administration Act* 38, 53 and Goldswain 2011 *SABR* 6. Also, all fundamental rights relevant to a specific statutory provision must be considered. See *Sarrahwitz v Maritz* 2015 4 SA 491 (CC) para 29. See also Moosa *The 1996 Constitution and the Tax Administration Act* 53.

²⁶⁰ Section 233 of the *Constitution*. See also Dugard 1997 *EJIL* 85. For purposes of this study, international law principles relevant to this study will be analysed in Chapter 4 which includes OECD guidelines that includes the *OECD Report: Inheritance Taxation in OECD Countries*; the *OECD Estate Tax Model* and the various estate duty agreements (available at <https://www.sars.gov.za/legal-counsel/international-treaties-agreements/estate-duty-agreements/>). South Africa is not a member of the OECD but is affiliated with the OECD and therefore adheres to the same value systems and principles as the OECD (See also Blom *Wealth Taxation from a South African Perspective* 23). See also Chaskalson, Marcus and Bishop "Constitutional Litigation" 3-15.

²⁶¹ Dugard 1997 *EJIL* 84.

with international norms²⁶² and is largely modelled on international counterparts.²⁶³ International law perspectives that may influence an evaluation of the Bill of Rights include the United Nations Charter²⁶⁴ and other international agreements dealing with human rights, whether or not South Africa has adopted such agreements²⁶⁵ to ensure alignment with international norms.²⁶⁶ Tax treaties²⁶⁷ may also find application in that where a situation of double taxation arises, the provisions of the tax treaty must be considered to address the instance of double taxation.²⁶⁸ For income tax and CGT purposes, section 108 of the *Income Tax Act* provides that to eliminate the double tax implications, the provisions of a tax treaty must be adhered to. For estate duty purposes, section 16(c) read with section 26 of the *Estate Duty Act* serves as a similar provision.²⁶⁹ Where a double estate tax situation arises and South Africa has entered into a tax treaty with such a foreign country, the relief for double taxation must be sought from the tax treaty and the unilateral relief under the *Estate Duty Act* cannot be relied on.²⁷⁰

The OECD²⁷¹ further states, in general, that the fundamental rights of taxpayers are important and for a tax system to operate effectively, taxpayers' cooperation is required, which is reliant on their perception of a fair tax system where their fundamental rights are laid down and respected. Any rights and powers granted in

²⁶² These include international human rights norms and conventions to bring these norms into harmony with South African law (see Dugard 1997 *EJIL* 84).

²⁶³ Dugard 1997 *EJIL* 84. This provides South Africa access to international human rights treaties.

²⁶⁴ A 1 of the *Charter of the United Nations and Statute of the International Court of Justice* (1945). See also Mangu 2011 <https://www.accord.org.za/ajcr-issues/the-historic-contribution-of-the-united-nations-to-the-resolution-of-conflicts-in-southern-africa/>.

²⁶⁵ Section 39(1)(b) of the *Constitution*.

²⁶⁶ Dugard 1997 *EJIL* 85.

²⁶⁷ See Strydom and Hopkins "International Law" 30-3 where tax treaties are defined as "international agreements entered into between states in terms of which states expressly agree to be bound by the terms of the treaty."

²⁶⁸ Section 231 of the *Constitution*.

²⁶⁹ Stiglingh *et al Silke: South African Income Tax* 1017.

²⁷⁰ Stiglingh *et al Silke: South African Income Tax* 1017-1018. See also Haupt *Notes on South African Income Tax* 863. See also para 4.2.7 below for a discussion on the relief mechanisms available in the case of double estate tax. South Africa has a limited number of estate duty treaties that results in limited application. The OECD also recommends that countries could consider widening their estate and inheritance tax treaties network to sufficiently address the double tax situation. Alternatively, unilateral relief provisions should be amended. See OECD *Inheritance Taxation in OECD Countries* 128.

²⁷¹ OECD *Taxpayers' Rights and Obligations: A Survey of the Legal Situation in OECD Countries* 10.

fiscal legislation should conform to the *Constitution*. Croome²⁷² states that taxpayers are considered in an unequal relationship to the State as they are not willing participants in the tax system but are compelled by statutes to contribute to the State. Bentley²⁷³ supports the OECD's observation that a taxpayer's compliance with the tax system increases if they feel that their rights are not violated but are fairly treated. Klue²⁷⁴ states that taxpayers question the fairness of a tax system where it is ineffectively managed or flawed by corruption.

In the South African context, any legislation must be measured against the Bill of Rights which applies to all laws.²⁷⁵ The powers granted to SARS to impose or collect tax in terms of specific tax legislation, may not in itself violate a taxpayer's fundamental rights, however, the execution thereof may violate a taxpayer's right to administrative justice under section 33 of the *Constitution*.²⁷⁶ If it is found that a taxpayer's fundamental rights are violated, section 36 of the *Constitution* will determine whether such limitation is allowed which may pose a challenge to taxpayers.²⁷⁷ A taxpayer's fundamental rights are therefore not absolute and may be restricted.²⁷⁸

Section 36 provides that a statute of general application may limit the rights contained in the *Constitution*.²⁷⁹ It is therefore important to determine whether the infringement of the right is valid. The principle behind the limitation of a right is that any law limiting a person's rights must apply in general and its application must be

²⁷² Croome *Taxpayers' Rights in South Africa* 23.

²⁷³ Bentley *Taxpayers' Rights: An International Perspective* 43. The same position is taken in Greenbaum 1997 *Revenue Law Journal* 138-162.

²⁷⁴ Klue 2012 <https://www.thesait.org.za/news/93372/The-social-contract-fair-share-taxes-and-other-myths.htm>.

²⁷⁵ Section 8(1) of the *Constitution*.

²⁷⁶ A taxpayer's rights may be violated where SARS fail to adhere to the provisions of the *Tax Administration Act* in administering a tax, for example where SARS does not inform a taxpayer of the status of an audit, provides no written conclusions or findings after completing an audit, does not take the necessary steps in raising assessments or depriving taxpayers of the opportunity to respond to queries or issues raising during an audit (see s 42(1) and (2)(b) of the *Tax Administration Act*; Botha 2018 *Tax & Exchange Control Alert* 6 and Goldswain 2017 *SABR* 56).

²⁷⁷ Goldswain 2017 *SABR* 56-57.

²⁷⁸ Goldswain 2017 *SABR* 56.

²⁷⁹ Moosa *The 1996 Constitution and the Tax Administration Act* 298.

reasonable and justifiable.²⁸⁰ Goldswain²⁸¹ states that any legislation, including fiscal legislation, may potentially pass the test under section 36 of the *Constitution* on the basis that it is "reasonable and justifiable in an open and democratic society".²⁸² A limitation to a taxpayer's fundamental right that is permitted is applied equally to all taxpayers.²⁸³

In the context of taxation, the fundamental rights envisaged under section 9 (equality), section 14 (privacy), section 25 (property), section 32 (access to information), section 33 (just administrative action) and section 34 (access to courts) become applicable. A detailed discussion of these rights and their limitation in terms of tax legislation is beyond the scope of this study, however, the recommendations set out in Chapter 6 will be measured against the fundamental rights.²⁸⁴ For purposes of this study with a focus on the *Estate Duty Act* and specifically the imposition of a tax, the rights under sections 9 and 25 will be briefly considered.

Section 9 provides that everyone is equal and enjoys equal protection and benefit under the law.²⁸⁵ The State may not unfairly discriminate against a person on any

²⁸⁰ Croome *Taxpayers' Rights in South Africa* 17; Currie and De Waal *Bill of Rights Handbook* 150 and Moosa *The 1996 Constitution and the Tax Administration Act* 298, 301.

²⁸¹ Goldswain 2017 *SABR* 56-57.

²⁸² Section 36 of the *Constitution*; Goldswain 2017 *SABR* 57. For example, the repealed search and seizure provisions under s 74D of the *Income Tax Act*, now enacted in ss 59-62 of the *Tax Administration Act* were found to pass s 36 of the *Constitution* (see *Investigating Directorate: SEO v Hyundai Motor Distributors* 2001 1 SA 545 (CC)). Similarly, the pay-now-argue-later principle, previously set out in ss 36(1), 40(2)(a) and (5) of the *Value-Added Tax Act* and now contained under ss 164 and 169 of the *Tax Administration Act*, was found to be constitutional (see *Metcash Trading Ltd v CSARS* 63 SATC 13, 2001 1 BCLR 1 (CC)). The provisions whereby SARS can make a third-party appointment (agent) to collect taxes on its behalf (previously s 99 of the *Income Tax Act* and now contained in s 156 of the *Tax Administration Act*), was also found to be constitutional in *Hindry v Nedcor Bank Ltd* 61 SATC 163, 1999 2 SA 757 (W).

²⁸³ Croome *Taxpayers' Rights in South Africa* 17; Goldswain 2017 *SABR* 56 and Chaskalson, Marcus and Bishop "Constitutional Litigation" 3-14.

²⁸⁴ For example, from an equality perspective, the validity of treating certain taxpayers differently from others, like a resident compared to a non-resident and a spouse compared to other family members (see paras 4.2.1-4.2.3 and 4.2.5 below).

²⁸⁵ See also Vanistendael "Legal Framework for Taxation" 19 where it is explained that the principle of equality is viewed as "an application of the concept of legality, under which the law must be applied without exception to all those in the same circumstances."

of the grounds set out in section 9(3).²⁸⁶ An exception to the rule is if it can be established that such discrimination is fair.²⁸⁷ If the legislature limits any right contained in the *Constitution*, such limitation must apply equally to all persons.²⁸⁸ Croome²⁸⁹ states that it is not lawful to impose a tax that only applies to a certain group of taxpayers. Moosa²⁹⁰ argues that taxing provisions cannot be arbitrary as they may run the risk of being declared invalid, however, an arbitrary provision may be permissible if it brings about redistributive justice in society. Croome argues²⁹¹ that even though tax legislation that imposes a tax in South Africa may potentially violate the right to equality, it may be saved by section 36 of the *Constitution* as it constitutes a law of general application applicable to all taxpayers. Such legislation, therefore, does not discriminate unfairly on the grounds under section 9 of the *Constitution*. Goldswain²⁹² states that the protection of a taxpayer's right to equality is still to be determined by the judiciary but agrees with Croome that in the case of a violation, there is a strong possibility that it will be saved by section 36 of the *Constitution*. According to Botha²⁹³ when the constitutionality of a tax provision is

²⁸⁶ Such grounds include race, gender, sex, pregnancy, marital status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, culture, language and birth.

²⁸⁷ Section 9(5) of the *Constitution*.

²⁸⁸ An example under the *Estate Duty Act* is where the imposition of estate duty applies to all deceased persons who have a dutiable estate. The distinction between an ordinarily resident and a non-resident regarding the levying of estate duty is aligned with international standards where non-residents are taxed on a source basis. See also Vanistendael "Legal Framework for Taxation" 19.

²⁸⁹ Croome *Taxpayers' Rights in South Africa* 17.

²⁹⁰ Moosa *The 1996 Constitution and the Tax Administration Act* 92-93. For example, providing for a lower tax rate to formerly disadvantaged persons will probably pass the test for constitutionality on the basis that it is remedial or restitutionary (see *City Council of Pretoria v Walker* 1998 2 SA 363 (CC); *Rates Action Group v City of Cape Town* 2004 5 SA 545 (C); Albertyn and Goldblatt "Equality" 35-40 and Goldswain 2011 *SABR* 11). In the context of estate duty, where it is only levied on deceased persons with a dutiable estate above a certain value will probably not be seen to unfairly discriminate against such persons due to the redistributive function to achieve vertical equity in society.

²⁹¹ Croome *Taxpayers' Rights in South Africa* 31.

²⁹² Goldswain 2011 *SABR* 22. Goldswain states that in the absence of case law on the right to equality directly about revenue issues there are several landmark decisions by the Constitutional Court regarding other branches of the law that provides guidance. Moosa also states that the only case in which the constitutionality of a tax (income tax) was challenged was in *De L v CSARS (ZATC)* (unreported) case number IT 12291, VAT 596 of 4 November 2010 para 3 where Molemela J sidestepped the issue on the basis that the Tax Court lacked constitutional jurisdiction (see Moosa *The 1996 Constitution and the Tax Administration Act* 93).

²⁹³ Botha 2020 *SAMLJ* 14, 21. Botha tested the constitutionality of s 23(m) of the *Income Tax Act* that differentiates between salaried and non-salaried individuals by limiting the allowing

measured against section 9(1) of the *Constitution*, a limitation is permissible if it is rationally connected to a legitimate governmental purpose.

Section 25(1) of the *Constitution* provides that no one may be deprived of his or her property unless it is done in terms of law of general application and no law may allow for the arbitrary deprivation of property. Croome²⁹⁴ states that tax levied on a taxpayer's entitlement to certain benefits or rights may be seen as a deprivation of property under section 25 of the *Constitution*. However, in *First National Bank of South Africa v CSARS*,²⁹⁵ Conradie J commented in the court *a quo* that in principle, tax does not amount to a deprivation of property and the freedom from taxation is not listed as a fundamental right. It was stated that the *Constitution* does not protect a subject against taxation, not even in the case of death, but it may be different if the tax is oppressive or unequal in its application.²⁹⁶ Ackerman J in the Constitutional Court concurred with the decision by Conradie J that taxation cannot be a deprivation of property.²⁹⁷ The approach is aligned with international standards.²⁹⁸ Croome²⁹⁹ states that where a taxing provision is generally applied to all South African citizens, a taxpayer will fail in challenging the constitutionality of such provision solely on the ground that it violates a right to property. Such limitation may cause a reasonable and justifiable deprivation of property and section 36 of the *Constitution* allows such limitation. Moosa³⁰⁰ agrees with the view taken that

deductions under s 11 for salaried individuals. The differentiation was argued as rational as the absence of such distinction might lead to an increase in the administrative burden of SARS and of salaried individuals which is against SARS's mandate to "secure the efficient and effective, and widest possible, enforcement" of, for example, the *Income Tax Act*.

²⁹⁴ Croome *Taxpayers' Rights in South Africa* 28.

²⁹⁵ 2001 7 BCLR 715 (CC), 63 SATC 432 (the *FNB v CSARS* case).

²⁹⁶ *FNB v CSARS* case para 449.

²⁹⁷ *First National Bank of South Africa v CSARS* 2002 7 (BCLR) 702 (CC), 64 SATC 471 para 27.

²⁹⁸ Croome *Taxpayers' Rights in South Africa* 32-36 where a comparison was done on the constitutional law, amongst others, of the European Union, India, the US, Ireland and Canada. See also *Gudmundsson v Iceland* 1960 YB 3 394 para 422 and *Daly v the Revenue Commissioner* 1995 3 IR para 1.

²⁹⁹ Croome *Taxpayers' Rights in South Africa* 36.

³⁰⁰ Moosa *The 1996 Constitution and the Tax Administration Act* 317. See also *Deutschmann v CSARS; Shelton v CSARS* 2000 2 SA 106 (E) para 124A where it is stated that the *Income Tax Act* and the *Value-Added Tax Act* are considered "laws of general application" for purposes of s 36(1) of the *Constitution* in respect of the Bill of Rights. See also van Schalkwyk 2004 *Meditari Accountancy Research* 190 where it is explained that the constitutional validity of the provisions of the *Value-Added Tax Act* was not attacked, and the focus was instead on SARS's actions that contravened the *Constitution*.

fiscal legislation³⁰¹ falls within the ambit of a "law of general application". According to Goldswain³⁰² even if the actual provision of the legislation, for example, the imposition of a tax, may at first instance appear to be interfering with a taxpayer's fundamental right under the Bill of Rights, it is not necessarily considered unconstitutional, on the basis that it is limited under section 36 of the *Constitution* and passes the test by being "reasonable and justifiable in an open and democratic society".³⁰³

Goldswain,³⁰⁴ Botha,³⁰⁵ and Moosa³⁰⁶ are of the view that apart from the taxing provisions themselves, greater success is achieved by taxpayers when attacking the constitutionality of the administrative and decision-making process by SARS in administering a tax. Goldswain³⁰⁷ states such victories are achieved because section 36 of the *Constitution* only applies to the interpretation of the "law of general application" and does not apply to the administrative actions or decisions by a SARS official. Botha³⁰⁸ is of the view that victory lies in the contravention of SARS in

³⁰¹ Including the *Income Tax Act*, the *Value-Added Tax Act*, and the *Tax Administration Act*. It is further assumed on the basis that it applies to the public in general under the relevant circumstances, that the *Transfer Duty Act* and the *Estate Duty Act* are also included.

³⁰² Goldswain 2017 *SABR* 55-56, 59 and Goldswain 2011 *SABR* 20.

³⁰³ *Investigating Directorate: SEO v Hyundai Motor Distributors* 2001 1 SA 545 (CC); *Metcash Trading Ltd v CSARS* 63 SATC 13, 2001 1 BCLR 1 (CC); *Hindry v Nedcor Bank Ltd* 61 SATC 163, 1999 2 SA 757 (W). *Harksen v Lane* 1997 11 BCLR 1489 (CC); *City Council of Pretoria v Walker* 1998 3 BCLR 257 (CC) para 82 and s 9 of the *Constitution*. Two exceptions where fiscal legislation was found to be unconstitutional. In *First National Bank of SA Ltd t/a Wesbank v CIR* 64 SATC 471, 2002 7 BCLR 702 (CC); s 114 of the *Customs and Excise Act*, 1964 was found unconstitutional on the basis that the seizure provisions were not considered "reasonable or justifiable" in an open and democratic society and therefore did not pass s 36 of the *Constitution*. In *Gaertner v Minister of Finance* 76 SATC 69, 2014 1 BCLR 38 (CC), a warrantless search of the taxpayer's property was seen as violating the taxpayer's right to privacy and therefore found unconstitutional.

³⁰⁴ Goldswain 2017 *SABR* 55. See also Cheadle "Limitations of Rights" 30.8 for the same interpretation. However, Woolman and Botha "Limitations" 34-53 are of the view that provided the four rules of law criteria listed by the authors in 34-48 are met, a wider meaning is preferred to include rules, directives and guidelines issued regarding the relevant law.

³⁰⁵ Botha 2018 *Tax & Exchange Control Alert* 6.

³⁰⁶ Moosa *The 1996 Constitution and the Tax Administration Act* 317.

³⁰⁷ Goldswain 2017 *SABR* 55. See also *Premier Mpumalanga v Executive Committee of the Association of the Governing Bodies of State-Aided Schools, Eastern Transvaal* 1999 2 SA 91 (CC) para 42; *Haynes v CIR* 64 SATC 321, 2000 6 BCLR (Tk) and *Deacon v Controller of Customs and Excise* 1999 6 BCLR 637 (SE).

³⁰⁸ Botha 2018 *Tax & Exchange Control Alert* 6. See also *Mr A v The Commissioner for the South African Revenue Service (ZATC)* (unreported) case number IT 13726 of 13 February 2018 where the Court held that ss 40 and 42 of the *Tax Administration Act* give effect to the right to

adhering to the procedural requirements of tax legislation that infringe section 33 of the *Constitution*, which protects the right to administrative action that is lawful, right and fair. According to Moosa³⁰⁹ the administrative action by SARS is authorised under the *Tax Administration Act* and such specific actions are not a "law of general application" as envisaged under section 36(1) of the *Constitution*.³¹⁰ Therefore, administrative actions that limit a taxpayer's fundamental rights contravene section 36(1) of the *Constitution* and are unconstitutional.³¹¹

In essence, to scrutinise the limitation of a taxpayer's right, the impact, if any, of the limitation of a fundamental right must be weighed against the powers placed on SARS to administer and collect the tax. The collection of a tax is in the public interest³¹² by growing the public treasury.³¹³ However, the collection of the tax must take place within the parameters of the *Constitution* and the enabling legislation.³¹⁴

Most of the changes that took place around tax policy include the move from a source-based tax system to a resident-based tax system, the introduction of a CGT,

administrative action under s 33 of the *Constitution* and SARS did not comply with the provisions and thereby contravenes the *Constitution*.

³⁰⁹ Moosa *The 1996 Constitution and the Tax Administration Act* 317.

³¹⁰ *Premier Mpumalanga v Executive Committee of the Association of the Governing Bodies of State-Aided Schools, Eastern Transvaal* 1999 2 SA 91 (CC) para 42; *City Council of Pretoria v Walker* 1998 3 BCLR 257 (CC) para 82. According to Cheadle "Limitations of Rights" 30.8, the "law of general application" includes only laws and not the conduct that is taken in terms of the law. Woolman and Botha "Limitations" 34-53 extend the meaning in certain circumstances to include rules, directives and guidelines issued regarding the relevant law.

³¹¹ Moosa *The 1996 Constitution and the Tax Administration Act* 317. An administrative action that contravenes s 36(1) of the *Constitution* may bypass its unconstitutionality if the *Tax Administration Act* authorises mechanisms to survive a constitutional review. For example, searches of a taxpayer's premises without a warrant were ruled unconstitutional in *Gaertner v Minister of Finance* 76 SATC 69, 2014 1 BCLR 38 (CC). However, despite the decision s 63 of the *Tax Administration Act* still provides for such searches but limitations and safeguards stipulated in s 63 may protect the provision from being unconstitutional (see also Goldswain 2017 *SABR* 69).

³¹² *CSARS v Brummeria Renaissance (Pty) Ltd* 2007 6 SA 601 (SCA) para 26. See also Dae 2012 *Journal of Economic Policy Reform* 71-72 where it is stated that taxation promotes equality in a society.

³¹³ *S v Van Rooyen* 2002 5 SA 246 (CC) para 140 where it is stated that tax finances the government's budget that is controlled by the national executive. See also Moosa *The 1996 Constitution and the Tax Administration Act* 10.

³¹⁴ Moosa 2018 *De Jure* 12. See also Moosa *The 1996 Constitution and the Tax Administration Act* 8, 15; James and Alley 2002 *Journal of Finance and Management in Public Services* 27-28; *Metcash Trading Ltd v SARS* 2001 1 SA 1109 CC para 20 and s 3(2)(e) of the *Tax Administration Act* provides for the collection of tax collection as an important element of tax administration.

the reduction of tax rates to avoid unjustified hardship in taxation as well as a unified *Tax Administration Act* to govern the administration of all taxes.³¹⁵

In the context of the *Estate Duty Act*, there are no court cases that challenged the provisions of the Act on constitutional grounds. The *Estate Duty Act* has been amended due to concepts of which the constitutionality has been questioned in other Acts that impacted its meaning under the *Estate Duty Act*. For example, the meaning of a "spouse" was amended to cater for all types of unions in South Africa to address the unfair discrimination against certain types of unions.³¹⁶ The Katz Commission in its review of the wealth tax system of South Africa also commented that any changes or recommendations regarding estate duty are subject to its adherence to the *Constitution*.³¹⁷ The constitutionality of certain provisions, for example, section 4(q) of the *Estate Duty Act* has been questioned by the Commissions of Enquiry and is discussed in Chapter 4.

The transformation of legislation to include interpretation and application that are consistent and aligned with the *Constitution* is known as "transformative constitutionalism". South Africa is continuously undergoing change that is relevant in the context of any fiscal legislation. The following section briefly explains this concept and its relevance to the *Estate Duty Act*.

2.4.3.2 Transformative constitutionalism

A transformative constitution is aimed at introducing a future that is vastly different from the past it rejected.³¹⁸ Klare³¹⁹ defined "transformative constitutionalism" as a long-term process of constitutional enactment, interpretation, and enforcement to

³¹⁵ Steyn and Stiglingh "The Complexity of Tax Simplification: Experiences from South Africa" 161.

³¹⁶ See para 4.2.3.2 below.

³¹⁷ Katz Commission *Third Report* 9 and Croome *Taxpayers' Rights in South Africa* 8-9. Reference was also made to the application of s 36 of the *Constitution* where a limitation of fundamental rights may be justified.

³¹⁸ Michelman "The Rule of Law, Legality and the Supremacy of the Constitution" 11-24. See also *S v Makwanyane* 1995 3 SA 391 (CC) para 262 where it is stated that transformative constitutionalism does not ignore the value of continuity but preserves values from the past that can be defended for the transformative future. See also Klare 1998 *SAJHR* 146; Moseneke 2002 *SAJHR* 146 and van der Walt 2005 *TSAR* 655.

³¹⁹ Klare 1998 *SAJHR* 146.

transform a country's social and political institutions and power relationships, steering them towards democracy, participation, and enhancing social equality. This transformation of legal frameworks is delivered through constitutional interpretation and enforcement by courts, and by public institutions such as tax administrations.³²⁰

Former Chief Justice Langa³²¹ states that all South African courts consider the *Constitution* as transformative and that the commitment to a transformed society lies at the heart of the new constitutional order. The Constitutional Court has also declared its view that the *Constitution* is of a transformative kind.³²² In *President of the Republic v South African Rugby Football Union*,³²³ the Court emphasises that its origin and purpose are to ensure any application by the courts of the *Constitution* upholds the transformative commitment. The Constitutional Court, therefore, has the responsibility to secure such applications.³²⁴

According to Langa³²⁵ there is no single accepted definition for transformative constitutionalism but supports the view that at the core of its meaning, means a change should happen where past wounds are healed to obtain a better future. Langa³²⁶ explains that transformative constitutionalism consists of two parts. First, economically, where services must be provided to all and levelling the previously disrupted economic playing field. Such transformation extends beyond socio-economic rights and includes providing greater access to education and opportunities.³²⁷ Secondly, a transformation in the legal culture should take place. Judicial decisions must be defended, not based on authority alone, but based on ideas and values. Judges should acknowledge the impact of their own personal,

³²⁰ Ogembo 2022 <https://www.law.ox.ac.uk/events/transformative-constitutionalism-and-taxation-africa>.

³²¹ Langa 2006 *STELL LR* 351. See also *Soobramoney v Minister of Health, KwaZulu-Natal* 1998 1 SA 765 (CC) para 8.

³²² Michelman "The Rule of Law, Legality and the Supremacy of the Constitution" 11-24. See also *Mkontwana v Nelson Mandela Metropolitan Municipality* 2005 1 SA 530 (CC) para 81 where O'Regan J states "[T]his Court has emphasised on many occasions; our Constitution is a document committed to social transformation."

³²³ 1999 4 SA 147 (CC) paras 73-76. See also Michelman "The Rule of Law, Legality and the Supremacy of the Constitution" 11-24.

³²⁴ Michelman "The Rule of Law, Legality and the Supremacy of the Constitution" 11-25.

³²⁵ Langa 2006 *STELL LR* 351.

³²⁶ Langa 2006 *STELL LR* 352-353.

³²⁷ Langa 2006 *STELL LR* 352.

intellectual, and moral perceptions in their decision-making.³²⁸ Langa³²⁹ perceives transformative constitutionalism as a society that is constantly open to change and debate and that is defined by transformation.

It is submitted that the *Constitution* had a significant impact on the tax regime in South Africa and through the application of the principle of "supremacy of the constitution", legislation, including tax legislation, must be interpreted through the lens of the *Constitution*. Although the provisions of the *Estate Duty Act* have not yet been challenged on constitutional grounds the Constitution has impacted it.

Transformative constitutionalism requires an ever-changing legal environment where legislation is constantly reviewed and amended to provide fairness and efficiency within the framework of the *Constitution*.³³⁰ In the context of the *Estate Duty Act*, transformative constitutionalism has impacted the *Estate Duty Act* where initial amendments were made to administrative provisions to be aligned with the *Constitution*,³³¹ and the inclusion as well as the extension of the definition of a "spouse" to eliminate the unfair discrimination against same-sex life partners before the inclusion, which was inconsistent with the provisions of section 9(3) of the *Constitution*. Subsequently, amendments were made regarding administrative provisions under the *Estate Duty Act* with the introduction of the *Tax Administration Act* with the object of simplifying the tax system.³³² These provisions include, amongst others, provisions dealing with search and seizure procedures,³³³ reduced and estimated assessments,³³⁴ prescription,³³⁵ the onus of proof,³³⁶ returns by

³²⁸ Langa 2006 *STELL LR* 353.

³²⁹ Langa 2006 *STELL LR* 354. See also *Soobramoney v Minister of Health, Kwazulu Natal* 1998 1 SA 765 (CC) para 8.

³³⁰ Langa supports the view that change needs to be at the core of society. See Langa 2006 *STELL LR* 351.

³³¹ Section 24 of the *Estate Duty Act* was subsequently repealed and included under the provisions of the *Tax Administration Act*.

³³² Steyn and Stiglingh "The Complexity of Tax Simplification: Experiences from South Africa" 164.

³³³ Repealed ss 8A, 8B, 8C, 8D and 8E of the *Estate Duty Act*. See also Cilliers *Meyerowitz on the Administration of Estates* 31.2.

³³⁴ Repealed ss 7(2) and 9B of the *Estate Duty Act*. See ss 95 and 93 of the *Tax Administration Act*.

³³⁵ Repealed s 9A of the *Estate Duty Act*. See s 99 of the *Tax Administration Act*.

³³⁶ Repealed s 23bis of the *Estate Duty Act*. See s 102 of the *Tax Administration Act*.

insurers,³³⁷ refunds³³⁸ and penalty provisions.³³⁹ The specific provisions that remained in the *Estate Duty Act*,³⁴⁰ must be read in conjunction with the *Tax Administration Act*.

The principle of transformative constitutionalism underlies the aim of the study where the existing provisions of the *Estate Duty Act* are reviewed and considered for amendments in the search for a revised *Estate Duty Act* to ensure alignment between the *Estate Duty Act* and the *Constitution*.

2.5 Conclusion

This chapter served as an introductory and framework chapter by providing an overview of the objectives of taxation, the "canons of taxation" and constitutional principles. It provides the underlying principles and theoretical framework relevant to this study to provide recommendations in the search for a revised *Estate Duty Act*. These aspects will be referred to throughout the study when discussing the development of the *Estate Duty Act* and identifying the problem areas to understand the areas where it is lacking.

The most important objective of taxation is the collection of revenue to fund the government's activities.³⁴¹ The observation has been made that if the primary objective of estate duty is to raise revenue it is failing therein as the revenue derived from estate duty is not material to the total tax revenue.³⁴² The taxes collected further also serve a secondary socio-economic objective that includes the

³³⁷ Repealed s 23 of the *Estate Duty Act*. See the Public Notice 241 issued in terms of s 26 of the *Tax Administration Act*.

³³⁸ Repealed s 25A of the *Estate Duty Act*. See Chapter 13 of the *Tax Administration Act*.

³³⁹ Repealed ss 28(1) and (2) and 28A of the *Estate Duty Act*. The only penalty provision that remained in the *Estate Duty Act* was that where a person fails to comply with any reasonable provision of the Commissioner or the Master, or obstructs them in carrying out the provisions of the *Estate Duty Act*, such person shall be guilty of an offence and be liable for conviction of a fine or to imprisonment for not more than two years (see s 28(2)(c) and (d) of the *Estate Duty Act*). See Chapters 15 and 16 of the *Tax Administration Act*.

³⁴⁰ For example, the provisions regarding returns, assessments and interest are contained in ss 7, 9 and 10 of the *Estate Duty Act*.

³⁴¹ See para 2.3.1 above.

³⁴² See para 2.3.1 above.

redistribution of resources.³⁴³ Estate duty is considered to not meet this objective sufficiently as the current progressive tax rate scale is limited to only two thresholds and a wider progressive scale should be considered.³⁴⁴ Tax policy considerations should not be limited to the objectives of taxation but also take cognisance and adhere to the "canons of taxation", which represent internationally accepted criteria for a good tax system that includes equity, certainty, convenience and efficiency.³⁴⁵

This chapter pointed out that the right to levy a tax must be exercised within the constitutional framework and any provision in contradiction, may be of no effect and considered null and void.³⁴⁶ Although the "canons of taxation" are not embedded in the *Constitution*, tax legislation should adhere to the Bill of Rights.³⁴⁷ The impact of the Bill of Rights on tax legislation was considered and specifically the right to equality and property due to its relevance under the *Estate Duty Act* regarding the treatment of different taxpayers based on their residency and the criteria for making certain property subject to estate duty.³⁴⁸ Although the provisions of the *Estate Duty Act* have not yet been under constitutional attack, it was, however, explained that where a provision under the fiscal legislation is challenged as a violation of a fundamental right, for example, the right to property, it will generally not be successful on the basis that fiscal legislation constitutes laws of general application and is not considered to discriminate unfairly.³⁴⁹ The meaning of transformative constitutionalism has been referred to as well as how it influenced the *Estate Duty Act*. It has been acknowledged that it is a principle that is always included in the review of any legislation.³⁵⁰

³⁴³ See para 2.3.2 above.

³⁴⁴ See para 2.3.2 above.

³⁴⁵ See para 2.4.2 above. This chapter provided a high-level overview of the "canons of taxation" to provide an understanding thereof and will be discussed more specifically about the *Estate Duty Act* throughout Chapter 4.

³⁴⁶ See para 2.4.3.1 above.

³⁴⁷ An analysis of the "canons of taxation" in respect of the *Estate Duty Act* is done throughout Chapter 4.

³⁴⁸ See para 2.4.3.1 above.

³⁴⁹ See para 2.4.3.1 above.

³⁵⁰ See para 2.4.3.2 above.

In conclusion, based on the theoretical framework laid down in this chapter, the next chapter will embark on the journey of an overview of the history that led to the introduction of the *Estate Duty Act*. Furthermore, the estate duty regime in South Africa has been a topic of debate for many years and various Commissions of Enquiry have been appointed to look at its efficiency and relevance. Various recommendations have been made by each of the Commissions on the form of a wealth transfer tax and specific changes that should be considered for the *Estate Duty Act* itself. Chapter 3 will also provide a critical analysis of the recommendations made by the previous Commissions of Enquiry (the Margo Commission, the Katz Commission, and the Davis Tax Committee) to assist in identifying problem areas under the *Estate Duty Act* to formulate recommendations for a revised *Estate Duty Act*.

CHAPTER 3 HISTORICAL OVERVIEW AND ANALYSIS OF FINDINGS BY THE COMMISSIONS OF ENQUIRY ON THE *ESTATE DUTY ACT*

Abstract

A review of the *Estate Duty Act* is not a novel concept in South Africa. Various Commissions have been appointed to review the South African tax system. The reviews by the Margo Commission (1987), the Katz Commission (1997) and the Davis Tax Committee (2016) and especially their recommendations considering the *Estate Duty Act* are analysed in this chapter. All three Commissions supported the retention of the *Estate Duty Act*, subject to a thorough revision thereof. Recommendations that still bear relevance to the *Estate Duty Act* relate to the retention of the deduction for spousal bequests, the form of the deduction for charitable bequests, the value of abatements, rate structures and the design of specific anti-avoidance rules. This chapter provides a critical analysis of the recommendations made by each Commission as well as its relevance in the search for a revised *Estate Duty Act*.

3.1 Introduction

In this chapter, a brief historical overview of South African estate duty law is provided to understand the journey to the existing *Estate Duty Act*. The historical development of death duties as they developed into an estate duty will be covered, followed by an analysis of the findings regarding the *Estate Duty Act* by the previous Commissions of Enquiry (the Margo Commission, 1987; the Katz Commission, 1997 and the Davis Tax Committee, 2016) in their review of the South African tax system. Since this study is aimed at searching for a revised *Estate Duty Act*, it is necessary to understand the historical development thereof, to identify recommendations.

Paragraphs 3.2 and 3.3 will cover a brief overview of the historical development of death taxes in South Africa and paragraphs 3.4 to 3.6 will cover the analysis of the recommendations made by the previous Commissions of Enquiry.

3.2 Historical overview of estate duty in South Africa

3.2.1 Pre-Union Legislation

The first wealth transfer tax was introduced in South Africa through a recipient-based succession duty.³⁵¹ The Cape Colony followed a precedent from the UK and introduced the *Succession Duty Act* in terms of which beneficiaries of a deceased estate paid a succession duty on the value of the legacies and inheritances they received from the estate.³⁵² In 1905, Natal³⁵³ and the Orange Free State³⁵⁴ also introduced a *Succession Duty Act* whereas the Transvaal introduced the *Estate Duty Act* 15 of 1899.

The Acts introduced by the colonies differed in the type of wealth transfer tax levied³⁵⁵ and therefore provided for different ways of levying succession or estate duties on deceased estates. The duties were levied at a different rate by each colony, which led to the repeal of the pre-Union Acts and the enactment of the *Death Duties Act* 29 of 1922 (the *Death Duties Act*).

3.2.2 Death Duties Act

The *Death Duties Act* imposed both an estate duty on the aggregate value of the dutiable estate and payable by the executor, as well as a succession duty on the beneficiaries of the estate at varying rates depending upon their relationship to the

³⁵¹ *Succession Duty Act* 5 of 1864 (the *Succession Duty Act*).

³⁵² Sections 2 and 3 of the *Succession Duty Act*.

³⁵³ *Duties on Succession to Property Act* 35 of 1905.

³⁵⁴ The *Statute Law of the Orange River Colony*, Chapter LXVIII of the Law Book, Succession Duty.

³⁵⁵ The Cape Colony, Natal and the Orange Free state levied a succession duty on the inheritance received by the heir and it was payable by the heirs, whereas Transvaal levied an estate duty payable by the estate of the deceased person.

deceased and the value of their bequests received.³⁵⁶ The design of the *Death Duties Act* followed the dual-duty approach followed by the UK at the time.³⁵⁷

Estate duty was levied under the *Death Duties Act* on the deceased estate of every person who died on or after 1 July 1922.³⁵⁸ An estate consisted of all property that passed and deemed property that was deemed to pass on the deceased person's death.³⁵⁹ Donations exceeding £100 that were made during the life of the deceased person but within two years before his or her death were included as deemed property in the estate.³⁶⁰ The two years were extended in 1951 to five years.³⁶¹ At the time, donations were not taxed, other than under the *Death Duties Act*.³⁶² The final step in calculating the dutiable estate included certain allowable deductions³⁶³ and a rebate.³⁶⁴

Succession duty under the *Death Duties Act* was modelled on the principles of the legacy and succession duty of the United Kingdom and was levied on the accrual of every bequest by an heir or a legatee.³⁶⁵ Such accrual was deemed to accrue whenever an heir or a legatee became entitled to property or an interest in the property.³⁶⁶ The dutiable amount of a succession duty was calculated after allowing

³⁵⁶ Chapters 1 and 2 of the *Death Duties Act*.

³⁵⁷ When the *Death Duties Act* was introduced in 1922, the UK levied a transferor-based (taxed levied on the estate) estate duty, a recipient-based (tax levied on the heir) legacy duty as well as a recipient-based succession duty on legatees and heirs for property transferred to them. Both recipient-based duties were abolished in 1949. See Rudnick and Gordon "Taxation of Wealth" 292 and Sandford 1987 *Fiscal Studies* 16.

³⁵⁸ Section 1 of the *Death Duties Act*.

³⁵⁹ Section 3(1) of the *Death Duties Act*. Deemed property was set out in s 3(4)(a)-(e) of the *Death Duties Act* and included certain life insurance policies effected by the deceased in which case the premiums were paid by him or her, limited interests held immediately prior to death, certain annuities, *donatio mortis causa* and qualifying *donatio inter vivos*.

³⁶⁰ Section 3(4)(e) of the *Death Duties Act*.

³⁶¹ Meyerowitz 1997 *The Taxpayer* 66. The rationale behind including such a donation of property close to death was considered to not have left the estate.

³⁶² No donations tax was levied under the *Income Tax Act* at the time which meant no donations were taxed in the hands of the donor during his or her lifetime and was only brought into consideration at death to be considered when calculating the applicable death duty. See Meyerowitz 1997 *The Taxpayer* 66-67.

³⁶³ Section 4(a)(i)-(x) of the *Death Duties Act*. The deductions under the *Death Duties Act* bear many similarities to the deductions under s 4(a) to (q) under the current *Estate Duty Act*.

³⁶⁴ Section 4(b) of the *Death Duties Act* that provided for a £1000 when initially introduced.

³⁶⁵ Section 8 of the *Death Duties Act*.

³⁶⁶ Sections 3(1) and 10 of the *Death Duties Act*.

a sliding scale abatement.³⁶⁷ The rate of succession duty was based on the blood relation between the deceased person and the heir or legatee.³⁶⁸ Any accrual to a surviving spouse was exempt,³⁶⁹ as well as any succession to any public institution of a charitable, educational or ecclesiastical nature³⁷⁰ or a public administration.³⁷¹ The heir or legatee was liable for the succession duty,³⁷² however, it was payable by the executor of the estate³⁷³ who would then reduce the amount of the bequest by the succession duty paid, or the executor was entitled to the duty paid in any other way.³⁷⁴ The *Death Duties Act* was repealed by the *Estate Duty Act* on 1 April 1955, which in its amended form is presently in force.

3.2.3 *The Estate Duty Act*

The *Estate Duty Act* retained the basic structure of the part of the *Death Duties Act* that levied an estate duty. The succession duty provisions under the *Death Duties Act* were not re-enacted, although some of its characteristics remained in the form of relief for a surviving spouse or child and the introduction of progressive tax rates to make up for any loss in revenue that may have resulted from the abolition of the succession duty. The biggest change from the *Death Duties Act* to the *Estate Duty Act* was a move away from succession duty and the retention of a transferor-based estate tax based on the value of the deceased estate at death and not an inheritance tax based on the inheritance acquired by an heir.³⁷⁵ The move away from a succession duty was motivated by administrative reasons according to the Minister of Finance as the administration thereof involved many complexities in the assessment and collection of a succession duty. The shortage of staff at the Master's

³⁶⁷ Section 14 of the *Death Duties Act* (which was £100 when the *Death Duties Act* was introduced). Currently, the abatement is found in s 4A of the *Estate Duty Act*.

³⁶⁸ Section 8 of the *Death Duties Act*.

³⁶⁹ Section 15(a) of the *Death Duties Act*. Like s 4(q) of the *Estate Duty Act*.

³⁷⁰ Section 15(b) of the *Death Duties Act*. Like s 4(h) of the *Estate Duty Act*.

³⁷¹ Section 15(c) of the *Death Duties Act*.

³⁷² Section 23(c) of the *Death Duties Act*.

³⁷³ Section 24 of the *Death Duties Act*.

³⁷⁴ Section 26 of the *Death Duties Act*.

³⁷⁵ The Margo Commission also preferred a recipient-based estate tax, but ultimately recommended a transferor-based estate duty for practical and administrative purposes (see Margo Commission *Margo Report* 20.44-20.45, 20.50). A decade later, the Katz Commission also supported the Margo Commission's view of a transferor-based estate tax (see Katz Commission *Fourth Report* 5.8).

office was also raised as a serious concern to administer and finalise deceased estates.³⁷⁶

The change to a transferor-based system may once again have been motivated by the abolition of the UK's legacy and succession duty in 1949 which also resulted in estate duty being the sole death duty in the UK.³⁷⁷ When the *Estate Duty Act* came into operation, estate duty was levied at progressive rates³⁷⁸ and donations made after 23 March 1955 were also included in the dutiable estate, provided that if any donations tax was paid during the deceased person's lifetime on such donations, a set-off would be allowed against the estate duty payable on the donated property that was included in the dutiable estate.³⁷⁹ When the *Income Tax Act* came into operation, the provisions regarding donations tax were incorporated under the *Income Tax Act*³⁸⁰ where transfers of property during a person's lifetime are now subject to donations tax at the time of transfer, subject to exclusions³⁸¹ and exemptions.³⁸² The same provisions are still in force today. The table below illustrates the steps that are followed to calculate the estate duty liability for estate duty purposes:

³⁷⁶ Muller *Wealth Transfer Taxation* 91. Although the assessing of estate duty is no longer delegated to the Master but administered by SARS under s 9 of the *Estate Duty Act*, the concerns with the shortage of staff at the Master in administering an estate as well as at SARS in assessing estate duty, remains a concern. Huge backlogs are experienced for executors to be appointed and to enable them to conduct the administrative functions of a deceased estate, both at the Master and at SARS (see Visser 2022 <https://www.moneyweb.co.za/in-depth/fisa/stumbling-blocks-to-winding-up-deceased-estates/>).

³⁷⁷ Muller *Wealth Transfer Taxation* 91.

³⁷⁸ The debate on progressive rates is ongoing to achieve vertical equity between the rich and the poor and to promote the second objective of taxation to redistribute wealth. See also para 2.3.2.3 above and De Vos 2020 <https://constitutionallyspeaking.co.za/privilege-and-inheritance-time-to-disrupt-intergeneration-transfers-of-wealth/>. Estate duty is still levied according to a progressive rate but with only two brackets, namely 20% if the dutiable amount is less than R30 million and 25% to the extent the estate's dutiable amount is above R30 million. When the *Estate Duty Act* was initially introduced it had a more gradual scale that was applied.

³⁷⁹ Meyerowitz 1997 *The Taxpayer* 66.

³⁸⁰ Sections 54-64 of the *Income Tax Act*.

³⁸¹ See s 56(1)(c) and (d) that are exempt from donations tax during the donor's lifetime but included as deemed property under s 3(3)(b) of the *Estate Duty Act*.

³⁸² See s 56(2)(b) of the *Income Tax Act* regarding the annual R100 000 exemption per annum for donations made and s 56(2)(c) of the *Income Tax Act* regarding *bona fide* contributions regarding the maintenance of another person.

Table 3.1: Layout to determine the estate duty liability

Property of the deceased person	A	Section 3(2)
Plus: Deemed property of the deceased person	B	Section 3(3)
Gross value of the estate (A + B)	C	
Less: deductions	D	Section 4(a) to (q)
Net value of the estate (C - D)	E	
Less: section 4A abatement of R3.5 million	(R3 500 000)	Section 4A
Dutiable amount (E – R3 500 000)	F	
Estate duty (F x 20%/25%) ³⁸³	X	

The above overview provides the background against which the recommendation of the previous Commissions of Enquiry discussed below will be measured in the search for a revised *Estate Duty Act*.

3.3 The Commissions of Enquiry

Over the years the South African Government has appointed various Commissions to review and determine the effectiveness of the South African tax structure, including the estate duty system as a wealth transfer tax in South Africa.³⁸⁴ These Commissions include the Margo Commission (1987), the Katz Commission (1997) and the Davis Tax Committee (2016). The purpose of the analysis regarding the previous reviews is to address the question of which recommendations were made by the various Commissions of Enquiry and to what extent are they still relevant today for purpose of the current *Estate Duty Act*. The approach that will be taken in answering the question is to review and analyse the various aspects addressed by each of the Commissions, as well as the recommendations made, to identify which of these recommendations still have bearing today and can be used to identify problem areas under the *Estate Duty Act* and to make recommendations for a revised *Estate Duty Act*.

³⁸³ The applicable rate is dependent on the value of the dutiable amount, if it is below R30 million it is 20% and to the extent it exceeds R30 million, it is 25%. See First Schedule to the *Estate Duty Act*.

³⁸⁴ Roeleveld 2015 *SAJAR* 144.

3.4 The Margo Commission (1987)

3.4.1 Introduction

The Margo Commission was specifically mandated by the Government to enquire into the South African tax structure (including all tax types) to make recommendations for the implementation of a reformed tax structure in South Africa.³⁸⁵ At the onset of its review of the estate duty regime at the time, the Margo Commission reconsidered whether capital is a basis for taxation. The Margo Commission³⁸⁶ stated that since capital is regarded as a contribution to a person's ability to pay taxes, it provides a basis for levying taxes that was also the basis on which estate duty was levied. Although estate duty has already been levied for a considerable amount of time in South Africa and was accepted as a form of taxation, it was not necessarily seen as the recommended way forward.³⁸⁷ The Margo Commission agreed with the OECD's view that the rationale for taxing capital (in the form of an estate duty) is based on social considerations (including horizontal and vertical equity) between people within a society.³⁸⁸ Horizontal equity is about treating people with comparable taxable capacity in a similar way, whereas vertical equity is about taxing people with a higher taxable capacity more in comparison to someone with a lower taxable capacity.³⁸⁹

Therefore, on the premise that capital should be retained as a basis of taxation,³⁹⁰ the Margo Commission reviewed the problems identified under the estate duty regime at the time to recommend an improved way forward.

The main problem that was identified in terms of the estate duty and donations tax regimes was the negative effect of inflation and the ease with which these taxes were avoided.³⁹¹ The negative effect of inflation (also referred to as bracket

³⁸⁵ Margo Commission *Margo Report* 2.

³⁸⁶ Margo Commission *Margo Report* 20.1.

³⁸⁷ Margo Commission *Margo Report* 20.4.

³⁸⁸ Margo Commission *Margo Report* 20.8.

³⁸⁹ Margo Commission *Margo Report* 20.9 and 20.10. See also paras 2.3.2.3 and 2.4.2.1.2 above.

³⁹⁰ Margo Commission *Margo Report* 20.14.

³⁹¹ Margo Commission *Margo Report* para 20.27.

creeping) has the effect that an increasing number of middle-class taxpayers become subject to estate duty. The avoidance of estate duty was achieved using generation-skipping instruments such as trusts. In such an instance the growth assets of a person are donated or sold to a trust by way of a low or interest-free loan and therefore no donations tax arises at the point of sale and the asset is not included in the deceased person's estate for estate duty purposes.³⁹² The value of the planner's estate is effectively "frozen" or "pegged" as the growth in the asset value falls outside the deceased estate and the debt owing will also diminish over time.³⁹³

The Margo Commission in formulating its recommendation regarding a wealth transfer tax on capital stated that due to the administrative and compliance burdens that are associated with an annual or recipient-based tax; no annual wealth tax, inheritance tax or accessions tax should be introduced.³⁹⁴ Instead, the Margo Commission considered how the existing structures in place could be reformed to produce a better wealth transfer tax system and made the recommendations set out below.³⁹⁵

3.4.2 Recommendations by the Margo Commission

The recommendations by the Margo Commission are analysed to determine whether it was accepted and introduced into the *Estate Duty Act*. The purpose of the analysis is to ascertain to what extent it was accepted and introduced into the *Estate Duty Act* and if not, to determine if it holds any relevance for the search for a revised *Estate Duty Act*. Each of the relevant recommendations is discussed below:

³⁹² The Margo Commission acknowledges the fact that taxpayers are allowed to arrange their affairs within the ambit of the law to minimise their tax liability (see *CIR v Kohler* 1953 2 SA 584 (A) para 591 and Margo Commission *Margo Report* para 20.29).

³⁹³ Margo Commission *Margo Report* 20.28. The current s 7C of the *Income Tax Act* introduced a deemed donation in the hands of the person who sold the asset to the trust for a low or interest-free loan. See also Coetsee *Introducing Measures to Prevent Estate Duty and Donations Tax Avoidance – Section 7C* 1-23; Investonline 2022 <https://www.investonline.co.za/trusts-for-financial-and-estate-planning/>; Van Gijsen 2016 *Insurance and Tax Journal* 1; Mukoma *The Effectiveness of the Introduction of Section 7C* 17-23 and Davis, Jooste and Beneke *Estate Planning* 2.9.2A and 6.3.6BA.

³⁹⁴ Margo Commission *Margo Report* 20.50.

³⁹⁵ Margo Commission *Margo Report* 20.50.

3.4.2.1 Capital transfer tax

The Margo Commission³⁹⁶ proposed a capital transfer tax³⁹⁷ to replace the existing estate duty and donations tax systems.³⁹⁸ The recommendation was accepted in principle, however, due to the time and complexity involved in drafting new legislation, "interim relief" was provided through corresponding amendments to the *Estate Duty Act*.³⁹⁹ Meyerowitz⁴⁰⁰ is of the view that the "interim relief"⁴⁰¹ was so close to the proposed capital transfer tax that there was no need for a new Act as the *Estate Duty Act* served that purpose. Muller⁴⁰² and Roeleveld⁴⁰³ confirm that it proved to be true. The OECD⁴⁰⁴ also supports the reform of an existing wealth transfer tax system in comparison to a repeal or introduction of a new tax.

Meyerowitz⁴⁰⁵ further cautions that a capital transfer tax may include such complexity that may lead to the inclusion of additional property in the estate duty net that was never included under the *Estate Duty Act* and encourage tax planning opportunities due to the uncertainty that may be created by the law. Muller⁴⁰⁶ states that the inconsistencies⁴⁰⁷ between the estate duty and donations tax systems provided a solid basis for why the Margo Commission identified a lack of integration between the two wealth transfer taxes that led to the need for tax reform and the recommendation of a capital transfer tax. Ostler⁴⁰⁸ agrees with Muller on the lack of

³⁹⁶ Margo Commission *Margo Report* 20.50. Although the recommendation was for a capital transfer tax, the recommendations are still relevant for this thesis to propose new perspectives to the current *Estate Duty Act*.

³⁹⁷ In formulating its recommendation, the Margo Commission opposed the introduction of a new CGT and proposed the capital transfer tax even though it would also operate like a CGT (see Margo Commission *Margo Report* 20.50).

³⁹⁸ Margo Commission *Margo Report* 20.50.

³⁹⁹ Meyerowitz 1988 *The Taxpayer* 57.

⁴⁰⁰ Meyerowitz 1988 *The Taxpayer* 120.

⁴⁰¹ The interim relief refers to the various amendments proposed for the *Estate Duty Act*. See paras 3.4.2.3 to 3.4.2.10 below for a discussion of each of the recommendations made.

⁴⁰² Muller *Wealth Transfer Taxation* 94.

⁴⁰³ Roeleveld 2015 *SAJAR* 145.

⁴⁰⁴ OECD *Inheritance Taxation in OECD Countries* 122.

⁴⁰⁵ Meyerowitz 1988 *The Taxpayer* 59-60.

⁴⁰⁶ Muller *Wealth Transfer Taxation* 435.

⁴⁰⁷ Muller discussed the inconsistencies in detail in her doctoral thesis (see Muller *Wealth Transfer Taxation* 225-229). The inconsistencies include, amongst others, the different Acts applicable, the different jurisdictional bases, the different valuation rules and the unilateral relief available.

⁴⁰⁸ Ostler *The Impact of Estate Planning* 57-58.

integration between estate duty and donations tax and support the Margo Commission's view that a reform is required. It is agreed with Muller and Ostler that a reform is required, however, it is submitted that, by taking into account the challenges of SARS in capacity and resources,⁴⁰⁹ as well as the time delay in drafting new legislation and developing the required knowledge, such reform should be in the form of revisions to the existing *Estate Duty Act* instead of introducing an entirely new system. The OECD's recommendation for a reform instead of a repeal is supported.

3.4.2.2 Tax rate

A combined death and gift tax was proposed that is imposed at a flat rate of 15%⁴¹⁰ on the disposition of property for no consideration.⁴¹¹ Although the recommended combined tax was not introduced, the progressive rates for estate duty were replaced with a flat rate of 15% for both estate duty⁴¹² and donations tax, separately.⁴¹³

Meyerowitz⁴¹⁴ welcomes the flat rate on the basis that it reduced the appetite for tax planning opportunities. Natrass⁴¹⁵ is however of the view that although the reduced flat rate was introduced to support the principle of simplicity, it did not align with the principle of equity. Natrass⁴¹⁶ further states that the previous progressive rates supported vertical equity and therefore better served the principle of equity as well as the objective of taxation to redistribute wealth in society. Dunton, Carpenter and Mabutha⁴¹⁷ agree that estate duty is not necessarily generating revenue but is breaking down condensed wealth, which implies progressive tax rates

⁴⁰⁹ Meyerowitz 1998 *The Taxpayer* 7.

⁴¹⁰ The maximum marginal rate for estate duty rate at the time was 35% and for donations tax, 25%. The low rate was intended to afford an opportunity to simplify the rules to determine the tax base. See Margo Commission *Margo Report* 20.53.

⁴¹¹ See Margo Commission *Margo Report* 20.53. In the case of property disposed of for inadequate consideration, the tax is levied on the difference between the full consideration and the actual consideration.

⁴¹² Section 16(1) of the *Taxation Laws Amendment Act* 87 of 1988.

⁴¹³ See Margo Commission *Margo Report* 20.53.

⁴¹⁴ Meyerowitz 1988 *The Taxpayer* 59.

⁴¹⁵ Natrass 1987 *Indicator SA* 27.

⁴¹⁶ Natrass 1987 *Indicator SA* 27.

⁴¹⁷ Dunton, Carpenter and Mabutha "The Hand Which Reaches Beyond the Grave" 302.

are more suitable. The OECD⁴¹⁸ also supports progressive tax rates as it enhances vertical equity and has redistributive effects. The flat rate remained until a progressive rate was reintroduced in 2018 that consists of two flat rates of 20% and 25% based on recommendations made by the DTC.⁴¹⁹

3.4.2.3 Deemed donations

Dispositions that were made for an inadequate consideration were recommended to be subject to tax to the extent they were inadequate.⁴²⁰ A disposition made for inadequate consideration was inserted as a deemed donation under section 3(3)(cB) of the *Estate Duty Act* at the time and tax was levied on the difference between the full value and the actual consideration.⁴²¹

Meyerowitz⁴²² supports the change as an attempt to overcome an avoidance scheme where such donations were going forward to be included as deemed property in the estate.⁴²³ Roeleveld⁴²⁴ also states that the introduction of CGT in 2001 has taken care of the Margo Commission's concern that estate duty is avoided when assets are moved before a taxpayer's death that did not trigger donations tax or CGT when it was sold. The OECD⁴²⁵ supports the taxation of gifts made during a person's lifetime to mitigate the possible avoidance of estate duty that may occur in the absence of such treatment.

⁴¹⁸ OECD *Inheritance Taxation in OECD Countries* 124.

⁴¹⁹ See para 3.6.2.4 below.

⁴²⁰ Margo Commission *Margo Report* 20.53.

⁴²¹ Margo Commission *Margo Report* 20.54. Section 3(3)(cB) read with s 3(4) were inserted by s 9(1)(b) of the *Taxation Laws Amendment Act* 87 of 1988 and applied with effect from 16 March 1988 as a response to the Margo Commission's recommendations. However, the provisions were deleted again by s 7(a) of the *Taxation Laws Amendment Act* 97 of 1933. See also Meyerowitz 1988 *The Taxpayer* 80.

⁴²² Meyerowitz 1988 *The Taxpayer* 120.

⁴²³ The inclusion of the deemed property provision (especially in the case of a family company) was mitigated by the application of s 4(p) of the *Estate Duty Act* in that where the deceased owned shares in a family company, a deduction was allowed for any deemed property included under s 3(3)(cB) if such property was considered to value the shares (see Meyerowitz 1988 *The Taxpayer* 120).

⁴²⁴ Roeleveld 2015 *SAJAR* 145-146. Section 7C of the *Income Tax Act* introduced an additional measure to combat avoidance schemes regarding assets moved to a trust or company by way of a low or interest-free loan.

⁴²⁵ OECD *Inheritance Taxation in OECD Countries* 125.

3.4.2.4 Section 4A abatement

The bulk concessional deductions and abatements were recommended to be replaced with a lump sum deduction of R10 000 per annum during a person's lifetime and R250 000 on death. These values should be adjusted regularly to compensate for the impact of inflation.⁴²⁶

The recommendation was, however, not implemented in its suggested form. Instead, the available deductions and abatements were withdrawn and replaced with a single abatement of R1 million under section 4A of the *Estate Duty Act*⁴²⁷ for every estate. The deductions and abatements that were withdrawn included –

- (a) the deduction for proceeds of life insurance policies;⁴²⁸
- (b) the deduction for investments in public stocks and bonds and stock issued by the Land and Agricultural Bank of South Africa;⁴²⁹
- (c) the primary abatement of R100 000;⁴³⁰
- (d) the abatement of R100 000 for a surviving spouse;⁴³¹
- (e) the abatement of R80 000 for each surviving child of the deceased person;⁴³²
and

⁴²⁶ Margo Commission *Margo Report* 20.54.

⁴²⁷ Section 11(1) of the *Taxation Laws Amendment Act* 87 of 1988. See Margo Commission *Margo Report* 20.54.

⁴²⁸ Section 4(k) of the *Estate Duty Act* that previously provided for a maximum deduction of R50 000 on dutiable insurance policies was deleted by s 10(1)(b) of the *Taxation Laws Amendment Act* 87 of 1988. See also para 4.2.2.2.2 below where it was considered to introduce a tax-free threshold for life insurance policies, but the proposal was subsequently withdrawn by National Treasury as it was creating the potential for estate duty avoidance. (See National Treasury *Budget Tax Proposals* 2008/09 30; Joffe 2008 *Tax Breaks* 8 and Joffe 2009 *De Rebus* 42).

⁴²⁹ Section 4(l) of the *Estate Duty Act* that previously allowed for a deduction up to a maximum of R100 000 less the deduction allowed under s 4(k) of the *Estate Duty Act* and deleted by s 10(1)(c) of the *Taxation Laws Amendment Act* 87 of 1988.

⁴³⁰ Section 4A(a) of the *Estate Duty Act*.

⁴³¹ Section 4A(d) of the *Estate Duty Act*.

⁴³² Section 4A(b) of the *Estate Duty Act*.

- (f) the abatement of R80 000 for each predeceased child of the deceased person who left a surviving descendant.⁴³³

Meyerowitz⁴³⁴ supports the section 4A amendment as it sufficiently made up for the other rebates (listed above) that were deleted. He also states that it may reduce bequests to surviving spouses as bequests to other persons were encouraged due to the R1 million available abatement. The South African Institute of Chartered Accountants (SAICA),⁴³⁵ however, states that although the increased abatement was supported, it should be adjusted for inflation to prevent bracket creeping from happening that may cause the estate of unintended taxpayers to become subject to estate duty. The OECD⁴³⁶ encourages a "tax-free" threshold for inheritances, especially from an equity perspective and through the adjustment of inflation it is ensured that the relevant group of taxpayers are subject to estate duty. The single abatement also promoted the canon of simplicity as well as the canon of certainty in comparison to the different abatements.

3.4.2.5 Bequests to a spouse or charity

The deductions for disposals to a surviving spouse under section 4(q) and disposals to charitable, religious or educational organisations under section 4(h) were recommended to be retained.⁴³⁷ The recommendations were accepted and resulted in no changes to the *Estate Duty Act* in this regard.⁴³⁸

⁴³³ Section 4A(c) of the *Estate Duty Act*.

⁴³⁴ Meyerowitz 1988 *The Taxpayer* 59, 120.

⁴³⁵ SAICA 1997

https://www.saica.co.za/integritax/1997/418_Tax_Commission_4th_interim_report_capital_transfer_tax.htm.

⁴³⁶ OECD *Inheritance Taxation in OECD Countries* 124.

⁴³⁷ Margo Commission *Margo Report* 20.54. The OECD acknowledges the rationale behind the preferential tax treatment on bequests to charities and although such treatment is encouraged, it is recommended that it should be limited to prevent abuse (see OECD *Inheritance Taxation in OECD Countries* 124).

⁴³⁸ Meyerowitz 1988 *The Taxpayer* 59.

3.4.2.6 Low or interest-free loans and preference share schemes

Low or interest-free loans,⁴³⁹ as well as the use of preference shares⁴⁴⁰ as a means of financing to transfer real wealth for inadequate consideration, were recommended to be subject to tax to protect the tax base. The recommendation was not accepted as it required further consideration.⁴⁴¹

Commentary received at the time agreed that no action should be taken as little revenue will be collected and new avoidance schemes may be triggered.⁴⁴² Meyerowitz⁴⁴³ and Davis, Beneke and Jooste⁴⁴⁴ agree with the recommendation and highlight the technical point that the failure to institute a claim for outstanding performance (when the donor does not enforce the repayment of the low or interest-free loan) does not constitute a renunciation of a right. Muller⁴⁴⁵ states that by allowing a right to prescribe, effectively removes an asset from the creditor's estate without any adverse tax consequences. The same avoidance schemes were raised in the Katz Commission's review⁴⁴⁶ as well as the DTC's review which finally resulted in the introduction of section 7C of the *Income Tax Act*.⁴⁴⁷

3.4.2.7 Generation-skipping instruments

Generation-skipping instruments, such as trusts should be subject to tax after a lapse of a certain period if the beneficiaries did not enjoy a vested right. A recommendation of 15 years was made.⁴⁴⁸ Although the recommendation was

⁴³⁹ Although no changes were made to tax legislation at the time of the Margo Commission's recommendations, s 7C was inserted in 2017 into the *Income Tax Act* to address the issues raised. The government was of the view that the recommendation requires further consideration before it is accepted. See also Meyerowitz 1988 *The Taxpayer* 80(b).

⁴⁴⁰ The recommendation to tax preference share schemes was done on the same basis as with trusts where transfer of wealth takes place (and in the latter instance relevant to a company) for inadequate consideration (see Margo Commission *Margo Report* 20.56).

⁴⁴¹ Margo Commission *Margo Report* 20.56-20.57.

⁴⁴² Meyerowitz *Meyerowitz on Income* 31.4.

⁴⁴³ Meyerowitz *Meyerowitz on Income* 31.4.

⁴⁴⁴ Davis, Beneke and Jooste *Estate Planning* 11.4.

⁴⁴⁵ Muller *Wealth Transfer Taxation* 255.

⁴⁴⁶ See para 3.5.2.8 below.

⁴⁴⁷ See para 3.6.2.8 below.

⁴⁴⁸ Margo Commission *Margo Report* 20.57.

accepted in principle, it was never implemented in fiscal legislation.⁴⁴⁹ Davis, Beneke and Jooste⁴⁵⁰ also comment that such a recommendation has never been implemented in a foreign jurisdiction. Muller⁴⁵¹ also does not support periodic taxation due to the complexity of drafting legislation, the administrative burden, and the cost-inefficiencies it would result in.

In the case of a limited interest that may grant a generation-skipping advantage, the Margo Commission advised treating the holders of such interest as having an interest in a portion of the full dominium itself.⁴⁵² The recommendation was noted but no further action was taken in this regard.⁴⁵³ Muller⁴⁵⁴ does not agree on the basis that although it may seem that such a proposal would reduce the manipulation regarding the valuation of limited interests, the issue that arises is that the taxation of the underlying property's bare dominium would be deferred until the full ownership in the property is realised, which brings to the table a completely different approach.

3.4.2.8 Specific anti-avoidance rules

The Margo Commission stated that specific anti-avoidance rules must be introduced, however little reasoning or further explanations were provided.⁴⁵⁵ This recommendation remained unattended at the time but the underlying issue remained as the absence of specific anti-avoidance rules was again raised during the reviews done by the Katz Commission⁴⁵⁶ and the DTC.⁴⁵⁷ Although to date no new specific anti-avoidance rules were introduced under the *Estate Duty Act*, it

⁴⁴⁹ Davis, Beneke and Jooste *Estate Planning* 2.8I.

⁴⁵⁰ Davis, Beneke and Jooste *Estate Planning* 2.8I.

⁴⁵¹ Muller *Wealth Transfer Taxation* 258.

⁴⁵² Margo Commission *Margo Report* 20.57.

⁴⁵³ Meyerowitz 1988 *The Taxpayer* 80(b).

⁴⁵⁴ Muller *Wealth Transfer Taxation* 239.

⁴⁵⁵ Margo Commission *Margo Report* 20.58. The OECD encourages the design of specific legislation to address avoidance schemes (including the use of a trust or similar structures), however, the design of such legislation depends on each country's legislative framework (see OECD *Inheritance Taxation in OECD Countries* 126).

⁴⁵⁶ See para 3.5.2.8 below.

⁴⁵⁷ See para 3.6.2.8 below.

remains a relevant issue as avoidance behaviour is always an aspect of a tax system that must continuously be monitored and addressed.⁴⁵⁸

3.4.2.9 Payment rules

The Margo Commission recommended that the capital transfer tax⁴⁵⁹ payable on donations made during a person's lifetime should be primarily paid by the donor and secondarily by the donee, and where the latter applies, a deduction should be allowed for the tax paid in determining the base.⁴⁶⁰ The recommendation was accepted and corresponding amendments were made to the *Estate Duty Act*.⁴⁶¹ The primary liability for the tax on donations made during the donor's lifetime was inserted on the donor and if he or she failed to pay, it rested on the donee.⁴⁶²

The Margo Commission⁴⁶³ proposed that any capital transfer tax payable on transfers at death, should be payable by the estate. The recommendation was accepted in principle, however, in the absence of the introduction of the new capital transfer tax, the principle already applied for estate duty purposes where the executor is liable for any estate duty payable unless any of the exceptions under section 11 of the *Estate Duty Act* for insurance policies, donations or limited interests apply where it may be payable by the beneficiary.

Recognising the concern of liquidity about deceased estates, the Margo Commission recommended a payment period of five years, subject to market-related interest being charged, for tax liability upon death.⁴⁶⁴ The recommendation was not accepted, and no changes were introduced under the *Estate Duty Act*. A delayed payment period may be a valid proposal on the basis that the liquidity of an estate

⁴⁵⁸ De Vos 2020 <https://constitutionallyspeaking.co.za/further-thoughts-on-the-disruption-of-the-intergenerational-transfers-of-wealth/>. See also para 4.2.7 for a detailed discussion on specific anti-avoidance measures as well as possible recommendations for consideration.

⁴⁵⁹ On the basis that the recommended new capital transfer tax was not introduced, the reference by the Margo Commission in this recommendation implies estate duty.

⁴⁶⁰ Margo Commission *Margo Report* 20.59.

⁴⁶¹ Meyerowitz 1988 *The Taxpayer* 80(b).

⁴⁶² Section 11(b)(ii) of the *Estate Duty Act* was amended to include the person liable to pay the tax on deemed donations under s 3(3)(cB) of the *Estate Duty Act*. (See s 13(1) of the *Taxation Laws Amendment Act* 87 of 1988 and Meyerowitz 1988 *The Taxpayer* 80(b)).

⁴⁶³ Margo Commission *Margo Report* 20.59.

⁴⁶⁴ Margo Commission *Margo Report* 20.60.

is often a difficulty in that the funds are stuck in the assets of the estate. Enforcing payment may result in the unforeseen sale of assets to settle tax liabilities that may create further challenges for beneficiaries.

3.4.2.10 Miscellaneous

The period regarding the deduction for certain books, pictures, statuary, or other works of art which are lent under a notarial deed to the State, or certain other bodies for a period not less than 50 years, was recommended to be reduced to 30 years.⁴⁶⁵ The recommendation was accepted and implemented.⁴⁶⁶

The deduction of a limited interest that was created by a predeceased spouse should be disallowed if the limited interest enjoyed by the deceased person was included in the estate of the predeceased spouse.⁴⁶⁷ The concession should not be allowed for any rights that exist after 1 November 1984.⁴⁶⁸

3.4.3 Summary of findings

The Margo Commission concluded that a capital transfer tax (as a combined estate duty and donations tax) will eliminate the erosion of the estate duty tax base and the levying of a low tax rate will hinder tax avoidance schemes.⁴⁶⁹ Although the principle of simplicity was enhanced by these recommendations, it was criticised for not keeping intact with the principle of equality and honouring the redistribution of wealth tax objective through the application of progressive tax rates.

⁴⁶⁵ Margo Commission *Margo Report* 20.63.

⁴⁶⁶ Meyerowitz 1988 *The Taxpayer* 80(b). Section 4(o) of the *Estate Duty Act* was amended by s 10(1)(f) of the *Taxation Laws Amendment Act* 87 of 1988 to reduce the period of 50 years to 30 years. See Margo Commission *Margo Report* 20.63.

⁴⁶⁷ Recommendations were also made to s 4(m) of the *Estate Duty Act* where limited interests or rights included in the estate of the deceased person that was created and the related property was included in a predeceased spouse's estate for which no deduction under s 4(q) was allowed to determine the net value of the predeceased spouse's estate. The recommendation was to delete the deduction for such interests or rights after 1 November 1984. Section 4(m) was amended under s 10(1)(d) of the *Taxation Laws Amendment Act* 87 of 1988 with effect from 16 March 1988 and still applies. See Margo Commission *Margo Report* 20.64.

⁴⁶⁸ Margo Commission *Margo Report* 20.64.

⁴⁶⁹ See paras 3.4.2.1 and 3.4.2.2 above.

Most of the recommendations by the Commission were accepted and introduced by the *Taxation Laws Amendment Act 87 of 1988*. The *Estate Duty Act* was amended for estate duty and the *Income Tax Act* for donations tax.⁴⁷⁰ The relevant amendments under the *Estate Duty Act* included the introduction of a deemed donation under section 3(3)(cB) of the *Estate Duty Act*, the introduction of a lump sum rebate at death,⁴⁷¹ and replacing the progressive rate structure with a flat rate of 15%.⁴⁷² These amendments to the *Estate Duty Act* were regarded as an "interim relief" instead of the new legislation to be brought in for the proposed capital transfer tax.⁴⁷³ The amendments came close to the recommendations made by the Commission that should be contained in a capital transfer tax, that there was no longer a need for a new piece of legislation.⁴⁷⁴ To date, no new legislation has been drafted, which also reflects the final recommendations by the Katz Commission,⁴⁷⁵ as well as those of the DTC.⁴⁷⁶ The recommendation for specific anti-avoidance rules concerning estate duty was not attended to but still has relevance and will be addressed in the recommendations by both the Katz Commission⁴⁷⁷ and the DTC⁴⁷⁸ before proposals will be considered in Chapter 4. Although the proposal for delayed payment rules under certain circumstances was not accepted, it is submitted that the recommendation bear relevance for the reasons set out above.⁴⁷⁹

The following section will analyse the review done by the Katz Commission on the estate duty system and specifically consider the recommendations made in that regard to determine its relevance for the *Estate Duty Act*.

⁴⁷⁰ Meyerowitz 1988 *The Taxpayer* 57-59.

⁴⁷¹ Section 11(1)(a) of the *Taxation Laws Amendment Act 87 of 1988*.

⁴⁷² Section 16(1)(a) of the *Taxation Laws Amendment Act 87 of 1988*.

⁴⁷³ Muller *Wealth Transfer Taxation* 93-94.

⁴⁷⁴ Muller *Wealth Transfer Taxation* 94.

⁴⁷⁵ See para 3.5.2.1 below.

⁴⁷⁶ See para 3.6.2 below.

⁴⁷⁷ See para 3.5.2.8 below.

⁴⁷⁸ See para 3.6.2.8 below.

⁴⁷⁹ See para 3.4.2.9 above.

3.5 The Katz Commission (1997)

3.5.1 Introduction

The Katz Commission followed the Margo Commission with a similar mandate to inquire into certain aspects of the South African tax system, including wealth transfer taxes. In 1997, the Katz Commission dealt with capital transfer tax and published the *Fourth Interim Report on Capital Transfer Tax*.⁴⁸⁰ The Katz Commission concurred with the Margo Commission's recommendation for a capital transfer tax and noted that it already existed in the form of estate duty and donations tax.⁴⁸¹ The Katz Commission stated that the objective in designing a capital transfer tax must reconcile the following three factors:

- (a) The most effective utilisation of SARS' limited resources.
- (b) The avoidance of unnecessary complexity.
- (c) The greatest possible achievement of vertical and horizontal equity in the tax system.⁴⁸²

Since South Africa had an existing form of capital transfer tax through its estate duty and donations tax system, the Katz Commission was of the view that a repeal thereof would raise serious questions about the equitable balance of the tax system and instead made various recommendations to improve the existing *Estate Duty Act* at the time.⁴⁸³

Although the Katz Commission was of the view that estate duty should remain despite its support of a capital transfer tax,⁴⁸⁴ it was acknowledged that a problem existed regarding estate duty avoidance schemes. Although a taxpayer is entitled to arrange his or her affairs within the ambit of the law to limit his or her tax

⁴⁸⁰ Available at <http://www.treasury.gov.za/publications/other/katz/default.aspx>.

⁴⁸¹ Katz Commission *Fourth Report* 1.5.

⁴⁸² Katz Commission *Fourth Report* 1.12.

⁴⁸³ Katz Commission *Fourth Report* 5.4. This recommendation is in line with the OECD's view that existing systems should be reformed instead of replaced or repealed (see OECD *Inheritance Taxation in OECD Countries* 122).

⁴⁸⁴ Katz Commission *Fourth Report* 1.5

liability,⁴⁸⁵ the Commission acknowledged that schemes were often entered into to "peg" the value of assets with growth and provide for potential generation-skipping that results in the future growth of such assets to fall outside the estate of the planner.⁴⁸⁶ The Margo Commission also referred to the same scheme that was utilised to avoid estate duty with relative ease.⁴⁸⁷

Considering the above, the following section will analyse the recommendations made by the Katz Commission, which will be evaluated to establish whether they have been accepted and if not, whether they are still relevant in the search for a revised *Estate Duty Act*.

3.5.2 Recommendations by the Katz Commission

3.5.2.1 Capital transfer tax

The Katz Commission conducted a thorough research project, including an international benchmarking exercise to conclude that South Africa should have a capital transfer tax to achieve horizontal and vertical equity as wealth is highly concentrated in the hands of a small group in society.⁴⁸⁸ This recommendation was however qualified on the basis that South Africa already has a form of capital transfer tax in place through donations tax charged on *inter vivos* capital transfers and estate duty charged on transfers at death.⁴⁸⁹ The Katz Commission concurred with the Margo Commission that donations tax and estate duty should be retained, even if in separate pieces of legislation.⁴⁹⁰

⁴⁸⁵ *CIR v Estate Kohler* 18 SATC 354.

⁴⁸⁶ Delport *The Definition of Property for Estate Duty Purposes* 172.

⁴⁸⁷ Margo Commission *Margo Report* 20.29. See also paras 3.4.2.6 and 3.4.2.7 above for a discussion on the avoidance schemes identified by the Margo Commission that continued to be a problem when the Katz Commission conducted its review.

⁴⁸⁸ Katz Commission *Fourth Report* 1.11, 5.1.

⁴⁸⁹ Katz Commission *Fourth Report* 5.2-5.3.

⁴⁹⁰ Katz Commission *Fourth Report* 5.7-5.8. The estate duty system was to continue operating as a transferor-based tax and did not change to a recipient-based tax. The acceptance of this recommendation is still reflected in the current versions of the *Estate Duty Act* as well as the donations tax provisions under *the Income Tax Act*. SAICA and the South African Institute of Chartered Secretaries and Administrators (SAICSA) supported the recommendation and cautioned that if changes to a single statute are made, ample time should be allowed to react

Furthermore, the Katz Commission, similar to the Margo Commission, did not favour the introduction of a CGT as it was not considered a wealth tax but more a tax on income.⁴⁹¹ Roeleveld⁴⁹² points out that CGT is not a tax on the transfer of wealth but seeks to tax the appreciation of wealth. Roeleveld⁴⁹³ also notes that the capital transfer tax that was recommended, although represented through the existing estate duty and donations tax systems, was like the CGT system that was later introduced in 2001. The introduction of CGT resulted in another type of tax at death that achieved the same objective as the recommended capital transfer tax in the form of the estate duty and donations tax systems.⁴⁹⁴ Dunton, Carpenter and Mabutha⁴⁹⁵ also state that the Commission's position to recommend a capital transfer tax and not a CGT and simultaneously replacing estate duty is relevant on the basis that it wanted to avoid two forms of taxation on wealth for the same event (whether on transfer or appreciation). A further observation was made that the type of tax or the medium through which the event is taxed should not be the focus but rather the fact that capital may be taxed twice.⁴⁹⁶ The continuing relevance of the double tax discussion regarding CGT and estate duty in the search for a revised *Estate Duty Act* is the extent to which relief should be provided under the *Estate Duty Act* on the basis that estate duty remains in force and CGT is levied on the same asset.⁴⁹⁷

to further changes to be made (see also Meyerowitz 1988 *The Taxpayer* 57-58 and Meyerowitz 1998 *The Taxpayer* 5).

⁴⁹¹ Katz Commission *Fourth Report* 7.1.6. See also the discussion in Loubser *Impact of the Davis Tax Committee's First Interim Report on Estate Duty* 29. It should be noted that both the Margo and Katz Commissions conducted their reviews prior to the implementation of CGT under the *Income Tax Act*.

⁴⁹² Roeleveld 2015 *SAJAR* 145.

⁴⁹³ Roeleveld 2015 *SAJAR* 146.

⁴⁹⁴ Roeleveld 2015 *SAJAR* 146. Roeleveld points out that there may be instances where the base cost of an asset may be low or nil which means the same amount on which CGT is levied is the market value of the asset on which the asset is included in the estate for estate duty purposes. It should be noted that this will be the position without considering the CGT and estate duty rebates that apply in the case of death.

⁴⁹⁵ Dunton, Carpenter and Mabutha "The Hand Which Reaches Beyond the Grave" 290.

⁴⁹⁶ Dunton, Carpenter and Mabutha "The Hand Which Reaches Beyond the Grave" 298.

⁴⁹⁷ See para 4.2.7 below where double taxation and the available relief at death is discussed.

Although very few amendments to the *Estate Duty Act* have been made to date,⁴⁹⁸ the Katz Commission made the following recommendation to address the deficiencies in the *Estate Duty Act*:

3.5.2.2 Tax rate

The Katz Commission directed the question about a flat rate versus a progressive rate as a policy decision to the Government.⁴⁹⁹ However, after considering various factors⁵⁰⁰ for and against a progressive estate duty rate, the Katz Commission supported the flat rate for estate duty.⁵⁰¹ From an international analysis regarding the application of a flat rate, it was observed by the Katz Commission that the 15% rate that was applicable at the time was sufficient to avoid extensive estate and tax planning that results in a reduced yield.⁵⁰²

SAICA⁵⁰³ opposed the recommendation of an increased rate on the basis that it results in many taxpayers focusing on tax planning opportunities to avoid the increased tax liability. Meyerowitz⁵⁰⁴ discussed various commentaries to the Katz Commission's report, where various rates were proposed different from the Katz Commission, for example, a flat rate below 20% (SAICA and the Life Offices' Association of South Africa (LOA)) or a flat rate of 35% (SAICSA). The general response was that high tax rates on capital should be avoided. The final change that was introduced by Government was an increased rate of 25%.⁵⁰⁵

⁴⁹⁸ Katz Commission *Fourth Report* 5.10. See also Roeleveld 2015 *SAJAR* 147.

⁴⁹⁹ Katz Commission *Fourth Report* 6.1.

⁵⁰⁰ The factors considered for a flat rate or a progressive rate for donations tax and estate duty included the administrative burden involved, the annual treatment thereof versus lifetime thresholds and equity considerations where a progressive rate may promote equity more. See Katz Commission *Fourth Report* 6.3-6.6.

⁵⁰¹ Katz Commission *Fourth Report* 6.1, 6.4. See also Meyerowitz 1997 *The Taxpayer* 67.

⁵⁰² Katz Commission *Fourth Report* 6.4. See Meyerowitz 1997 *The Taxpayer* 67. The OECD is of the view that a progressive tax rate is more effective as it enhances vertical equity and has a more redistributive effect in comparison to a flat rate (OECD *Inheritance Taxation in OECD Countries* 124).

⁵⁰³ SAICA 1997
https://www.saica.co.za/integritax/1997/418_Tax_Commission_4th_interim_report_capital_transfer_tax.htm. See also Meyerowitz 1998 *The Taxpayer* 6.

⁵⁰⁴ Meyerowitz 1998 *The Taxpayer* 6.

⁵⁰⁵ Section 11(1) of the *Taxation Laws Amendment Act* 37 of 1996 and effective 14 March 1996.

3.5.2.3 Section 4A abatement

The Katz Commission⁵⁰⁶ recommended that the primary rebate of R1 million under section 4A of the *Estate Duty Act* should remain, however, it should be reviewed in future to assess the impact of inflation thereon. SAICA⁵⁰⁷ supported the recommendation that the primary abatement should remain and be adjusted to counter the impact of inflation and proposed a value of R4 million. The rationale was that it would ensure that estate duty was imposed only on those taxpayers who should be subject to estate duty and not extend it to middle-income earners. SAICA⁵⁰⁸ proposed an adjustment every five years in comparison to SAICSA,⁵⁰⁹ who proposed an annual increase in the abatement to align it with inflation. The LOA⁵¹⁰ also supported an increased abatement of R1.5 million with regular adjustments for inflation. An additional observation by the LOA was that should the deductions for spousal bequests be deleted, the abatement should be increased to R2 million. After the Katz Commission's review, the primary abatement was increased to R1.5 million from 1 March 2002,⁵¹¹ then to R2.5 million from 1 March 2006,⁵¹² and the last adjustment was made to R3.5 million from 1 March 2007.⁵¹³ The real-time value of the abatement has not been maintained, especially if one considers the time lapse since its last update 15 years ago.⁵¹⁴

⁵⁰⁶ Katz Commission *Fourth Report* 6.7. The recommendation is aligned with the OECD's view on "tax-free thresholds" (see OECD *Inheritance Taxation in OECD Countries* 124).

⁵⁰⁷ SAICA 1997
https://www.saica.co.za/integritax/1997/418_Tax_Commission_4th_interim_report_capital_transfer_tax.htm.

⁵⁰⁸ SAICA 1997
https://www.saica.co.za/integritax/1997/418_Tax_Commission_4th_interim_report_capital_transfer_tax.htm. See also Meyerowitz 1998 *The Taxpayer* 7.

⁵⁰⁹ Meyerowitz 1998 *The Taxpayer* 7.

⁵¹⁰ Meyerowitz 1998 *The Taxpayer* 6.

⁵¹¹ Section 5(1) of the *Taxation Laws Amendment Act* 30 of 2002.

⁵¹² Section 17(1) of the *Taxation Laws Amendment Act* 9 of 2006.

⁵¹³ Section 1 of the *Taxation Laws Amendment Act* 8 of 2007.

⁵¹⁴ If this amount is to be indexed for inflation, the value today is approximately R8.4 million.

3.5.2.4 Low or interest-free loans

The Katz Commission⁵¹⁵ focused on the estate duty avoidance schemes where assets are sold to a trust on a loan account (low or interest-free loans) with no donations tax implications⁵¹⁶ during the donor's lifetime and the assets are excluded from the estate for estate duty purposes. The growth of the asset is not accounted for in the estate. Similar schemes were identified where preference shares are used as a form of funding to transfer wealth at a low cost.⁵¹⁷ The preference share scheme involves the disposal of assets by the planner during his or her lifetime to a company under an arrangement where the consideration is discharged by way of the issuing of low-coupon preference shares. The value of the asset is therefore "pegged" and removed from the planner's estate. Any growth in the value of the asset is in the company and not included for estate duty purposes, except for the minimal value of the preference shares held.⁵¹⁸

The Katz Commission⁵¹⁹ stated that no specific legislation is required to address the low or interest-free loans and preference share schemes⁵²⁰ and left it to SARS to consider any necessary action. It was proposed that specific anti-avoidance rules⁵²¹ should be considered in future as opposed to general anti-avoidance rules⁵²² and guidance could be sought from the UK.⁵²³

⁵¹⁵ Katz Commission *Fourth Report* 7.3. The Katz Commission was of the view that the lack of interest charged on low-interest or interest-free loans with the disposal of an asset to a trust should be treated as a taxable capital transfer. In 2016, this scheme has been addressed through the insertion of s 7C of the *Income Tax Act*.

⁵¹⁶ There were also no CGT implications as it was only introduced in 2001.

⁵¹⁷ See Katz Commission *Fourth Report* 8.1.

⁵¹⁸ See Katz Commission *Fourth Report* 8.1-8.2 read with 7.6-7.8. See also para 2.2 above.

⁵¹⁹ Katz Commission *Fourth Report* 7.5-7.8.

⁵²⁰ Katz Commission *Fourth Report* 8.1-8.4. Where issues regarding the valuation of preference shares are concerned, the Commission recommended that s 5(1)(f)*bis* of the *Estate Duty Act* should be amended to provide for revaluations when preference shares are used to maintain control of a company.

⁵²¹ Based on international research it was found that the insertion of such specific legislation to remedy the problem against interest-free loans resulted in horrendous complexity with questionable results. See Meyerowitz 1997 *The Taxpayer* 68.

⁵²² Katz Commission *Fourth Report* 9.4. The OECD supports specific measures to address avoidance schemes, but the design should be according to each country's legal framework (see OECD *Inheritance Taxation in OECD Countries* 127).

⁵²³ Katz Commission *Fourth Report* 9.5.

LOA⁵²⁴ criticises the Katz Commission's lack of urgency to address the avoidance schemes and recommended that remedial legislation is essential. Friedland⁵²⁵ and Delport⁵²⁶ do not agree with taking no action and leaving it to SARS to develop anti-avoidance legislation to combat such schemes as they considered it a "major fiscal time bomb".

SAICA⁵²⁷ supports the recommendation on the basis that if any changes were to be made, the necessary enforcement from SARS should be in place and the limitations⁵²⁸ experienced by SARS do not make it feasible. Meyerowitz⁵²⁹ supports the recommendation for specific anti-avoidance measures due to the complexity involved with avoidance schemes.

Although no amendments were made to legislation at the time, section 7C of the *Income Tax Act* was subsequently introduced as a specific anti-avoidance measure to prevent donations tax avoidance using low or interest-free loans to a trust or company.⁵³⁰ A relevant point made by the Katz Commission regarding preference share schemes that should also be considered in the search for a revised *Estate Duty Act* is that when preference shares are used to maintain the control of a company, section 5(1)(f)*bis* of the *Estate Duty Act* should be amended to provide for revaluations.⁵³¹

3.5.2.5 Generation-skipping instruments

Generation-skipping trusts are used as an avoidance mechanism to acquire assets from the planner subject to the trust holding the assets for a period beyond one generation. The effect thereof is that inter-generational transfers of capital take

⁵²⁴ LOA's commentary as referred to in Meyerowitz 1998 *The Taxpayer* 7.

⁵²⁵ Friedland *Financial Mail* 18.

⁵²⁶ Delport *The Definition of Property for Estate Duty Purposes* 174.

⁵²⁷ Meyerowitz 1998 *The Taxpayer* 7.

⁵²⁸ The limitations experienced by SARS included the limited time available to SARS to design new legislation and the lack of capacity and resources (see Meyerowitz 1998 *The Taxpayer* 7).

⁵²⁹ Meyerowitz 1998 *The Taxpayer* 7.

⁵³⁰ Section 12(1) of the *Taxation Laws Amendment Act* 15 of 2016.

⁵³¹ Katz Commission *Fourth Report* 8.1-8.4. See also Delport *The Definition of Property for Estate Duty Purposes* 174-175.

place without attracting any tax liability.⁵³² Further, the trust assets are also excluded from the planner's estate resulting in estate duty savings.

The Katz Commission accepted the conduit principle⁵³³ stipulated in section 25B of the *Income Tax Act* and laid down in common law⁵³⁴ to govern income distributed from or retained in trusts.⁵³⁵ The Katz Commission recommended that the trust assets should be subject to a period valuation (every 25-30 years)⁵³⁶ and be subject to capital transfer tax.⁵³⁷ This has the effect that trust assets should be treated as deemed assets for capital transfer tax purposes to be subject to tax, where they would otherwise be excluded.

SAICA⁵³⁸ criticised the recommendation on the basis that it is incorrect to tax capital growth in a trust. It was also stated that the 25-30 years period is unrealistic as in the absence of a trust the transfer of assets from one generation to the next usually takes 50 years. LOA⁵³⁹ prefers the taxation of a trust to taxing interest-free loans and agrees with the 25-30 years period.

Delpont⁵⁴⁰ criticises the Katz Commission's recommendation as an attempt to disguise the failure in drafting legislation to make the necessary differentiation between different trusts and encourages estate planning activities instead of shrinking it. Delpont⁵⁴¹ also raises a concern regarding the recommendation as it singled out trusts for fiscal scrutiny, whereas companies and close corporations are also used effectively instead of trusts.

⁵³² See Katz Commission *Fourth Report* 10.1.

⁵³³ Katz Commission *Fourth Report* 10.2(a) and Loubser *Impact of the Davis Tax Committee's First Interim Report on Estate Duty* 29.

⁵³⁴ *SIR v Rosen* 1971 1 SA 172 (A).

⁵³⁵ Katz Commission *Fourth Report* 10.2(b).

⁵³⁶ A "period valuation" implies that after a certain period, a tax liability should be raised based on the assets in the trust, for example, every 20 or 25 years. This recommendation is like the recommendation by the Margo Commission for generation-skipping trusts. See para 4.2.2.7 above.

⁵³⁷ Katz Commission *Fourth Report* 10.3(a). The proposed rate was at a rate applicable to *inter vivos* donations and assets without rebates. See Katz Commission *Fourth Report* 10.9.

⁵³⁸ Meyerowitz 1998 *The Taxpayer* 8.

⁵³⁹ LOA's commentary as referred to in Meyerowitz 1998 *The Taxpayer* 8.

⁵⁴⁰ Delpont *The Definition of Property for Estate Duty Purposes* 179.

⁵⁴¹ Friedland *Financial Mail* 21.

The recommendation was made before the inclusion of CGT in the legislation. From 1 October 2001, capital distributions and distributions of capital gains realised in a trust are subject to CGT under paragraph 80 of the Eighth Schedule to the *Income Tax Act*. Loubser⁵⁴² states that the application of the CGT regime in this regard gives in part effect to the recommendation of the Katz Commission that the trust assets should be subject to a capital transfer tax. It is also submitted that the higher CGT and income tax rate for trusts may result in trust schemes being less effective as estate duty saving mechanisms and further making the recommendation by the Katz Commission less relevant in the context of the *Estate Duty Act*.

3.5.2.6 Bequests to a spouse

The justification for the deduction for bequests to a surviving spouse that results in its exclusion from the estate duty has been questioned, especially in light of the equality provisions of the *Constitution* in that a differentiation based on gender or marital status is not justifiable.⁵⁴³ Furthermore, the unit for income tax purposes is the individual whereas in the case of estate duty the marital unit is considered for section 4(q) purposes.⁵⁴⁴

The deduction for estate duty purposes for bequests to a surviving spouse should remain even though it was only for pragmatic grounds.⁵⁴⁵ The retention of the exemption was also encouraged by sociological factors⁵⁴⁶ that prevailed in South Africa at the time.⁵⁴⁷ LOA⁵⁴⁸ provides a contradictory view that the deletion of the deduction will improve the integrity of the tax system in South Africa. The concern

⁵⁴² Loubser *Impact of The Davis Tax Committee's First Interim Report on Estate Duty* 29.

⁵⁴³ Katz Commission *Fourth Report* 11.2(a).

⁵⁴⁴ Katz Commission *Fourth Report* 11.2(b). Section 4(q) of the *Estate Duty Act* provides that any bequests made to the surviving spouse are deducted from the net value of the estate and not subject to estate duty.

⁵⁴⁵ Section 4(q) of the *Estate Duty Act* and Katz Commission *Fourth Report* 11.3.

⁵⁴⁶ Katz Commission *Fourth Report* 1.11(b)-1.11(d) set out the sociological factors that included the fact that all types of families across South Africa do not demarcate the ownership of family assets; it was often difficult to distinguish outright donation and discharging "the duty of support" and when asset transfers were taxed in a significant way (by gift or bequest) the physical transfers were slowed down. Owners would instead keep the asset to accumulate wealth in beneficiaries' hands without any effort on their part.

⁵⁴⁷ Katz Commission *Fourth Report* 11.3.

⁵⁴⁸ LOA's commentary as referred to in Meyerowitz 1998 *The Taxpayer* 9.

raised regarding the deduction's constitutionality was kept aside as the deduction remained, however, it was raised again in the DTC review in 2016.⁵⁴⁹ The OECD⁵⁵⁰ agrees in general with the retention of the preferential treatment to a spousal bequest although a limitation should be considered. If compared with international standards, the deduction is aligned with the international treatment of spousal bequests. The constitutionality of the deduction and its relevance for purposes of making a recommendation is further discussed in paragraph 3.6.2.1 below.

3.5.2.7 Charitable bequests

A need was identified to modify the scope of qualifying social and economically beneficial bequests.⁵⁵¹ According to the Katz Commission, the criteria for the bequest to qualify for the deduction should be tightened.⁵⁵² The Katz Commission⁵⁵³ proposed an alternative to the existing deduction under section 4(h) of the *Estate Duty Act* in that a charitable bequest to certain non-governmental organisations (NGOs)⁵⁵⁴ will continue to form part of the deceased estate for estate duty purposes, but the estate duty attributable to the bequest will be regarded as a deemed payment of estate duty and be applied as a credit against the estate duty liability.

Meyerowitz⁵⁵⁵ states that it would be problematic for Government to decide on qualifying organisations should this recommendation be implemented. He also cautions against the ad hoc approach to qualify for the credit as it would not encourage testators to plan their estates due to the uncertainty as to which NGOs would qualify. The canon of certainty will therefore be undermined. The NGO Coalition⁵⁵⁶ recommends that any selection process should be consultative, a

⁵⁴⁹ See para 3.6.2.1 below.

⁵⁵⁰ OECD *Inheritance Taxation in OECD Countries* 78.

⁵⁵¹ Katz Commission *Fourth Report* 12.1.

⁵⁵² Submissions were made to the Katz Commission to support changes to the estate duty regime to encourage socially and economically beneficial requests. Such bequests promote causes identified by Government as being important to the public good. See Katz Commission *Fourth Report* 12.2-12.3.

⁵⁵³ Katz Commission *Fourth Report* 12.2.

⁵⁵⁴ This type of organisation will be determined periodically (see Katz Commission *Fourth Report* 12.2).

⁵⁵⁵ Meyerowitz 1998 *The Taxpayer* 9.

⁵⁵⁶ Meyerowitz 1998 *The Taxpayer* 9.

prioritised activity-based approach should be followed and only bequests to such NGOs should qualify for the credit. The OECD⁵⁵⁷ also recommends a credit approach according to a set scale instead of a deduction approach based on the bequest made. The credit approach would ensure that all taxpayers receive the same tax benefit for equivalent donations made.⁵⁵⁸

The recommendation to allow for a credit against the estate duty payable for bequests to certain NGOs has not yet been given effect to.⁵⁵⁹ Although the limitation to certain NGOs may be questionable on the basis that the canon of certainty may be infringed, the credit approach is still valid in that it promotes the canon of equity by limiting the abuse of preferential treatment and allowing similar credits to similar bequests.

3.5.2.8 Specific anti-avoidance rules

The Katz Commission,⁵⁶⁰ like the Margo Commission, emphasised the need for specific anti-avoidance rules to counter some of the above-mentioned estate duty avoidance schemes in the absence of any general anti-avoidance rules.⁵⁶¹ The schemes create scope for specific anti-avoidance rules to be considered.

The Katz Commission⁵⁶² did not favour general anti-avoidance rules for estate duty for the following reasons:

- (a) At the time when the transaction is challenged, the founder would have died. This makes the entire issue of evidence and the evaluation thereof very difficult;
- (b) There would be much uncertainty and confusion which would undermine the sensible planning of one's affairs; and

⁵⁵⁷ OECD *Inheritance Taxation in OECD Countries* 127.

⁵⁵⁸ OECD *Inheritance Taxation in OECD Countries* 127. The OECD also makes an alternative recommendation to not allow bequest to heirs with a significantly lower tax burden where if the bequest was directly made to the ultimate beneficiary, it would have resulted in a higher tax burden.

⁵⁵⁹ Katz Commission *Fourth Report* 12.2.

⁵⁶⁰ Katz Commission *Fourth Report* 9.4.

⁵⁶¹ Delport *The Definition of Property for Estate Duty Purposes* 187. See also Katz Commission *Fourth Report* 9.4.

⁵⁶² Katz Commission *Fourth Report* 9.4(a)-(c).

(c) There would be a wasteful proliferation of litigation.

The Katz Commission recommended the introduction of specific anti-avoidance rules over a period of time.⁵⁶³ The Commission also recommended an alternative approach to seek guidance from the specific provisions under the *Inheritance Tax Act*, 1984 (the *Inheritance Tax Act*) in the UK.⁵⁶⁴ The *Inheritance Tax Act* contains rules to counter artificial arrangements to manipulate the value of assets, for example, schemes where an asset is sold but is only delivered or the purchase price is paid more than a year later.⁵⁶⁵ The purchaser then pays more than the selling price and consequently disguises a gift in the delayed purchase price paid. Conversely, the seller may receive less than the true market value and consequently disguise the partial gift of an asset. As an avoidance measure for this scheme, section 262 of the *Inheritance Tax Act* assumes the chargeable transfer at the time of payment or when the asset is transferred at the current value for each occasion to prevent the transfer of value in advance of an asset that is likely to increase in value.⁵⁶⁶ Other provisions include rules for associated operations where transactions are treated as gifts;⁵⁶⁷ or provisions that deter the artificial arrangements in partnerships where an artificial reduction of the market value of shares takes place.⁵⁶⁸

It is worth noting that the UK has since the time of the Katz Commission's review introduced specific rules to combat the avoidance of estate duty that will be discussed in Chapter 5.⁵⁶⁹ The Katz Commission⁵⁷⁰ referred to the UK's rules for purposes of guidance and to illustrate that where a certain method of avoidance exists, specific anti-avoidance rules should be designed to counter the abuse.

Although the recommendation is repeated in each review, including the DTC's,⁵⁷¹ it

⁵⁶³ Similar to the rules set out in s 3(5) and s 5(1)(f) *bis* of the *Estate Duty Act*.

⁵⁶⁴ See Katz Commission *Fourth Report* 9.5. See also para 5.2.9 below where the UK inheritance tax rules are discussed in detail.

⁵⁶⁵ Section 262(1) of the *Inheritance Tax Act*.

⁵⁶⁶ See Katz Commission *Fourth Report* 9.5(d). See also para 3.5.2.8 above.

⁵⁶⁷ Katz Commission *Fourth Report* 9.5(a).

⁵⁶⁸ Katz Commission *Fourth Report* 9.5(b) and (c).

⁵⁶⁹ See para 5.2.9 below.

⁵⁷⁰ Katz Commission *Fourth Report* 9.6.

⁵⁷¹ See para 3.6.2.8 below.

has to date not yet been implemented but still has relevance in the prevention of tax avoidance schemes.

3.5.2.9 Jurisdictional basis

The Katz Commission⁵⁷² was of the view that the estate duty system at the time was levied on a source-based system and the question was whether it should be extended to a residence-based system. Capital assets acquired outside South Africa by way of inheritance or donation from non-residents fell outside the net.⁵⁷³ The Commission⁵⁷⁴ held that although a move to a residence-based system for estate duty would be attractive, they considered such an extension to exceed the enforcement capabilities of South Africa. It was therefore recommended that capital transfer tax should not be imposed on a worldwide basis.⁵⁷⁵

The recommendation by the Katz Commission that estate duty and donations tax (a capital transfer tax) for persons "ordinarily resident" in South Africa should not be imposed on a worldwide basis was made before 2001 when South Africa moved from a source-based taxation system to a residence-based taxation system.⁵⁷⁶ The change in the basis of taxation would have made the recommendation of no effect as the residence-based system resulted in residents being subject to tax on a worldwide basis. Meyerowitz⁵⁷⁷ also expresses the view that since the inception of the *Estate Duty Act*, estate duty was effectively levied on a worldwide basis with a few specific exceptions relating to property outside South Africa that was obtained before becoming ordinarily resident.⁵⁷⁸

⁵⁷² Katz Commission *Fourth Report* 13.1.

⁵⁷³ Section 4(e) of the *Estate Duty Act*.

⁵⁷⁴ Katz Commission *Fourth Report* 13.3.

⁵⁷⁵ Katz Commission *Fourth Report* 13.2-13.4.

⁵⁷⁶ Katz Commission *Fourth Report* 13.2-13.4.

⁵⁷⁷ Meyerowitz 1997 *The Taxpayer* 71.

⁵⁷⁸ The approach is aligned with the most common approach in OECD countries where an estate tax is levied on the worldwide assets of a resident and only on the assets sourced within a country in the case of a non-resident (see OECD *Inheritance Taxation in OECD Countries* 73).

3.5.3 Summary of findings

The Katz Commission in its review of the South African tax system referred to a wealth transfer tax as a measure to reduce the disparity of income and assets between various groups of taxpayers in South Africa.⁵⁷⁹ The Commission concluded that a major justification for a wealth tax is that it promotes horizontal and vertical equity and that the contribution of such a tax to the *fiscus* should not be underestimated.⁵⁸⁰ The Katz Commission considered the applicability of various types of wealth taxes⁵⁸¹ and favoured a transfer tax imposed on the wealth when it is transferred either as a gift *inter vivos* or as a result of death.⁵⁸² Ingram⁵⁸³ states that a wealth transfer tax system can be "measured by its ability to contribute to the reaching of the objectives of taxation". The OECD⁵⁸⁴ also supports the view that a wealth transfer tax levied upon the death of a person has a strong equity argument.

In principle, the Katz Commission supported the Margo Commission's recommendation for a capital transfer tax⁵⁸⁵ but favoured the retention of the existing transferor-based estate duty system.⁵⁸⁶

The Katz Commission made recommendations⁵⁸⁷ for an increased flat rate for estate duty, the retention of the section 4A abatement and the retention of the preferential treatment of bequests to a spouse or charities that were accepted and implemented.⁵⁸⁸ However, at the time, many of the recommendations have been

⁵⁷⁹ Katz Commission *Fourth Report* 1.4.

⁵⁸⁰ Katz Commission *Fourth Report* 1.4 and DTC *First Estate Duty Report* 22.

⁵⁸¹ These taxes included an annual wealth tax, a one-off wealth tax, a land tax and a capital transfer tax. See Katz Commission *Fourth Report* 1.5.

⁵⁸² Katz Commission *Fourth Report* 1.5.

⁵⁸³ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 39.

⁵⁸⁴ OECD *Inheritance Taxation in OECD Countries* 121.

⁵⁸⁵ Katz Commission *Fourth Report* 1.5. See also para 3.5.2.1 above.

⁵⁸⁶ Katz Commission *Fourth Report* 5.8. The Katz Commission agreed that although an inheritance tax would better adhere to the principle of "ability-to-pay", estate duty is easier to administer as one taxpayer is dealt with in comparison to many (see Muller *Wealth Transfer Taxation* 94).

⁵⁸⁷ See paras 3.5.2.1 to 3.5.2.9 above.

⁵⁸⁸ See paras 3.5.2.2; 3.5.2.3; 3.5.2.6 and 3.5.2.7 above. See also Katz Commission *Fourth Report* 14.1-14.16 provides a summary of the recommendations made. See also Muller *Wealth Transfer Taxation* 94.

ignored and the insertion of the CGT regime and the change from a source-based system to a residence-based system of taxation have made some of the recommendations superfluous.⁵⁸⁹ The remainder of the recommendations, for example, indexing the section 4A abatement for inflation,⁵⁹⁰ the design of specific anti-avoidance rules,⁵⁹¹ valuation rules where preference shares are used in estate duty avoidance schemes⁵⁹² and a credit approach against the estate duty payable for certain bequests,⁵⁹³ instead of the existing deduction approach, have not been introduced and are still valid to the existing estate duty regime based on the discussions above.

The following section will analyse the latest review done by the DTC to determine the relevance of its recommendations made in the search for a revised *Estate Duty Act*.

3.6 The Davis Tax Committee (2016)

3.6.1 Introduction

The same concerns of inequality (horizontal and vertical equity) raised by the Katz Commission were faced by the DTC in its mandate to enquire about the progressivity of the South African tax system and the role and relevance of estate duty therein. The DTC was to consider how estate duty can play a more supportive role in enhancing an equitable and progressive tax system.⁵⁹⁴ The DTC was once again faced with the same consideration of a capital transfer tax but concurred with the decisions of the Margo and Katz Commissions to retain the existing estate duty system.⁵⁹⁵ Since the DTC embarked on the premise that estate duty should remain,

⁵⁸⁹ See paras 3.5.2.5 and 3.5.2.9 above. See also Roeleveld 2015 *SAJAR* 147.

⁵⁹⁰ See para 3.5.2.3 above.

⁵⁹¹ See para 3.5.2.8 above.

⁵⁹² See para 3.5.2.8 above.

⁵⁹³ See para 3.5.2.7 above.

⁵⁹⁴ DTC *First Estate Duty Report* 25.

⁵⁹⁵ DTC *First Estate Duty Report* 40-41.

concerns of inequity should be addressed through the revision of the existing *Estate Duty Act* instead of introducing a new wealth tax.⁵⁹⁶

The DTC in its review of the estate duty regime in South Africa, issued the *First Estate Duty Report* in January 2015 followed by the *Final Estate Duty Report* in April 2016.⁵⁹⁷

The question with which the DTC was confronted was: "What is an equitable combined effective estate duty package?"⁵⁹⁸ In addressing the question, the DTC looked at several components relevant to calculating an estate duty liability, but the two main considerations were whether the deduction for a bequest to a surviving spouse should be withdrawn or limited,⁵⁹⁹ and the increase of the section 4A abatement.⁶⁰⁰ In addition, the retention of the retirement exemption under section 3(2)(i) of the *Estate Duty Act* was reviewed, the estate duty rate as well as the existing anti-avoidance rules available under the *Estate Duty Act* set out in section 3(3)(d).⁶⁰¹

Various recommendations made for donations tax and CGT purposes in terms of the *Income Tax Act* fall outside the scope of this study, however, to the extent that the *Estate Duty Act* may be impacted (especially concerning *donatio mortis causa* and the existing double tax effect for CGT) it will be briefly discussed in the search for a revised *Estate Duty Act*.

Each of the relevant recommendations made by the DTC will be discussed below.

⁵⁹⁶ DTC *First Estate Duty Report* 23. The view is supported by the OECD (see OECD *Taxation in OECD Countries* 121).

⁵⁹⁷ Reports issued by the DTC are available at <https://www.taxcom.org.za/library.html>.

⁵⁹⁸ DTC *Final Estate Duty Report* 11.

⁵⁹⁹ DTC *First Estate Duty Report* 51.

⁶⁰⁰ DTC *First Estate Duty Report* 64-65 and DTC *Final Estate Duty Report* 15. The increased abatement was to discourage estate planners from pursuing estate duty savings mechanisms, including trusts.

⁶⁰¹ The DTC placed a lot of focus on trust arrangements which is relevant for this study for the potential redrafting of s 3(3)(d) of the *Estate Duty Act* that deems trust assets to form part of the deceased estate, provided certain requirements were met (see DTC *Final Estate Duty Report* 28-30).

3.6.2 Recommendations by the Davis Tax Committee

The DTC,⁶⁰² in formulating its recommendations, stated that the estate duty system could achieve many of its objectives, subject to some modification, without resorting to drastic measures of implementing a capital transfer tax. The following recommendations were made:

3.6.2.1 Deduction for a bequest to a surviving spouse

Section 4(q) of the *Estate Duty Act* provides for a deduction on any bequest that accrues to the surviving spouse. The deduction under section 4(q) effectively postpones the estate duty liability where the estate is transferred to the surviving spouse.⁶⁰³ For married taxpayers, estate duty liability will be of little effect if the section 4A abatement is used in conjunction with the section 4(q) deduction.⁶⁰⁴

The Katz Commission⁶⁰⁵ addressed the constitutionality of the section 4(q) deduction and was of the view that discrimination based on marital status is no longer appropriate which would render section 4(q) unconstitutional, however, the Katz Commission⁶⁰⁶ recommended the deduction should remain on pragmatic grounds. This conclusion was criticised by the DTC⁶⁰⁷ on the following grounds:

- (a) The exemption is fundamental to the CGT, donations tax and estate duty regimes and the constitutional implications are important and cannot be dismissed on pragmatic grounds alone.

⁶⁰² DTC *First Estate Duty Report* 6, 34. The OECD supports the view that shortcomings of an existing estate taxation system should be fixed through a reform instead of a repeal or the implementation of a new tax (see OECD *Inheritance Taxation in OECD Countries* 53). The South African Institute of Taxation (previously the South African Institute of Tax Practitioners) (SAIT) also supports the retention of the existing estate duty regime but states that any modifications should be well-researched and based on South African conditions to make them feasible and not just based on foreign concepts (see SAIT *Submission on The DTC First Interim Report on Estate Duty* 6).

⁶⁰³ DTC *First Estate Duty Report* 29.

⁶⁰⁴ DTC *Final Estate Duty Report* 12.

⁶⁰⁵ Katz Commission *Fourth Report* 11.3.

⁶⁰⁶ Katz Commission *Fourth Report* 11.3.

⁶⁰⁷ DTC *First Estate Duty Report* 48 and DTC *Final Estate Duty Report* 14.

- (b) The family structures and the development thereof over the years and the growth in single-parent families cannot be ignored.
- (c) The motivation behind bequests is wider to include the maintenance of parents and extended family and not only the spouse and children.⁶⁰⁸
- (d) The definition of "spouse" as the "driver" of the section 4(q) deduction was amended in 2001 to provide for all forms of marriage in South Africa, as well as any relationship, same-sex or heterosexual, that the Commissioner is satisfied is intended to be permanent.⁶⁰⁹ The DTC⁶¹⁰ expressed the concern that the meaning of "permanent" is open for interpretation and subject to manipulation, abuse and the inconsistent application thereof.
- (e) The joint taxation of taxpayers has been removed from the income tax provisions under the *Income Tax Act*, but it continues for purposes of CGT, donations tax and estate duty resulting in inconsistency in the South African tax system.⁶¹¹

The DTC⁶¹² recommended that the *Estate Duty Act* should reflect the same principle of "one taxpayer, one return" as per the *Income Tax Act* for income tax purposes and therefore recommended that the section 4(q) deduction be withdrawn and replaced with an increased, single all-encompassing and equitable primary abatement under section 4A.⁶¹³

The Fiduciary Institute of Southern Africa (FISA) argues that the existing section 4(q) deduction recognises that in most instances of death, the deceased may have been in a relationship. The view by the DTC that there are no pragmatic

⁶⁰⁸ It should be noted that internationally separate exemptions or deductions are provided for children and extended family. However, the OECD strongly recommends against such extended preferential treatment as it reduces the revenue-raising capacity of estate tax and may result in huge transfers of wealth not being subject to any estate tax (see OECD *Inheritance Taxation in OECD Countries* 82).

⁶⁰⁹ See paragraph 4.2.3.2 above for an analysis of the amendments made to the definition of "spouse" in s 1 of the *Estate Duty Act*.

⁶¹⁰ DTC *First Estate Duty Report* 48-49 and DTC *Final Estate Duty Report* 13.

⁶¹¹ DTC *First Estate Duty Report* 49.

⁶¹² DTC *First Estate Duty Report* 51 and DTC *Final Estate Duty Report* 14.

⁶¹³ See para 3.6.2.2 below.

reasons for retaining the deduction, while simultaneously proposing the surviving spouse's abatement be used by the first-dying spouse is flawed.⁶¹⁴ FISA⁶¹⁵ admits that the deduction should be retained as it is fundamental for the survivor's financial stability and recommended as an alternative that the deduction can be capped to ensure that the correct taxpayers, like high-net-worth individuals, are caught in the estate duty net.

FISA⁶¹⁶ also raises the point that spouses are legally responsible to support each other, which may result in a claim under the *Maintenance of the Surviving Spouse Act* 27 of 1990 (the *Maintenance of the Surviving Spouse Act*) against the predeceased spouse's estate. Section 2 of the *Maintenance of the Surviving Spouse Act* stipulates that the surviving spouse will be able to claim a reasonable amount for his or her maintenance from the estate.⁶¹⁷ However, such a claim is qualified in that a claim is only allowed to the extent that the surviving spouse's own means are insufficient.⁶¹⁸ Ingram⁶¹⁹ states that a maintenance claim against a deceased estate is only likely to take place if the surviving spouse's maintenance needs are not provided for through the bequest to the surviving spouse together with his or her own means. Lamprecht⁶²⁰ supports the view that a maintenance claim will not arise if the entire estate is bequeathed to the surviving spouse, however, where the surviving spouse receives only a portion of the predeceased spouse's estate, a maintenance claim may impact the residue of the estate.

⁶¹⁴ See para 3.6.2.3 below for a discussion on the portable abatement under s 4A(2) of the *Estate Duty Act*.

⁶¹⁵ FISA *Comments on the First Interim Report on Estate Duty* 7.

⁶¹⁶ FISA *Comments on the First Interim Report on Estate Duty* 7.

⁶¹⁷ Section 2(1) of the *Maintenance of the Surviving Spouse Act*.

⁶¹⁸ Section 2(1) of the *Maintenance of the Surviving Spouse Act*. The principle is also supported in *Oshry v Feldman* 2010 6 ZASCA 95 (SCA) in that if the predeceased spouse's estate has the means to support the surviving spouse, it will be done provided the surviving spouse does not possess the necessary means. The value of the claim will be determined by considering the needs of the surviving spouse against the ability of the predeceased spouse's estate (see also s 3 of the *Maintenance of the Surviving Spouse Act*).

⁶¹⁹ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 46.

⁶²⁰ Lamprecht 2016 <https://www.pressreader.com/south-africa/the-citizen-gauteng/20160309/282192240083277>.

The South African Institute of Taxation, previously the South African Institute of Tax Practitioners (SAIT)⁶²¹ argues that the DTC's⁶²² statement that estate duty is only paid upon the death of all spouses assumes that spouses only bequeath their assets to surviving spouses. SAIT⁶²³ disagrees on the basis that even though a deduction may be available regarding inter-spousal bequests, it does not automatically result in all assets being bequeathed to the spouse. SAIT⁶²⁴ claims that bequests to a spouse are often followed by a taxable transfer to children.

SAIT's view is supported by the fact that Discovery⁶²⁵ states in 2022 that more than 70% of working South Africans die intestate. Le Roux⁶²⁶ agrees with the statistics and refers to the statistics provided by the Master of the High Court (the Master) that less than 15% of South Africans die with a will. The Master⁶²⁷ explains the intestate succession rules and states that the order of preference is first, the spouse of the deceased, secondly the deceased's children, thirdly the deceased's parent in the absence of a spouse or children and lastly, the deceased's siblings if both the deceased's parents have died.

Van Deventer⁶²⁸ explains that under the intestate succession rules, where the deceased dies leaving a spouse, but no children, the surviving spouse will inherit everything.⁶²⁹ If the deceased is survived by a spouse and children, the spouse will

⁶²¹ SAIT *Submission on The DTC First Interim Report on Estate Duty* 6.

⁶²² DTC *First Estate Duty Report* 29.

⁶²³ SAIT *Submission on The DTC First Interim Report on Estate Duty* 6.

⁶²⁴ SAIT *Submission on The DTC First Interim Report on Estate Duty* 6.

⁶²⁵ Discovery 2022 <https://www.fanews.co.za/article/life-insurance/9/estates-wills/1001/the-number-of-people-in-south-africa-without-a-will-is-concerning-finds-survey/35433>.

⁶²⁶ Le Roux 2023 <https://www.pps.co.za/business-brief/less-15-south-africans-have-will-when-they-pass-away#:~:text=Shockingly%2C%20statistics%20obtained%20in%202022,are%20often%20lost%20in%20translation>.

⁶²⁷ Department of Justice 2023 <https://www.justice.gov.za/master/wills-is.html>.

⁶²⁸ Van Deventer 2022 <https://www.vandeventers.law/Legal-Articles/entryid/2108/what-happens-if-i-die-without-a-will-in-south-africa>.

⁶²⁹ Section 1(1)(a) of the *Intestate Succession Act*.

inherit a child share⁶³⁰ or a total of R250 000, whichever is greater.⁶³¹ The balance will then be equally distributed between the children. Therefore, since most South African residents die intestate, the surviving spouse is not automatically the sole heir, but most estates will devolve to the surviving spouse as well as the children of the deceased, which supports SAIT's view above.

SAIT⁶³² further states that the recommendation is contrary to basic international principles and the existence of the deduction is due to married couples typically operating as a single economic unit. It was noted that it is a common principle of estate duty or succession taxes that the transfer of assets from one generation to the next is subject to the tax but not transfers between spouses.⁶³³ Corresponding relief between married couples for CGT,⁶³⁴ donations tax⁶³⁵ and transfer duty⁶³⁶ recognises that spouses form an economic unit and inter-spousal transfers should therefore not be subject to tax unless tax avoidance is involved.

Perhaps the rationale behind retaining spouses as an economic unit concerning CGT, donations tax and estate duty is due to the taxing events being less frequent and not on an annual basis like income tax, but more event-related, for example, death, a sale, or a donation. Furthermore, the assets involved are often linked with the sustainability of the family unit in the case of death where estate duty or a deemed CGT may arise.

⁶³⁰ A child share is determined by dividing the value of the intestate estate by the number of surviving children of the deceased as well as deceased children who have left descendants, plus the number of surviving spouses (see Department of Justice 2023 <https://www.justice.gov.za/master/wills-is.html> and s 1(4)(f) of the *Intestate Succession Act* to calculate a child's share).

⁶³¹ Section 1(1)(c) of the *Intestate Succession Act*.

⁶³² SAIT *Submission on The DTC First Interim Report on Estate Duty* 7.

⁶³³ SAIT *Submission on The DTC First Interim Report on Estate Duty* 7. This view is based on the principle that a transfer to a surviving spouse is not inter-generational and if the deduction is removed or limited, it may be detrimental to the family. See Loubser *Impact of the Davis Tax Committee's First Interim Report on Estate Duty* 82.

⁶³⁴ The rollover relief for CGT is set out in s 9HA of the *Income Tax Act*.

⁶³⁵ Section 56(1)(a) and (b) of the *Income Tax Act*.

⁶³⁶ Section 9(1)(i) of the *Transfer Duty Act*.

SAICA⁶³⁷ notes that the recommendation would have negative effects on the surviving spouse by placing undue hardship on him or her if the bequest is made subject to estate duty. SAICA⁶³⁸ supports the pragmatic approach recommended by the Katz Commission instead of being overly academic and technically correct. SAICA⁶³⁹ considers the impact of section 4(q) to merely defer the estate duty liability and not to be an avoidance technique. It was therefore proposed that the section 4(q) deduction should remain in place. Considering the current South African conditions and the number of people that die intestate, the critique by SAICA is valid.⁶⁴⁰

After the commentary received by the DTC, it issued the *Final Estate Duty Report*. The recommendation in the *First Estate Duty Report* was sustained in that the section 4(q) deduction regarding spousal bequests as well as the portable primary abatement⁶⁴¹ should be removed from the *Estate Duty Act*.⁶⁴² The DTC's⁶⁴³ main reasoning in both reports was that the same provisions were considered inequitable.

Ingram⁶⁴⁴ has done a study to illustrate the impact of the DTC's recommendation to remove the section 4(q) deduction as well as the portable abatement under section 4A(2) of the *Estate Duty Act*. Ingram⁶⁴⁵ specifically considers the type of spousal relationships and the matrimonial regime that may exist between spouses.

⁶³⁷ SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 3.

⁶³⁸ SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 3.

⁶³⁹ SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 3.

⁶⁴⁰ See Discovery 2022 <https://www.fanews.co.za/article/life-insurance/9/estates-wills/1001/the-number-of-people-in-south-africa-without-a-will-is-concerning-finds-survey/35433> and Le Roux 2023 <https://www.pps.co.za/business-brief/less-15-south-africans-have-will-when-they-pass-away#:~:text=Shockingly%2C%20statistics%20obtained%20in%202022,are%20often%20lost%20in%20translation.>

⁶⁴¹ See para 3.6.2.3 below for the discussion of the portable abatement.

⁶⁴² DTC *Final Estate Duty Report* 14.

⁶⁴³ DTC *Final Estate Duty Report* 14.

⁶⁴⁴ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 49-53.

⁶⁴⁵ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 49-53. Ingram also illustrated in Chapter 2 of his study that under the existing estate duty provisions, all types of spousal relationships, irrespective of the type of matrimonial property regime involved, the tax liability was the same (see Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 21-23).

Based on Ingram's study, it is observed that although the deletion of section 4(q) from the *Estate Duty Act* may contribute to the tax system being equitable towards single-parent households, the estate duty liability will be different for equal taxpayers, being the spouses involved, based on its composition, the marital property regime and the timing of the death of the spouses.⁶⁴⁶

A brief discussion of Ingram's findings regarding each marital property regime will be provided. For ease of reference, the calculations done by Ingram will be shown to illustrate the impact of the recommendation on the estate duty calculation. The basis of Ingram's calculations is a combined estate value of R20 million for both spouses and the assumption that the after-tax estate value of the first-dying spouse remains unchanged in the surviving spouse's estate.⁶⁴⁷

3.6.2.1.1 Marriage in Community of Property

For a marriage in community of property, the joint assets of the estate are jointly owned by the spouses where the total assets are shared equally at the death of the first-dying spouse. In the absence of the section 4(q) deduction, only the primary abatement is available to be used in the first-dying spouse's estate. The second dying spouse will be subject to estate duty on his or her half share of the joint estate as well as the total amount received from the first-dying spouse.

Ingram⁶⁴⁸ illustrated the impact on the estate duty liability as follows:

⁶⁴⁶ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 51, 53.

⁶⁴⁷ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 49.

⁶⁴⁸ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 49.

Table 3.2: Estate duty impact of marriage in community of property

Marriage in community of property	
<u>Death of Spouse A</u>	
Net Value of Estate (Section 4 of EDA)	R 10,000,000.00
Minus Primary abatement (Section 4A EDA)	R -3,500,000.00
Dutiable amount of Estate (Section 4A EDA)	R 6,500,000.00
x 20% (Tax Rate)	R 1,300,000.00
<u>Death of Spouse B</u>	
Net Estate Value of Spouse A (after tax)	R 8,700,000.00
Net Estate Value of Spouse B	R 10,000,000.00
Total Estate Value	R 18,700,000.00
Minus Primary abatement (Section 4A EDA)	R -3,500,000.00
Dutiable amount of Estate (Section 4A EDA)	R 15,200,000.00
x 20% (Tax Rate)	R 3,040,000.00
Total Estate Duty Paid	R 4,340,000.00

Table 4-2: Tax impact of recommendations – Marriage in community of property

3.6.2.1.2 Marriage out of community of property without the accrual system

A marriage out of community of property without the accrual system is where each spouse retains their specific assets and liabilities and the estate duty liability in the event of death will be calculated on the net value of each spouse's estate. If one spouse's estate value is significantly higher than the other spouse's (for example, the homemaker), the order in which the spouse dies may impact the estate duty liability if section 4(q) does not apply. Ingram⁶⁴⁹ illustrates the impact as follows:

⁶⁴⁹ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 50.

Table 3.3: Estate duty impact of marriage out of community of property without the accrual

Marriage out of community of property			
	Equal Estates	Homemaker as first-dying spouse	Homemaker as surviving spouse
<u>Death of Spouse A</u>			
Net Value of Estate (Section 4 of EDA)	R 10,000,000	R -	R 20,000,000.00
Minus Primary abatement (Section 4A EDA)	R -3,500,000	R -3,500,000	R -3,500,000.00
Dutiable amount of Estate (Section 4A EDA)	R 6,500,000	R -3,500,000	R 16,500,000.00
x 20% (Tax Rate)	R 1,300,000	R -	R 3,300,000.00
<u>Death of Spouse B</u>			
Net Estate Value of Spouse A (after tax)	R 8,700,000	R -	R 16,700,000.00
Net Estate Value of Spouse B	R 10,000,000	R 20,000,000	R -
Total Estate Value	R 18,700,000	R 20,000,000	R 16,700,000.00
Minus Primary abatement (Section 4A EDA)	R -3,500,000	R -3,500,000	R -3,500,000.00
Minus Primary abatement of spouse (Section 4A(2) EDA)	R -	R -	R -
Dutiable amount of Estate (Section 4A EDA)	R 15,200,000	R 16,500,000	R 13,200,000.00
x 20% (Tax Rate)	R 3,040,000	R 3,300,000	R 2,640,000.00
Total Estate Duty Paid	R 4,340,000	R 3,300,000	R 5,940,000.00

Table 4-3: Tax impact of recommendation – Marriage out of community of property (without accrual)

Ingram⁶⁵⁰ illustrates that even when the combined estate values of the spouses are equal, the estate duty liability will be different depending on who dies first. If the principle of horizontal equity is considered as discussed in Chapter 2,⁶⁵¹ equal taxpayers should bear equal tax liabilities. Ingram⁶⁵² concludes that if the spouses are considered equal taxpayers, the canon of equity is not adhered to, based on the different tax liabilities that arise. Furthermore, the canon of certainty will also not be adhered to due to the difference in tax liability that will occur depending on who

⁶⁵⁰ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 51.

⁶⁵¹ See para 2.4.2.1.2(a) above.

⁶⁵² Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 51.

dies first between the two spouses. This results in uncertainty as to the ultimate estate duty liability.⁶⁵³

3.6.2.1.3 Marriage out of community of property with the accrual system

In a marriage out of community of property but including the accrual system, the growth of the combined estate value of the spouses after marriage will either result in a liability in the estate of the spouse with the highest growth⁶⁵⁴ and an asset in the estate of the spouse with the smallest growth.⁶⁵⁵

Ingram⁶⁵⁶ illustrates the impact as follows:

⁶⁵³ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 51.

⁶⁵⁴ Section 4(1A) of the *Estate Duty Act*.

⁶⁵⁵ Section 3(3)(cA) of the *Estate Duty Act*.

⁶⁵⁶ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 52.

Table 3.4: Estate duty impact of marriage out community of property with the accrual

Marriage out of community of property including the accrual system			
	Both spouses started with minimal estate value and estates accrued equally	Homemaker as first-dying spouse (assumed that income-earning spouse started with R10 million in estate value)	Homemaker as surviving spouse (assumed that the income-earning spouse started with R10 million in estate value)
<u>Death of Spouse A</u>			
Net Value of estate (Section 4 of EDA)	R 10,000,000	R 5,000,000	R 20,000,000
Property owned by Spouse A (Section 4(2) of EDA)	R 10,000,000	R -	R 20,000,000
* Deemed Property: Accrual Claim against spouse (Section 4(3) of EDA)	R -	R 5,000,000	R -
* Minus accrual claim from surviving spouse (Section 4(1A))			R -5,000,000
Minus Primary abatement (Section 4A EDA)	R -3,500,000	R -3,500,000	R -3,500,000
Dutiable amount of Estate (Section 4A EDA)	R 6,500,000	R 1,500,000	R 11,500,000
x 20% (Tax Rate)	R 1,300,000	R 300,000	R 2,300,000
<u>Death of Spouse B</u>			
Net Estate Value of Spouse A (after tax)	R 8,700,000	R 4,700,000	R 12,700,000
Net Estate Value of Spouse B	R 10,000,000	R 15,000,000	R 5,000,000
Total Estate Value	R 18,700,000	R 19,700,000	R 17,700,000
Minus Primary abatement (Section 4A EDA)	R -3,500,000	R -3,500,000	R -3,500,000
Minus Primary abatement of spouse (Section 4A(2) EDA)	R -	R -	R -
Dutiable amount of Estate (Section 4A EDA)	R 15,200,000	R 16,200,000	R 14,200,000
x 20% (Tax Rate)	R 3,040,000	R 3,240,000	R 2,840,000
Total Estate Duty Paid	R 4,340,000	R 3,540,000	R 5,140,000
<u>* Accrual claim of Homemaker</u>			
Total Estate of income-earning spouse at death of first-dying spouse	R 20,000,000		
Total Estate of income-earning spouse at date of marriage	R -10,000,000		
Accrual in Estate	R 10,000,000		
Spouse's share in accrual (Accrual / 2)	R 5,000,000		

Table 4-4: Tax impact of recommendation – Marriage out of community of property (with accrual)

Ingram⁶⁵⁷ reached the same conclusion as in the case where the accrual system does not apply where the canons of equity and certainty are not adhered to as the estate duty consequences will be different depending on the composition of the estate and the order in which the spouses die.

The calculations above have shown that the deletion of section 4(q) and the portable abatement under section 4A(2) of the *Estate Duty Act* will not adhere to the canon of equity when applied to the different matrimonial property regimes. Ingram⁶⁵⁸ states that the deletion of the section 4(q) deduction and the portable abatement leads to equal taxpayers suffering unequal tax liabilities depending on the composition of their estates and the order of their deaths. Furthermore, the difference in estate duty liabilities depending on the order in which the spouses die leads to uncertainty and therefore the canon of certainty will not be adhered to.⁶⁵⁹

To date, the withdrawal of the section 4(q) deduction for inter-spousal bequests⁶⁶⁰ has not yet been implemented and the retention thereof is consistent with the international standards and the OECD's approach,⁶⁶¹ however, to avoid the DTC's concern for potential abuse, a limitation of the deduction can be considered.

3.6.2.2 Section 4A abatement

The primary abatement under section 4A of the *Estate Duty Act* has been R3.5 million since 1 March 2007. This resulted in a major fiscal drag to enter the estate duty system.

The DTC⁶⁶² in its *First Estate Duty Report* recommended an increased abatement of R6 million. In its review of the primary abatement, the DTC also considered the

⁶⁵⁷ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 52.

⁶⁵⁸ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 53.

⁶⁵⁹ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 53.

⁶⁶⁰ Together with the withdrawal of the s 4(q) deduction it was further proposed that the inter-spousal exemption within the donations tax system should also be removed. An exemption from donations tax for the reasonable maintenance of the taxpayer and their family can remain. See SAICA 2017 https://www.saica.co.za/integritax/2017/2580_Final_Report_on_Estate_Duty.htm.

⁶⁶¹ OECD *Inheritance Taxation in OECD Countries* 75.

⁶⁶² DTC *First Estate Duty Report* 64.

difference in treatment between life insurance policies (subject to estate duty) and retirement fund death benefits (exempt from estate duty). Life policies are seen to provide security to the surviving family members when a young breadwinner passes away as the retirement fund death benefit would still be low in value to truly benefit from the estate duty exemption.⁶⁶³ The final recommendation by the DTC⁶⁶⁴ in its *Final Estate Duty Report* was that the primary abatement under section 4A should substantially increase to R15 million for every taxpayer, irrespective of their marital status. This recommendation goes together with the withdrawal of the section 4(q) deduction.⁶⁶⁵

The DTC⁶⁶⁶ was of the view that the recommendation addressed any concern of financial hardship in relation to the estate duty regime and took care of the inconsistencies associated with the section 4(q) deduction. The recommendation also has the effect that the estate duty regime will apply to high-net-worth individuals and exclude the middle class from the estate duty net.⁶⁶⁷ It is, however, submitted that although the DTC qualified the increased abatement that it is subject to the withdrawal of the section 4(q) deduction, such qualification may be considered misplaced as the need for an increased abatement has been raised throughout the years to combat the impact of inflation and ensure the correct group of taxpayers are subject to estate duty.

SAIT⁶⁶⁸ supported the increased abatement but focused its concerns on schemes where assets are transferred to children free from wealth tax. SAIT⁶⁶⁹ further recommended that a unified estate duty and donations tax limit could be considered, provided it is set at sufficiently high levels. SAICA⁶⁷⁰ welcomed an increase but recommended an annual increase and not a mere one-off increase to counter the

⁶⁶³ DTC *Final Estate Duty Report* 15-16.

⁶⁶⁴ DTC *Final Estate Duty Report* 17-19.

⁶⁶⁵ DTC *Final Estate Duty Report* 17.

⁶⁶⁶ DTC *Final Estate Duty Report* 17. See also par 3.5.2.3 above.

⁶⁶⁷ DTC *Final Estate Duty Report* 18.

⁶⁶⁸ SAIT *Submission on The DTC First Interim Report on Estate Duty* 11.

⁶⁶⁹ SAIT *Submission on The DTC First Interim Report on Estate Duty* 11.

⁶⁷⁰ SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 13.

impact of inflation. The OECD⁶⁷¹ also supports a "tax-free threshold" that is regularly adjusted for inflation to ensure the correct group of taxpayers is included in the net.

Although the recommendation to increase the primary abatement to R15 million contributes to the objectives of taxation through the redistribution of wealth and meets the principle of vertical equity,⁶⁷² it has not yet been implemented. The recommendation is essential to ensure only the wealthy taxpayers are subject to estate duty and the delay in implementation results in the estate duty net being spread too wide catching a much broader spectrum of taxpayers than it is supposed to.

3.6.2.3 Section 4A(2) portable abatement

Section 4A(2) of the *Estate Duty Act* allows any unused portion of the abatement by the first-dying spouse to be transferred to the surviving spouse which may result in a maximum abatement of R7 million in the surviving spouse's estate. The DTC⁶⁷³ in its *First Estate Duty Report* proposed the withdrawal of the portable abatement between spouses and instead allow the surviving spouse's primary abatement as a deduction from the first-dying spouse's estate. The portion of the surviving spouse's primary abatement that was used in the first-dying spouse's estate will reduce the available abatement to the surviving spouse upon his or her death. Ingram⁶⁷⁴ states that the proposal also serves as a portable abatement, however, the timing of when the combined abatement between the two spouses will be used is different to the current portable abatement. Therefore, the proposed repeal of section 4(q) of the *Estate Duty Act* will force spouses to make use of the surviving spouse's primary abatement to reduce the estate duty liability of the first-dying spouse. The impact of the recommendation is that the estate duty liability between spouses can only be deferred to the second-dying spouse. When compared to the existing position where the section 4(q) deduction is available and provided the estate is bequeathed to the surviving spouse, the first-dying spouse will have no estate duty liability due to the

⁶⁷¹ OECD *Inheritance Taxation in OECD Countries* 124.

⁶⁷² Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 56.

⁶⁷³ DTC *First Estate Duty Report* 51.

⁶⁷⁴ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 40.

section 4(q) deduction and the second-dying spouse will have the full R7 million available to reduce the estate duty liability.

The DTC⁶⁷⁵ favoured the withdrawal of the portable abatement on the basis that it promotes inequality as it discriminates against single-parent households. For example, if one compares a married couple with a single parent and both have the same estate value, the single parent will have a higher estate duty liability than the spouses in a spousal relationship where the value of his or her estate exceeds R3.5 million as the portable abatement is not available to such a parent. Ingram⁶⁷⁶ states that the canon of equality is not met on the basis that equal taxpayers (based on their estate value) do not pay equal tax.

The DTC⁶⁷⁷ further acknowledged the double tax effect the recommendation (together with the withdrawal of section 4(q)) may have where the estate value of the first-dying spouse exceeds R7 million. The first-dying spouse will use the available primary abatement of both spouses and when the assets are transferred to the surviving spouse's estate, it will again be subject to estate duty resulting in a double tax effect. The DTC's⁶⁷⁸ recommendation to mitigate the double taxation was to create a table in respect of 10 years and in the case where assets were taxed in the first-dying spouse's estate, it should be excluded from the surviving spouse's estate. However, the effective administration of such a table was questioned, especially based on the canon of the economy in the collection.

SAICA⁶⁷⁹ criticises the recommendation to repeal the portable abatement on the basis that it did not consider the different nuptial agreement arrangements.

The above recommendation was not sustained in the DTC's *Final Estate Duty Report*, instead, the DTC⁶⁸⁰ proposed that the portable abatement under section 4A(2) of the *Estate Duty Act* should be withdrawn together with the section 4(q)

⁶⁷⁵ DTC *First Estate Duty Report* 48.

⁶⁷⁶ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 41.

⁶⁷⁷ DTC *First Estate Duty Report* 51.

⁶⁷⁸ DTC *First Estate Duty Report* 51.

⁶⁷⁹ SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 5.

⁶⁸⁰ DTC *Final Estate Duty Report* 14.

deduction and be replaced with an increased primary abatement available to all taxpayers equally, as discussed above.⁶⁸¹

3.6.2.4 Tax rate

The estate duty rate has since the Katz Commission's recommendation been reduced to 20%⁶⁸² with the introduction of the CGT regime and remained at a flat rate.⁶⁸³ The DTC,⁶⁸⁴ however, revisited the rate structure and recommended a progressive rate⁶⁸⁵ in that the first R30 million of the dutiable value of the estate should be subject to estate duty at 20% and to the extent that it exceeds R30 million, a rate of 25% should apply.⁶⁸⁶ This recommendation was introduced into the law and the estate duty rate was amended with effect from 1 March 2018.⁶⁸⁷

3.6.2.5 Retirement fund benefits exemption

From 1 January 2009, the *Estate Duty Act* was amended to exclude *any* retirement fund death benefits from the property of an estate.⁶⁸⁸ The debate on whether retirement fund death benefits should be retained or amended was revisited by the DTC.⁶⁸⁹ The retirement fund death benefit exemption was seen of limited effect in the case of the untimely death of a taxpayer below the age of 50 years and who also had small retirement savings in comparison to life insurance policies.⁶⁹⁰ The DTC,⁶⁹¹ however, did not extend the exemption to life insurance benefits as based

⁶⁸¹ See para 3.6.2.2 above.

⁶⁸² Section 4 of the *Taxation Laws Amendment Act 5* of 2011.

⁶⁸³ The reduction in the estate duty rate is due to the impact on the liquidity of the deceased estate if both CGT and estate duty is imposed. National Treasury *Explanatory Memorandum to the Taxation Laws Amendment Bill, 2001* 15.

⁶⁸⁴ DTC *Final Estate Duty Report* 18.

⁶⁸⁵ The OECD also supports a progressive tax rate to promote vertical equity and its redistributive effect (see OECD *Inheritance Taxation in OECD Countries* 124).

⁶⁸⁶ First Schedule to the *Estate Duty Act*.

⁶⁸⁷ Section 1(1) of the *Rates and Monetary Amounts and Amendment of Revenue Laws Act 21* of 2018. The amendment applies to any estate of a person who dies on or after 1 March 2018.

⁶⁸⁸ Section 3(2)(i) of the *Estate Duty Act*. Before the exclusion, retirement fund death benefits in the form of annuities were excluded from the property of an estate, but lump sum pay-outs were included as deemed property in the estate. See the deleted s 3(3)(a)*bis* of the *Estate Duty Act*.

⁶⁸⁹ DTC *First Estate Duty Report* 59-61.

⁶⁹⁰ DTC *First Estate Duty Report* 59.

⁶⁹¹ DTC *First Estate Duty Report* 60.

on the statistics available at the time, the value of the insurance policy pay-outs rarely exceeded the R3.5 million abatement and there was no justification for the exemption to include the life insurance benefits.

However, since the insertion of the blanket exemption of all the retirement fund death benefits, estate planning opportunities were created where large amounts were contributed to retirement funds to achieve estate duty savings.⁶⁹² Although the DTC was of the view that the exemption should be retained as per the original rationale to assist families,⁶⁹³ it acknowledged a loophole in respect of excessive contributions made shortly before death that escaped estate duty. On the basis that such a loophole was not the intention of the National Treasury, it was recommended that all retirement fund contributions made on or after 1 March 2015 that were disallowed in determining taxable income, should be included in the estate of the deceased taxpayer.⁶⁹⁴

Section 3(2)(bA) of the *Estate Duty Act* was introduced where any excess contributions that were made after 1 March 2015 that did not qualify for a deduction under section 11F(1) of the *Income Tax Act*⁶⁹⁵ or paragraph 2 of the Second Schedule to the *Income Tax Act*, or exempt under section 10C of that Act, were included as property in the estate.⁶⁹⁶ This amendment took effect from 1 January 2016 and applied to persons who died on or after that date and to contributions made on or after 1 March 2015.

⁶⁹² DTC *First Estate Duty Report* 61 and DTC *Final Estate Duty Report* 12. Such contributions are also referred to as "deathbed retirement fund contributions".

⁶⁹³ The OECD is of the view that the justification for the preferential treatment of pension benefits is limited and may lead to wealth being built up and passed to beneficiaries with minimum tax liabilities (see OECD *Report on Inheritance Taxation in OECD Countries* 125).

⁶⁹⁴ DTC *First Estate Duty Report* 61.

⁶⁹⁵ Section 11F(1) of the *Income Tax Act* states: "Notwithstanding section 23(g), for the purposes of determining the taxable income of a natural person in respect of any year of assessment there must be allowed as a deduction from the income of that person any amount contributed during a year of assessment to any pension fund, provident fund or retirement annuity fund in terms of the rules of that fund by a person that is a member of that fund."

⁶⁹⁶ Section 2 of the *Taxation Laws Amendment Act* 25 of 2015. This recommendation was already made in the DTC's *First Report on Estate Duty* and implemented into the law before the final publication of the DTC's *Final Report on Estate Duty*.

The amendment, however, erroneously included not only excess contributions in terms of section 11F but also amounts which were not taken into consideration in terms of the Second Schedule to the *Income Tax Act* in determining the taxable portion of the death benefit lump sum.⁶⁹⁷

To rectify the error, a retrospective amendment was made to the now repealed section 3(2)(bA)⁶⁹⁸ of the *Estate Duty Act* to include any excess contributions to a retirement fund that was allowed as a deduction under paragraph 5 of the Second Schedule to the *Income Tax Act* in determining the taxable portion of the death benefit lump sum that is deemed to accrue to the deceased person immediately before death.⁶⁹⁹ The amendment was deemed to have come into effect regarding the estate of a person who died on or after 30 October 2019 and applied to any contributions made on or after 1 March 2016.

Subsequently, section 3(2)(bA) of the *Estate Duty Act* was deleted as it was held that the provision was erroneously included in the *Estate Duty Act* as property but should instead have been included as *deemed* property.⁷⁰⁰ A new section 3(3)(e)⁷⁰¹ of the *Estate Duty Act* was inserted that contained the same wording as the repealed section 3(2)(bA).⁷⁰² No further amendments have been made to date.⁷⁰³

⁶⁹⁷ National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019* 50.

⁶⁹⁸ The repealed s 3(2)(bA) of the *Estate Duty Act* stated: "so much of the amount of any contribution made by the deceased in consequence of membership or past membership of any pension fund, provident fund, or retirement annuity fund, as was allowed as a deduction in terms of paragraph 5 of the Second Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962), to determine the taxable portion of the lump sum benefit that is deemed to have accrued to the deceased immediately before his or her death;"

⁶⁹⁹ Section 1 of the *Taxation Laws Amendment Act* 34 of 2019.

⁷⁰⁰ National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020* 50. See also Davis, Jooste and Beneke *Estate Planning* 2.4.7.

⁷⁰¹ Section 3(3)(e) of the *Estate Duty Act* states: "so much of the amount of any contribution made by the deceased in consequence of membership or past membership of any pension fund, provident fund, or retirement annuity fund, as was allowed as a deduction in terms of paragraph 5 of the Second Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962), to determine the taxable portion of the lump sum benefit that is deemed to have accrued to the deceased immediately before his or her death."

⁷⁰² Section 1 of the *Taxation Laws Amendment Act* 23 of 2020. The amendment was also deemed to have come into effect regarding the estate of a person who died on or after 30 October 2019 and applied to any contributions made on or after 1 March 2016.

⁷⁰³ The DTC, in its *Final Estate Duty Report*, did not make any additional recommendation for estate duty purposes apart from standing by its view that the retirement fund death benefit exemption should be retained (see DTC *Final Estate Duty Report* 12). An additional recommendation was

3.6.2.6 Capital Gains Tax

In the reviews by the Katz and Margo Commissions, CGT was not yet applicable and therefore not discussed in detail. The impact of an additional wealth tax was addressed and not considered relevant on the basis that CGT is not a tax on the transfer of wealth but more like an income tax as it aims to tax the appreciation of wealth.⁷⁰⁴

However, in the review of the DTC, CGT has been in operation. Although the DTC was not of the same view as critics about the double tax effect that both CGT and estate duty may have at death, it acknowledged the concerns raised.⁷⁰⁵ The debate about the "double tax effect" of estate duty and CGT at death has been ongoing since the inception of CGT in 2001.⁷⁰⁶

Roeleveld⁷⁰⁷ analyses the argument between either excluding death as a CGT event or abolishing estate duty entirely and concluded that no justification or policy decision is supporting the position that both estate duty and CGT as "wealth taxes" is levied at death on the same asset. This is also evident from the Katz Commission and Margo Commission Reports that did not recommend two capital transfer taxes but only one, namely estate duty.⁷⁰⁸

The DTC,⁷⁰⁹ however, did not agree with the position put forward by Roeleveld on the basis that both CGT and estate duty do not constitute a "wealth tax" imposed on the transfer thereof. CGT is considered an income tax on capital income and estate duty and donations tax are wealth taxes. In the DTC's⁷¹⁰ opinion, there is sufficient relief under the CGT provisions to address the concern of "double taxation

made regarding income tax to increase the maximum deduction of R350 000 for tax-deductible retirement fund contributions under section 11F of the *Income Tax Act* to consider inflation.

⁷⁰⁴ Roeleveld 2015 *SAJAR* 145 and DTC *Final Estate Duty Report* 20.

⁷⁰⁵ DTC *Final Estate Duty Report* 20.

⁷⁰⁶ DTC *Final Estate Duty Report* 19.

⁷⁰⁷ Roeleveld 2015 *SAJAR* 143.

⁷⁰⁸ It is worth noting, however, that both the Margo and Katz Commissions conducted their reviews before the implementation of CGT in 2001. The only point to be taken from this is that the presence of one wealth transfer tax is recommended above two types of tax on the same event.

⁷⁰⁹ DTC *Final Estate Duty Report* 20.

⁷¹⁰ DTC *Final Estate Duty Report* 20.

at death" in this regard. The relief referred to includes the CGT exemption at death of R300 000,⁷¹¹ the roll-over relief for bequests to a resident surviving spouse,⁷¹² the primary residence exclusion⁷¹³ of R2 million, the unlimited exclusions from CGT for retirement fund benefits,⁷¹⁴ personal use assets such as motor cars, personal effects, certain boats and aircraft.⁷¹⁵

On the premise that this study will not reconsider the debate between estate duty and CGT, it is accepted that on the basis that estate duty will remain, relief under the CGT rules fall outside the scope of this study.⁷¹⁶

3.6.2.7 Donations tax

The DTC⁷¹⁷ reviewed the exemptions regarding inter-spousal donations under section 56(1)(a) and (b) of the *Income Tax Act*. The DTC stated that if lifetime donations between spouses do not attract donations tax, such donations are encouraged (especially considering the recommendation to repeal section 4(q) of the *Estate Duty Act*) which may result in significant estate duty savings. Ingram's⁷¹⁸ illustration of the estate duty saving effect raised by the DTC is set out below where it is assumed that the deceased spouse's net asset value is R10 million and R6.5 million is bequeathed to the surviving spouse to fully use the R3.5 million primary rebate.

⁷¹¹ Paragraph 5(2) of the Eighth Schedule to the *Income Tax Act*. This exclusion serves the same purpose for CGT purposes as the primary abatement under s 4A of the *Estate Duty Act* for estate duty purposes.

⁷¹² Section 9HA(2)(a) of the *Income Tax Act*. For CGT purposes, the roll-over relief provisions are limited to the resident surviving spouse. However, the deduction under s 4(q) of the *Estate Duty Act* is available to any surviving spouse, whether or not a resident.

⁷¹³ Paragraph 45 of the Eighth Schedule to the *Income Tax Act*.

⁷¹⁴ Paragraph 54 of the Eighth Schedule to the *Income Tax Act*.

⁷¹⁵ Paragraph 53 of the Eighth Schedule to the *Income Tax Act*.

⁷¹⁶ See also para 3.5.2.1 above for a discussion on the double tax effect.

⁷¹⁷ DTC *First Estate Duty Report* 52.

⁷¹⁸ Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 43-44.

Table 3.5: The difference between a spousal bequest and a donation

Scenario 1: Bequeath		Scenario 2: Donation before death	
Estate Duty		Donations Tax	
Net Value of Estate (Section 4 of EDA)	R 10,000,000	Value of property (section 55 of ITA)	R 6,500,000
Minus Primary Rebate (Section 4A EDA)	R -3,500,000	Exclusion (Section 56(1)(a), (b) or (c) of ITA)	R -6,500,000
Dutiable amount of Estate (Section 4A EDA)	R 6,500,000		R -
x 20% (Tax Rate)	R 1,300,000.0	Estate Duty	
		Net Value of Estate (Section 4 EDA)	R 3,500,000
		Minus Primary abatement (Section 4A EDA)	R -3,500,000
		Dutiable amount of estate (Section 4A EDA)	R -
		x 20% (Tax Rate)	R -

Table 4-1: Comparison of difference in taxation on bequeath and donation

To protect the estate duty system, the DTC⁷¹⁹ recommended that exemptions under section 56(1)(a) and (b) of the *Income Tax Act* should exclude donations of interest in either fixed property or companies as well as any donation of assets as a *donatio mortis causa*. However, on the basis that property donated as a *donatio mortis causa* is exempt under section 56(1)(c) of the *Income Tax Act*, it made the aforementioned recommendation ineffective which led to the DTC⁷²⁰ also proposing the repeal of section 56(1)(c) of the *Income Tax Act*.

FISA⁷²¹ questions the proposed limitation of inter-spousal donation exemptions to exclude fixed property and shares based on fairness, as such donations are not always for estate duty savings but for reasonable use.

SAIT⁷²² is also of the view that the focus on abuse arising from inter-spousal donations mentioned by the DTC was misplaced as inter-spousal transfers are made for many different reasons that are often unrelated to tax charges. Inter-spousal relief between older couples is more of a timing benefit as most spouses die within 10 years of one another.

⁷¹⁹ DTC *First Estate Duty Report* 52.

⁷²⁰ DTC *First Estate Duty Report* 52.

⁷²¹ FISA *Comments on the First Interim Report on Estate Duty* 7-8.

⁷²² SAIT *Submission on the DTC First Interim Report on Estate Duty* 11.

SAIT⁷²³ furthermore disagrees with the DTC to remove the exemption regarding a *donatio mortis causa* contained in section 56(1)(c) of the *Income Tax Act* as although it is not subject to donations tax, the value of the donation is included as deemed property⁷²⁴ in the estate for estate duty purposes. Therefore, the rationale behind the recommendation to protect the estate duty system may not be justified in this instance.

SAICA,⁷²⁵ like SAIT, raises its concern with the DTC's recommendation to remove the exemption for a *donatio mortis causa* contained in section 56(1)(c) of the *Income Tax Act* as the DTC was of the view that it allows for the reduction of an estate in anticipation of death. SAICA⁷²⁶ notes that as such donations are included as deemed property in the estate under section 3(3)(b) of the *Estate Duty Act*, no such reduction of the estate takes place, and the recommendation should be withdrawn.

The recommendation was sustained in the DTC's *Final Estate Duty Report*. The DTC's⁷²⁷ final recommendation was that the exemptions under section 56(1)(a) and (b) of the *Income Tax Act* should also specifically exclude any donations that will be treated as disposals for CGT purposes or a *donatio mortis causa* under section 56(1)(c) of the *Income Tax Act*. To mitigate any abuse of transfers of cash and personal use assets between spouses, the DTC⁷²⁸ recommended that the exemption be limited to a certain amount. In addition, section 56(1)(c) of the *Income Tax Act* regarding *donatio mortis causa* should be removed to curb the practice of donating substantial amounts of cash in anticipation of death.⁷²⁹

The DTC⁷³⁰ further acknowledged that the abovementioned recommendation might result in difficulties where the transfer of assets between spouses in terms of a

⁷²³ SAIT *Submission on the DTC First Interim Report on Estate Duty* 11.

⁷²⁴ Section 3(3)(b) of the *Estate Duty Act*.

⁷²⁵ SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 9.

⁷²⁶ SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 9.

⁷²⁷ DTC *Final Estate Duty Report* 14.

⁷²⁸ DTC *Final Estate Duty Report* 14.

⁷²⁹ The recommendation was made in the *First Estate Duty Report* and reaffirmed in the *Final Estate Duty Report*. See DTC *First Estate Duty Report* 53 and DTC *Final Estate Duty Report* 22.

⁷³⁰ DTC *Final Estate Duty Report* 15.

divorce settlement becomes subject to donations tax and CGT. To mitigate the impact an exemption, like death benefits, from estate duty and CGT was recommended, provided that any future relief for death benefits and divorce abatements should be reduced by the exemption allowed.⁷³¹

None of the above recommendations has to date been given effect. Relevant for consideration in the search for a revised *Estate Duty Act* is that the deletion of the exemption from donations tax of a *donatio mortis causa* under section 56(1)(c) of the *Income Tax Act* will require the deletion of section 3(3)(b) of the *Estate Duty Act* which results in no deemed property for estate duty purposes.⁷³² However, the DTC's recommendation is not sound in its justification to protect the estate duty system or to eliminate estate duty avoidance as put forward by SAIT and SAICA above.

3.6.2.8 General anti-avoidance rules for estate duty

The DTC⁷³³ held the view in its *First Estate Duty Report* that the general anti-avoidance rules set out in the *Income Tax Act*⁷³⁴ are not an effective deterrent against estate duty saving mechanisms. This view concurred with the finding of the Katz Commission⁷³⁵ that general anti-avoidance rules for estate duty should not be pursued as it has little prospect of success as when the arrangement is challenged, the founder is dead which causes difficulty regarding evidence and the evaluation thereof.

⁷³¹ DTC *Final Estate Duty Report* 14.

⁷³² This deletion was greatly criticised by public commentary discussed in the thesis as the exempt donation is included as a deemed asset for estate duty purposes and no avoidance of estate duty takes place.

⁷³³ DTC *First Estate Duty Report* 35 and DTC *Final Estate Duty Report* 30.

⁷³⁴ The general anti-avoidance rules for income tax are set out in s 80A-L of the *Income Tax Act*.

⁷³⁵ Katz Commission *Fourth Report* 9.4.

In the *Final Estate Duty Report*, the DTC⁷³⁶ endorsed the need for the application of section 3(3)(d)⁷³⁷ of the *Estate Duty Act* to be extended to serve as an anti-avoidance rule.

SAICA⁷³⁸ opposes the recommendation for specific estate duty anti-avoidance measures on the basis that there are already existing measures under section 3(3)(d) of the *Estate Duty Act* and section 7(6) of the *Income Tax Act* that should be properly enforced but has notably been very few times applied. SAICA, therefore, recommends that instead of introducing more complexity to the estate duty regime with more rules, the existing ones must first be applied more effectively.

SAIT⁷³⁹ notes that a common planning tool involves schemes that exploit the mismatch between estate duty and income tax. These schemes entail that the underlying property falls outside the estate of the taxpayer while the underlying income forms part of the taxpayer's taxable income. SAIT⁷⁴⁰ recommends that a specific estate duty anti-avoidance rule should be considered to include the underlying asset as a deemed asset in the estate.

In conclusion, although the DTC⁷⁴¹ recommended further anti-avoidance measures under section 3(3)(d) for a wider application to combat the avoidance of estate duty where an asset was acquired by the trust because of an interest-free loan, National Treasury did not follow the DTC recommendation. Instead, section 7C of the *Income Tax Act* was introduced as an anti-avoidance measure to prevent estate duty and donations tax avoidance using interest-free or low-interest loans to a trust by

⁷³⁶ DTC *Final Estate Duty Report* 32. The DTC specifically referred to trust arrangements and the use of low or interest-free loans to avoid estate duty and recommended that s 3(3)(d) should be extended to include deeming provisions that identify "deemed control" of a trust.

⁷³⁷ Section 3(3)(d) of the *Estate Duty Act* includes as deemed property any "property (being property not otherwise chargeable under this Act or the full value of which is not otherwise required to be taken into account in the determination of the dutiable amount of the estate) of which the deceased was immediately prior to his death competent to dispose of for his own benefit or for the benefit of his estate."

⁷³⁸ SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 13.

⁷³⁹ SAIT *Submission on The DTC First Interim Report on Estate Duty* 9.

⁷⁴⁰ SAIT *Submission on The DTC First Interim Report on Estate Duty* 9.

⁷⁴¹ DTC *Final Estate Duty Report* 32.

deeming the difference in the interest charged and the official interest rate to be a deemed donation in the hands of the donor.⁷⁴²

Furthermore, the recommendation to introduce specific estate duty anti-avoidance rules has also not yet been implemented and remains relevant in the search for a revised *Estate Duty Act*.⁷⁴³

3.6.3 Summary of findings

The DTC, in principle, agreed with the conclusion of the Katz Commission to retain the existing estate duty system, subject to a thorough review to operate more effectively.

The DTC's recommendations for a more effective estate duty system included the retention of the retirement fund death benefits exemption but including excess contributions before death as property in the estate.⁷⁴⁴ Specifically regarding spousal bequests, the withdrawal of the section 4(q) deduction and the portable abatement was proposed.⁷⁴⁵ The DTC also introduced a progressive estate duty rate,⁷⁴⁶ proposed an increase in the section 4A abatement,⁷⁴⁷ as well as the broadening of section 3(3)(d) as an estate duty anti-avoidance rule.⁷⁴⁸

Some of the recommendations have been accepted for example the inclusion of excess retirement fund contributions and the progressive estate duty rate, however, most of the remaining recommendations have not yet been considered for further implementation into the *Estate Duty Act*.⁷⁴⁹

⁷⁴² Section 12(1) of the *Taxation Laws Amendment Act* 15 of 2016. Section 7C was introduced with effect from 19 July 2017.

⁷⁴³ This recommendation was made by the Katz Commission and repeated in the DTC's *First Estate Duty Report*. In the DTC's *Final Estate Duty Report*, it focused its discussion mainly on trusts and the avoidance of estate duty and referred again to the application of s 3(3)(d) of the *Estate Duty Act*. Focus was again placed on widening the scope of s 3(3)(d) but this may apply considering specific rules to deal with specific estate duty avoidance schemes.

⁷⁴⁴ See para 3.6.2.5 above.

⁷⁴⁵ See paras 3.6.2.1 and 3.6.2.3 above.

⁷⁴⁶ See para 3.6.2.4 above.

⁷⁴⁷ See para 3.6.2.2 above.

⁷⁴⁸ See para 3.6.2.8 above.

⁷⁴⁹ See paras 3.6.2 above.

Various commentaries on the DTC's *First Estate Duty Report* were reviewed that highlighted several concerns regarding the recommendations made in the report. The general conclusion to the commentary was that many of the recommendations must be reconsidered and further researched before they are implemented into the legislation as they do not comply with the canons of equity and certainty.⁷⁵⁰

It was specifically noted that the recommendation to delete section 4(q) of the *Estate Duty Act* may promote the primary objective of taxation to raise revenue, but it will not necessarily adhere to the requirements of a good wealth transfer tax system, namely equity and certainty as reflected through the canons of taxation designed by Adam Smith and illustrated in Ingram's study.⁷⁵¹ The recommendation to increase the primary abatement may promote the achievement of one of the secondary objectives of taxation, namely the redistribution of wealth and resources, but caution must be taken where an increase in the tax liability of wealthy taxpayers takes place as it may result in a decrease in economic growth.⁷⁵²

3.7 Conclusion

The chapter contained an analysis of the reviews done by the Margo Commission, the Katz Commission as well as the DTC on estate duty and its efficiency as a wealth transfer tax in South Africa in addressing inequality.⁷⁵³ The reasons behind the recommendations made by each Commission were assessed based on the criticisms against the recommendations as well as the support in favour thereof.⁷⁵⁴ The recommendations were also measured against the canons of taxation. In the analysis of the withdrawal of the deduction in terms of section 4(q) for spousal bequests, the research study by Ingram was relied on to illustrate the impact of the recommendation which has been the major recommendation in each of the Commissions but especially by the DTC where a withdrawal was proposed.⁷⁵⁵

⁷⁵⁰ See paras 3.6.2.1-3.6.2.8 above.

⁷⁵¹ See paras 2.4.3 and 3.6.2.1-3.6.2.3 above.

⁷⁵² Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 57.

⁷⁵³ See paras 3.4, 3.5 and 3.6 above.

⁷⁵⁴ See paras 3.4.3, 3.5.3 and 3.6.3 above.

⁷⁵⁵ See para 3.6.2.1 above.

Each of the Commission's recommendations was discussed and measured against the *Estate Duty Act* in its current form to establish which of the recommendations are still to be considered in the search for a revised *Estate Duty Act*.⁷⁵⁶

This chapter noted that some of the recommendations by the Margo and Katz Commissions regarding the tax rate and the primary abatement do not promote vertical equity although it may adhere to the canon of simplicity.⁷⁵⁷ Furthermore, in the case of the DTC, the recommendation for the withdrawal of the spousal bequest was found to not adhere to the canons of equity and certainty.⁷⁵⁸

Having considered the historical development of the *Estate Duty Act* and the critical analysis of the recommendations by the various Commissions of Enquiry to establish which of the recommendations have been implemented and which remains relevant for future consideration, Chapter 4 will primarily focus on analysing the problem areas experienced under the *Estate Duty Act* to determine if any recommendations are required in the search for a revised *Estate Duty Act*.

⁷⁵⁶ See paras 3.4.2, 3.5.2 and 3.6.2 above.

⁷⁵⁷ See paras 3.4.2.4, 3.4.2.2, 3.5.2.2 and 3.5.2.3 above.

⁷⁵⁸ See paras 3.6.2.1-3.6.2.3 above.

CHAPTER 4 PROBLEM AREAS RELATING TO THE ESTATE DUTY ACT

Abstract

In this chapter the *Estate Duty Act* will be discussed with particular reference to the problems experienced, including the jurisdictional basis, the scope of property, the constitutionality of exempting spousal bequests, the meaning of "accrual" to establish when an inheritance accrues to qualify for a deduction in the estate duty calculation, the rationale behind valuation rules, relief from double taxation, the lack of specific anti-avoidance rules and various administrative misalignments. In the search for a revised *Estate Duty Act*, the chapter aims to analyse these issues and to measure the *Estate Duty Act's* adherence to the canons of taxation as the foundation of a good tax system. An analysis of these problems proves that a revised *Estate Duty Act* is both desirable and needed and preliminary recommendations to address the problems were identified.

4.1 Introduction

Following the historical development of estate duty and the critical analysis of the recommendations for improvement by the Commissions of Enquiry in Chapter 3, this chapter points out the key problem areas that will have to be considered in the search for a revised *Estate Duty Act*. This chapter aims to address the following questions:

- (a) What are the existing problem areas under the *Estate Duty Act*?
- (b) Does the *Estate Duty Act* adhere to the canons of taxation?
- (c) How can the problem areas be addressed?

To answer these questions; each identified problem is discussed and evaluated against the canons of taxation under paragraphs 4.2.1 to 4.2.9 where preliminary

suggestions are set out with the aim to provide recommendations under Chapter 6 to address the issues regarding the specific provisions of the *Estate Duty Act*.

4.2 Problem areas under the Estate Duty Act

4.2.1 Jurisdictional basis

4.2.1.1 Misalignment between the *Income Tax Act* and the *Estate Duty Act*

Estate duty in South Africa, since its inception, is primarily levied on worldwide assets that are aligned to the residence basis⁷⁵⁹ of taxation.⁷⁶⁰ In addition, estate duty is also levied on a source basis⁷⁶¹ regarding persons who are not ordinarily resident in South Africa at the date of their death.⁷⁶²

The jurisdictional basis for estate duty in South Africa is based on whether a person is ordinarily resident in South Africa at the time of their death.⁷⁶³ When South Africa moved from a source-based to a residence-based tax system in 2001, no changes were made to the concept of "ordinarily resident" under the *Estate Duty Act*.⁷⁶⁴ However, the definition of "resident" under section 1(1) of the *Income Tax Act* has been amended for income tax, donations tax and CGT purposes to include a person who is "ordinarily resident", as well as a person who has become a "resident" by way of the physical presence test. The difference in bases emphasises the mismatch in that a taxpayer may be a resident for purposes of one type of tax (donations tax, capital gains tax or income tax) and a non-resident for another tax (estate duty).

⁷⁵⁹ See Stiglingh *et al Silke: South African Income Tax* 26 and Haupt *Notes on South African Income Tax* 25-26.

⁷⁶⁰ Section 3(1) of the *Estate Duty Act*.

⁷⁶¹ See Stiglingh *et al Silke: South African Income Tax* 26 and Haupt *Notes on South African Income Tax* 25-26.

⁷⁶² Section 3(2)(c)–(h) of the *Estate Duty Act* where property and rights to property situated outside South Africa are not included in the estate for estate duty purposes.

⁷⁶³ The concept of "ordinarily resident" is not defined by the *Estate Duty Act* and obtains its meaning from case law as discussed under para 4.2.1.2 below as a person's permanent home where one returns to after their wanderings. See also para 4.2.1.2.1 above where the issues in relation thereto under the *Estate Duty Act* are further addressed. It should be noted that the concept of "ordinarily resident" does not refer to a person's domicile, citizenship or permanent residence and should be specifically established for tax purposes.

⁷⁶⁴ Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 86.

This does not adhere to the canon of certainty and points out the need for a review of the meaning of a "resident" for estate duty purposes.⁷⁶⁵

The physical presence test entails a person who is physically present in South Africa for more than 91 days in the current year of assessment (for example, the 2023 year of assessment) and in each of the previous five years of assessment (2022-2018), as well as an aggregate of 915 days during the previous five years (2022-2018). If these requirements are met, the person will become a resident from the first day of the 2023 year of assessment, being the year under consideration.⁷⁶⁶

Roeleveld⁷⁶⁷ states that the *Estate Duty Act* has not kept pace with significant changes under *Income Tax Act* regarding the concept of a "resident" for tax purposes. This may lead to the outcome where a person is a tax resident for income tax, CGT and donations tax purposes (by way of physical presence test) under the *Income Tax Act* while remaining a non-resident under the *Estate Duty Act* as the taxpayer was not "ordinarily resident" at the date of death and therefore only subject to estate duty on South African property.⁷⁶⁸

For example, a foreign national moves to South Africa on a work assignment and has no intention to stay in South Africa permanently but intends to return to his home country upon the completion of his assignment where he still holds strong ties. Although the person's intention is not to remain in South Africa permanently, the duration of the assignment in South Africa results in him becoming a resident after five years in terms of the physical presence test. The person will be treated as a resident under the *Income Tax Act* and his worldwide income and assets are subject to tax in South Africa. However, on the basis that he does not regard South

⁷⁶⁵ In addition to the difference in the meaning of the concept of a resident, it is further noted that for income tax, CGT and estate duty purposes, the source-based system applies to a non-resident, however, a non-resident is not subject to donations tax for any property donated. The jurisdictional basis for donations tax therefore excludes the source-based system (see s 54 of the *Income Tax Act* and s 3 of the *Estate Duty Act*. Davis, Beneke and Jooste state that there is no rationale why a non-resident is not subject to donations tax in its entirety (see Davis, Beneke and Jooste *Estate Planning* 2.9.1).

⁷⁶⁶ See the definition of "resident" in s 1 of the *Income Tax Act*.

⁷⁶⁷ Roeleveld 2015 *SAJAR* 153.

⁷⁶⁸ Roeleveld 2015 *SAJAR* 153.

Africa as his real home, holds stronger ties to his home country and intends to return to his home country once the assignment is completed, he is not ordinarily resident in South Africa. Therefore, in the event of death, only South African-sourced assets will be included in the estate for estate duty purposes. Any property situated outside South Africa will not be included in the taxpayer's estate for estate duty purposes.

The misalignment between the concept of "resident" (being a physically-present resident) and "ordinarily resident" under the *Income Tax Act*, and "ordinarily resident" under the *Estate Duty Act* results in different property to be considered for estate duty purposes in comparison to CGT purposes upon death. For example, foreign assets of a physically-present tax resident do not fall within the estate for estate duty purposes as the person is not "ordinarily resident". However, such foreign assets⁷⁶⁹ are subject to CGT⁷⁷⁰ that will constitute a debt owed by the deceased at the date of death. When considering the qualifying deductions in the context of the estate duty calculation, specifically section 4(b) of the *Estate Duty Act*, the tax payable for foreign assets that are not included in the estate for estate duty purposes, is not deductible. This means that the CGT payable on foreign assets that are not included in the estate of a non-resident for estate duty purposes, is not deductible as a tax debt.⁷⁷¹

The above conclusion is reached based on the introductory wording of section 4 of the *Estate Duty Act* which provides that deductions are allowed against the property *included* in the estate under section 3 of the *Estate Duty Act*. Since the foreign assets (that were subject to CGT) were not included in the estate for estate duty purposes and specifically excluded under section 3(2) regarding a person not ordinarily resident in South Africa at the date of death, the debt will not qualify as a deduction. This position is also supported by the wording of section 4(b) that the debt is not discharged from assets included in the estate and therefore not allowed.

⁷⁶⁹ Assets that may fall within this category are immovable and movable property situated outside South Africa, debts and intellectual property rights not enforceable in South Africa. See Roeleveld 2015 *SAJAR* 153.

⁷⁷⁰ The CGT liability arises due to the deemed disposal of property by the deceased person under s 9HA of the *Income Tax Act*, subject to certain exclusions.

⁷⁷¹ Section 4(b) of the *Estate Duty Act*.

This effect creates uncertainty and is considered to not adhere to the canon of equality as the debt was still a debt paid by the estate regarding the deceased person's income tax liability at death in which case he was dealt with as a "resident".

The following table illustrates the impact of the misalignment in the definition of a "resident" for income tax purposes and "ordinarily resident" for estate duty purposes. For purposes of the illustration, it is assumed that a deceased person is a single person who is a resident for income tax purposes by way of his physical presence. The deceased is taxed at the top marginal tax rate of 45%. The deceased owned two immovable properties as investment properties in South Africa valued at R4 million and R2.5 million respectively as well as a foreign immovable property valued at R3 million. The base cost of all the properties is Rnil. There are no brought-forward assessed capital losses or capital gains.

The CGT and estate duty impact are as follows:

Table 4.1: The CGT and estate duty impact on a physically present resident

Capital gains tax (Resident and the disposal of worldwide assets are subject to CGT)		Estate duty (Non-resident and only SA-sourced assets are subject to estate duty)	
South African property 1	R4 000 000	South African property 1	R4 000 000
South African property 2	R2 500 000	South African property 2	R2 500 000
Foreign property	R3 000 000	Foreign property	–
Aggregate gain	R9 500 000	Gross estate	R6 500 000
Less death exclusion	(R300 000)	Less the section 4(b) – debts due	(R1 133 053)**
Net gain	R9 200 000	Net value	R5 366 347
Inclusion @ 40%	R3 680 000	Less section 4A	(R3 500 000)
Capital gains tax at 45%	R1 656 000*	Dutiable amount	R1 866 347
		Estate duty @ 20%	R373 269
*Portion of the CGT relating to South African property: $R1\ 656\ 000 \times R6\ 500\ 000 / R9\ 500\ 000$ = R1 133 053		**The full CGT liability of R1 656 000 is not allowed as a deduction for estate duty but is limited to the portion relating to the SA property included in the estate, which is R1 133 053.	

The impact, therefore, is that the CGT paid on the foreign property is not deductible for estate duty purposes as the foreign property was not included in the estate.

Roeleveld⁷⁷² supports a review of the definition of "ordinarily resident" for estate duty purposes due to the consequential mismatch it results in when compared with CGT. Thorpe⁷⁷³ supports the view taken by Roeleveld on the basis that the same taxpayer is being treated differently for estate duty and CGT due to the misalignment of the resident concepts. The narrow application of the "ordinarily resident" concept is also reflected in the estate tax treaties where the treaties only apply to a person who is "ordinarily resident" and not a resident by way of physical presence for income tax purposes.⁷⁷⁴

Silke⁷⁷⁵ states, regarding the application of section 4(b) of the *Estate Duty Act*, on the same principle in a slightly different context that, since retirement fund death benefits are excluded from property for estate duty purposes, any tax paid thereon does not qualify as a deduction under section 4(b). Meyerowitz⁷⁷⁶ also confirms the view that any debt in relation to an asset not included in the estate is not deductible.

Van Jaarsveld⁷⁷⁷ and Muller⁷⁷⁸ state that any capital gains tax liability qualifies as a deduction under section 4(b), without qualifying their view with regards to capital gains tax paid on foreign property. The *Estate Tax Model*⁷⁷⁹ provides that the words "property that forms part of the estate" are limited to property falling within the scope of estate tax (and in the South African context, estate duty), irrespective of a different scope of property that may apply for income tax purposes. When calculating the estate duty liability, only the property included under the *Estate Duty Act* should be taken into account.

The *Estate Tax Model* states that it is doubtful that any taxes paid on the transfer of property not included in the estate can be taken into account in calculating the estate tax liability. It is therefore concluded that the principle applied under the

⁷⁷² Roeleveld 2015 *SAJAR* 153.

⁷⁷³ Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 86.

⁷⁷⁴ Roeleveld 2015 *SAJAR* 153.

⁷⁷⁵ Stiglingh *et al Silke: South African Income Tax* 1043.

⁷⁷⁶ Meyerowitz *Administration of Estates* 28.6. See also Cilliers *Administration of Estates* 540.

⁷⁷⁷ Van Jaarsveld *The Levying of Capital Gains Tax at Death* 3.

⁷⁷⁸ Muller *Wealth Transfer Taxation* 220.

⁷⁷⁹ OECD *Estate Tax Model* 49.

Estate Duty Act by not allowing a deduction under section 4(b) regarding a tax liability (CGT) of an asset not included in the estate is sound, however, the misalignment due to the different tax bases remains a concern.

The misalignment due to the different concepts of "resident" for different tax types can be addressed through a revised definition of "resident" for estate duty purposes, which may further bring alignment across taxes to promote the canon of certainty where a taxpayer will be dealt with similarly across taxes and not be treated differently in respect of one tax to another.⁷⁸⁰

To determine the changes that may be required for a revised definition, its meaning should first be considered. The meaning of "ordinarily resident" will be explained in the following paragraph.

4.2.1.2 The meaning of "ordinarily resident"

It has been explained that "ordinarily resident" is not defined in the *Income Tax Act* or the *Estate Duty Act* but its meaning is obtained from case law, and more specifically in *Cohen v Commissioner for Inland Revenue*⁷⁸¹ and *Commissioner of Inland Revenue v Kuttel*.⁷⁸² Both Supreme Court of Appeal judgments were handed down in 1946 and 1992, respectively, in the then Appellate Division but still serve as the points of reference when answering the question of whether a person is "ordinarily resident" under South African tax laws, including the *Estate Duty Act*.⁷⁸³ Both judgments were handed down for income tax purposes when South Africa operated under a sourced-based tax system and regarding taxpayers who left South

⁷⁸⁰ See para 6.2.1.2 below.

⁷⁸¹ 1946 AD 174 13 SATC para 362 (the *Cohen* case).

⁷⁸² 1992 3 SA 242 (A) 54 SATC para 298 (the *Kuttel* case). The meaning of "ordinarily resident" was provided in the *Cohen* case and *Kuttel* case in the context of income tax, however, Meyerowitz stated that the same meaning was equally applicable to estate duty (see Meyerowitz *Administration of Estates* 27.10 and Cilliers *Administration of Estates* 508). This position is supported by Silke that further provides that it is about determining whether a person is "ordinarily resident" in South Africa, whether for income tax or estate duty purposes (see Stiglingh *et al Silke: South African Income Tax* 1033). See also, Hardie *Analysis of the Expression "Ordinarily Resident"* 12.

⁷⁸³ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 3.

Africa,⁷⁸⁴ which further raises the question of whether it is still relevant in modern times and specifically regarding a deceased taxpayer.

In the *Cohen* case,⁷⁸⁵ the issue before the court was whether an individual who was domiciled in South Africa could be considered "ordinarily resident" even though he was not physically present in South Africa for the entire year of assessment. For 10 years between 1930 and 1940, the individual travelled abroad for business but returned to South Africa after his business trips. The individual's family subsequently accompanied him for almost two years; however, the trips were continuously considered to be temporary as they would return to their home in South Africa. Schreiner JA⁷⁸⁶ stated that in making the determination it is a factual enquiry and one is not limited to one year of assessment, but the individual's mode of life must be considered over a broader period extending beyond the year of assessment in question. Schreiner JA⁷⁸⁷ interpreted the word "ordinarily" in a narrow sense and stated *obiter* that a person can only be "ordinarily resident" in one country at any point in time. It was concluded that a person's ordinary residence is the place a person naturally and as a matter of course returns to after their wanderings, also referred to as a person's real home or a person's usual or principal residence.⁷⁸⁸

In the *Kuttel* case,⁷⁸⁹ the taxpayer emigrated from South Africa and obtained permanent residence in the US. The taxpayer and his wife settled in the US, while the children finished their schooling in South Africa before they also joined their parents permanently in the US. The taxpayer spent most of their time abroad and Goldstone JA⁷⁹⁰ stated that although a person may have more than one residence at any time, "ordinarily resident" must be interpreted narrower. Goldstone JA⁷⁹¹

⁷⁸⁴ *Cohen* case para 363 and *Kuttel* case paras 302-303.

⁷⁸⁵ *Cohen* case para 362. See also SARS *Interpretation Note No 3 2*.

⁷⁸⁶ *Cohen* case para 366. See also SARS *Interpretation Note No 3 2*.

⁷⁸⁷ *Cohen* case para 371. See also SARS *Interpretation Note No 3 3*.

⁷⁸⁸ *Cohen* case para 371. See also *Income Tax Case 1170 1971 34 SATC 76 (C)* where a taxpayer was on a fourteen-month assignment outside South Africa accompanied by his wife and children. The taxpayer's primary residence was rented out while on assignment and a similar outcome as in the *Cohen* case was decided that the taxpayer remained "ordinarily resident" in South Africa.

⁷⁸⁹ *Kuttel* case para 298. See also SARS *Interpretation Note No 3 3*.

⁷⁹⁰ *Kuttel* case para 304. See also SARS *Interpretation Note No 3 4*.

⁷⁹¹ *Kuttel* case para 306. See also SARS *Interpretation Note No 3 4*.

confirmed the meaning attributed by Schreiner JA⁷⁹² in the *Cohen* case and in applying the meaning to the facts of the case, it was decided that the taxpayer was not ordinarily resident in South Africa.

In summary, the principles established by the South African courts in establishing ordinary residence are described by Hardie⁷⁹³ as follows:

- (a) It is the place where a person has his usual or principal place of residence, that is, their real home.⁷⁹⁴
- (b) It is the place a person returns to after their wanderings.⁷⁹⁵
- (c) It is possible to have more than one residence, but a person can only be ordinarily resident in one place.⁷⁹⁶
- (d) Return trips to South Africa is not an issue but the reasons behind the trips are important.⁷⁹⁷
- (e) Physical presence is not a requirement to be ordinarily resident in South Africa.⁷⁹⁸
- (f) A home in South Africa does not automatically mean a person is ordinarily resident in South Africa.⁷⁹⁹
- (g) A taxpayer's circumstances must be considered beyond the year under consideration but including the year before and after the year in question.⁸⁰⁰

⁷⁹² *Cohen* case para 371.

⁷⁹³ Hardie Analysis of the Expression "Ordinarily Resident" 24-25. See also SARS *Interpretation Note No 35*.

⁷⁹⁴ *Cohen* case para 371.

⁷⁹⁵ *Cohen* case para 371.

⁷⁹⁶ *Cohen* case para 371 and *Kuttel* case paras 304-305.

⁷⁹⁷ *Kuttel* case para 306.

⁷⁹⁸ *Cohen* case para 362.

⁷⁹⁹ *Kuttel* case para 306.

⁸⁰⁰ *Cohen* case paras 372-373. SARS also issued guidelines to determine a taxpayer's ordinary residence based on the principles laid down by the courts (see SARS *Interpretation Note No 35*). See also para 3.3.2.1 above for a list of the factors that may be considered as well as SARS 2022 <https://www.sars.gov.za/individuals/cease-to-be-a-resident/>.

4.2.1.2.1 Criticism against the concept of "ordinarily resident"

4.2.1.2.1.1 Need for certainty

Roeleveld⁸⁰¹ states that the concept of "ordinarily resident" under the *Estate Duty Act* is outdated and did not keep pace with the changes under the *Income Tax Act* where the concept of "resident" is not limited to an ordinary resident but includes a physical presence test.⁸⁰² Whitfield⁸⁰³ states that the meaning of "ordinarily resident" is important and should for clarity purposes be defined in the *Estate Duty Act*, instead of reverting to case law for its meaning. Stark, Arendse and Renaud⁸⁰⁴ state that the meaning of "ordinarily resident" is both vague and uncertain and requires modernising.

Ketchemin⁸⁰⁵ states that the "ordinarily resident" test and the requirement of a "real home" overlook the need for certainty that could be obtained through a pattern of physical presence instead. Hardie⁸⁰⁶ states that the general principles laid down by case law do not provide specific guidelines for all scenarios which results in uncertainty in taxation. Smith⁸⁰⁷ emphasises the importance of the canon of certainty for a good system, which is also endorsed by the OECD.⁸⁰⁸

On the basis that the meaning of "ordinarily resident" solely relies on guidance from case law from decades ago, it is predominantly reliant on a taxpayer's subjective intention that must be supported by surrounding objective factors.⁸⁰⁹ Although the relevant case law provides principles that can be followed in deciding, it is limited in its application, especially in the modern context of globalisation where the frequent movement of a taxpayer is a common occurrence.⁸¹⁰ A determination of a

⁸⁰¹ Roeleveld 2015 *SAJAR* 153.

⁸⁰² See also the discussion above under para 4.2.1.1.

⁸⁰³ Whitfield *Tax Implications Arising for South African Residents* 181.

⁸⁰⁴ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 22.

⁸⁰⁵ Ketchemin *Fiscal Jurisdiction in Income Tax Law* 74.

⁸⁰⁶ Hardie *Analysis of the Expression "Ordinarily Resident"* 12.

⁸⁰⁷ Adam Smith Institution *Condensed Wealth of Nations* 70.

⁸⁰⁸ OECD *Electronic Commerce: Taxation Framework Conditions* 4.

⁸⁰⁹ *Income Tax Case 961* 1961 SATC 648 para 649.

⁸¹⁰ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 15 and Hardie *Analysis of the Expression "Ordinarily Resident"* 7.

taxpayer's residence status upon death may also become problematic, especially if one has to rely on the intention of a person who is no longer available to justify any stance taken. It is important to have certainty in determining whether a person is ordinarily resident for estate duty purposes as it establishes the starting point of a person's estate duty liability.⁸¹¹ Whether or not a person was ordinarily resident at the date of death determines which assets must be included in the deceased estate, that is, worldwide assets for an ordinary resident in comparison to only South African-sourced assets for persons who are not ordinarily resident.⁸¹² The definition of "ordinarily resident"⁸¹³ can therefore be seen as a cornerstone of estate duty in South Africa.

4.2.1.2.1.2 Time of becoming "ordinarily resident"

The timing of becoming "ordinarily resident" is relevant for purposes of section 4(e) of the *Estate Duty Act*.⁸¹⁴ It is important to establish when a person became ordinarily resident for the first time to potentially qualify for the deduction. This also leads to the issue of whether a person becomes ordinarily resident for the first time

⁸¹¹ The context of the *Cohen* case para 371 and the *Kuttel* case para 306 was to determine the meaning of "ordinarily resident" under the *Income Tax Act* to determine the entitlement of exemptions under a sourced-based tax system. However, under the current residence-based tax system for income and estate duty purposes, it is the first step in determining the tax liability as a resident in comparison to a non-resident. See Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 21.

⁸¹² Section 3(1) of the *Estate Duty Act*.

⁸¹³ The meaning of "ordinarily resident" is not dependent on a person being a national or citizen of South Africa, but there are factors that are taken into account to support a person's contention of being "ordinarily resident" in South Africa. Although "nationality" and "citizenship" are often used interchangeably, citizenship is obtained by birth, i.e. if one was born and raised in South Africa, or it may be acquired based on certain requirements being met. Once citizenship is obtained, a person is regarded as a national (see Department of Home Affairs 2023 <http://www.dha.gov.za/index.php/immigration-services/citizenship-requirements>). See also Haupt *Notes on South African Income Tax* 26.

⁸¹⁴ Section 4(e) of the *Estate Duty Act* allows for a deduction regarding property that was included in the deceased estate that is situated outside South Africa at the date of death, but the property was acquired at different times and is outside South Africa at the date of acquisition as well as at the date of death. If property was acquired prior to becoming "ordinarily resident" and is subsequently brought into South Africa, the deduction does not apply. It also does not apply if it was acquired inside South Africa and subsequently moved outside South Africa. Therefore, on both dates the property must have been situated outside South Africa. Furthermore, if the deceased was "ordinarily resident" in South Africa at the date of acquisition, the deduction is only allowed if the property is acquired by way of donation or inheritance from a person who is not "ordinarily resident" in South Africa at the date of the donation or their death. See also Meyerowitz *Administration of Estates* 28.13 and Cilliers *Administration of Estates* 544.

at birth (similar to a *domicile* at birth)⁸¹⁵ or only after a resident left South Africa, became a resident elsewhere and returns to South Africa and become ordinarily resident.⁸¹⁶ Stein⁸¹⁷ and Meyerowitz⁸¹⁸ favour the argument that a person becomes an ordinarily resident for the first time at birth. This provides clarity and certainty in interpreting the provision. However, Stein⁸¹⁹ points out that the counterargument that a person is considered to become ordinarily resident for the first time only after having been ordinarily resident elsewhere is also possible which may result in uncertainty as to when the provision may apply and when not. Whitfield⁸²⁰ states that clarity in this regard is lacking under the *Estate Duty Act*.

4.2.1.2.1.3 Cessation of residence

In addition to establishing whether and when a person is ordinarily resident, the cessation of residence before death will influence the estate duty calculation on the basis that worldwide assets are not taken into account but only South African-sourced assets.⁸²¹ The test for cessation is similar to the principles applied in establishing whether a person has become "ordinarily resident" in that it is a subjective intention of a taxpayer to no longer regard South Africa as their real

⁸¹⁵ The concept of "domicile" can consist of a "domicile of origin", "domicile of choice" or a "domicile of dependency". Domicile is in general the place where a person's permanent home is situated. A "domicile of origin" is acquired at birth, usually based on the father's domicile. A "domicile of choice" is where a person resides by choice on a permanent basis or indefinitely. To change a domicile, a new domicile must be obtained. A "domicile of dependency" is based on the person's domicile on whom a person is legally dependent (for example, in the case of a minor it is the domicile of a parent or in the case of a wife, the domicile of her husband, or in the case of a mentally disordered person, the domicile of the person they are dependent on). See Weber-Frisch and Duquenois-Djoua 2014 *ERA Forum* 415 and OECD *Estate Tax Model* 51-52.

⁸¹⁶ Whitfield *Tax Implications Arising for South African Residents* 121. See also Stein *Estate Duty: Principles and Planning* 81; Meyerowitz *Administration of Estates* 28.13 and Cilliers *Administration of Estates* 544.

⁸¹⁷ Stein *Estate Duty: Principles and Planning* 81.

⁸¹⁸ Meyerowitz *Administration of Estates* 28.13. See also Cilliers *Administration of Estates* 544.

⁸¹⁹ Stein *Estate Duty: Principles and Planning* 81.

⁸²⁰ Whitfield *Tax Implications Arising for South African Residents* 121.

⁸²¹ Section 3(2) of the *Estate Duty Act*; Haupt *Notes on South African Income Tax* 865 and Stiglingh *et al Silke: South African Income Tax* 1033.

home that must be supported by the surrounding objective factors.⁸²² It is again a question of fact that must be determined based on each taxpayer's circumstances.⁸²³

Whitfield⁸²⁴ states that the *Estate Duty Act* also does not guide as to how and when a person ceases to be ordinarily resident in South Africa. On the basis that a taxpayer's wealth is already linked to them before their death, the OECD recommends that clear rules or provisions should also be put in place for when a person ceases to be a resident shortly before their death.⁸²⁵ Such rules will serve as anti-avoidance measures and may be effective in the form of tail provisions.⁸²⁶

Currently, such tail provisions are lacking, and a person can cease to be "ordinarily resident" without becoming a resident elsewhere,⁸²⁷ creating a possible scenario where a person is not resident anywhere and no estate taxes may be payable. Any changes would need to be measured against possible double estate tax implications, for example, if a person became a resident for estate tax purposes in a foreign jurisdiction during the same period, they are deemed to remain a resident for estate duty purposes. Tail provisions may need to cater for such exceptions to eliminate possible double tax implications.

It is accepted that the application of the "ordinarily resident" test requires specific insight into a taxpayer's intention and circumstances, including future plans, and indicative steps to support the taxpayer's intention. Such insights might not always be available, especially in the context of a deceased person, where the executor would be required to provide the necessary proof of another taxpayer's (the deceased person's) intention. This creates difficulty and uncertainty as often times the executor is not personally involved with the deceased during their lifetime to be privy to such insights. Although it may be accepted that the *Cohen* case and *Kuttel*

⁸²² SARS 2022 <https://www.sars.gov.za/individuals/cease-to-be-a-resident/>.

⁸²³ See also para 4.2.8.3 for a discussion of anti-avoidance rules proposed by the OECD that includes tail provisions when a taxpayer ceases to be a resident.

⁸²⁴ Whitfield *Tax Implications Arising for South African Residents* 61.

⁸²⁵ OECD *Inheritance Taxation in OECD Countries* 73.

⁸²⁶ OECD *Inheritance Taxation in OECD Countries* 73. See also para 4.2.8.3 below. Tail provisions consist of clawback provisions where a jurisdiction continues to tax an individual for a period of time after the person ceased to be a tax resident/domicile.

⁸²⁷ Olivier 2001 *Journal of South African Law* 25.

case provide useful guidance, it remains limited in its application due to the constantly changing world and the movement of taxpayers. This may lead to uncertainty about a taxpayer's residence status and therefore undermine the canon of certainty,⁸²⁸ which may lead to the question of whether a statutory residence test would provide more certainty.⁸²⁹

4.2.1.2.2 Commentary on statutory test

Hardie⁸³⁰ states that in the absence of defined rules in law or the case of an outdated law, tax certainty is compromised. He is of the view that the introduction of amended tax legislation in a measured way could provide the necessary tax certainty. Hardie⁸³¹ also points out the risk that in the pursuit of tax certainty, tax avoidance will always be a continuous concern.

The Katz Commission⁸³² during its investigation into the South African tax system did not favour a detailed statutory definition of "resident"⁸³³ due to the risk involved in introducing legislative definitions that may impact international trade and investment by taxpayers who continuously look for avoidance opportunities. The Katz Commission⁸³⁴ decided that it was willing to compromise on tax certainty to minimise tax avoidance by ensuring that the correct aspects were taxed and not rendered tax-free due to liberal legislative drafting.⁸³⁵

⁸²⁸ See para 2.4.2.2 above. See also Adam Smith Institution *Condensed Wealth of Nations* 70 and Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 21. The OECD also endorsed the importance of certainty as fundamental in any good tax system (see OECD *Electronic Commerce: Taxation Framework Conditions* 4).

⁸²⁹ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 15.

⁸³⁰ Hardie *Analysis of the Expression "Ordinarily Resident"* 12.

⁸³¹ Hardie *Analysis of the Expression "Ordinarily Resident"* 12.

⁸³² Katz Commission *Fifth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa: Basing the South African Income Tax System on the Source or Residence Principle Options and Recommendations* (the *Fifth Report*) 5.1

⁸³³ Specifically with reference to the meaning of "ordinarily resident".

⁸³⁴ Katz Commission *Fifth Report* 5.1. See also Hardie *Analysis of the Expression "Ordinarily Resident"* 13-14. Although the case law relied on in determining the meaning of "ordinarily resident" was in the context of income tax, the same meaning was applied in respect of all South African tax laws, including estate duty (see Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 3).

⁸³⁵ For example, where a definition for "ordinarily resident" is introduced that results in unintended taxpayers falling outside the scope of the definition and not being subject to estate duty,

The Income Tax Codification Committee of Great Britain⁸³⁶ also considered the issue of tax uncertainty under the UK tax regime that similarly based its meaning of "ordinarily resident" on case law and therefore criticised the absence of a statutory definition of residence. The Committee opted for the creation of a statutory residence test to provide both clarity and flexibility under various circumstances and abolish the concept of "ordinarily resident" under its tax laws, which led to the drafting of the statutory residence test in 2013.⁸³⁷ Hardie⁸³⁸ supports the approach by the Committee in the context of South Africa for the creation of a statutory residence test that is clear and flexible to apply to various scenarios. It is submitted that despite the Katz Commission's reservations, the clarity that is available through a statutory test, without the aspect of the taxpayer's intention, can provide the required certainty and consistency that is currently lacking. A detailed discussion of the UK statutory resident test is set out in the comparative study in Chapter 5.⁸³⁹

The OECD⁸⁴⁰ states that in the context of estate tax, nationality⁸⁴¹ and residence are the most predominant connecting factor to impose an estate or inheritance tax.

whereas if the general case law principles are applied, the intended taxpayers are subject to estate duty.

⁸³⁶ Great Britain Treasury *Income Tax Codification Committee Report Vol 1* 37. The UK residence rules and jurisprudence have formed the basis of the South African principles, including ascribing meaning to tax residence and "ordinarily resident" (see Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 19).

⁸³⁷ *Cohen* case para 371 and *Kuttel* case para 306 defined "ordinarily resident" in the South African context and relied on UK cases when establishing its meaning. See para 5.2.3.2.3 below for a detailed discussion on the UK statutory resident test. It is accepted that the reliance on the UK case for the meaning of "ordinarily resident" was in the context of income tax and under UK inheritance tax, reference is made to "domicile" instead of being "ordinarily resident". For purposes of determining the meaning of "ordinarily resident" under estate duty, it is still relevant to consider the statutory residence test that replaced the meaning of "ordinarily resident" under the UK tax regime, even though "ordinarily residence" was only applied under UK income tax laws. See also Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 19.

⁸³⁸ Hardie *Analysis of the Expression "Ordinarily Resident"* 14.

⁸³⁹ See para 5.2.3.2.3 below.

⁸⁴⁰ OECD *Estate Tax Model* 50 and OECD *Inheritance Taxation in OECD Countries* 73. Countries where the legal system is based on English common law, base their estate tax system on "domicile" (having a more long-term connection to the country) which has a different meaning as "residence".

⁸⁴¹ Ketchemin criticises the use of nationality on the basis that in the case of a non-resident national, there is no economic link, and it may be difficult to enforce and collect taxes if there is no voluntary compliance from the taxpayer. Also, such an approach is undesirable in light of international economic integration. A policy based on a person's closest connection to a country is more desired. Nationality as a connecting factor is considered against public policy (see

However, where a country refers to "residence" it usually has virtually the same meaning as "domicile".⁸⁴² The *Estate Tax Model*⁸⁴³ does not prescribe a specific meaning to "domicile" or provide standards that domestic laws have to fulfil but recommends that it is determined based on each country's domestic law. The OECD⁸⁴⁴ supports objective tests laid down in legislation without relying on subjective factors to make the residence of a taxpayer easily determinable. A move away from the subjective test in determining a person's ordinary residence and instead following a more objective test will be aligned with the recommendation.⁸⁴⁵

Rudnick and Gordon⁸⁴⁶ state that the rules of income tax in determining whether an individual is a resident for tax purposes cannot be relied upon for estate tax purposes⁸⁴⁷ as income tax is established for each year of assessment, but for estate tax purposes it is a one-off determination in respect of long period. Rudnick and Gordon,⁸⁴⁸ however, admit that the concept of "domicile" is difficult to administer due to various complex factors that must be evaluated and there is objectively no clear-cut determination. A more objective determinable test may therefore be considered a more feasible test to determine residence for inheritance tax purposes as well.⁸⁴⁹

4.2.1.2.3 "Ordinarily resident" versus "domicile"

The concept of "ordinarily resident" is not the same as "domicile", however, its determination is also based on various objective factors that must support a

Ketchemin *Fiscal Jurisdiction in Income Tax Law* 19-20 and Baker "Some Thoughts on Jurisdiction and Nexus" 462).

⁸⁴² When defining "tax residence", the predominant international approach is to rely on the meaning for income tax purposes, which is based on have a permanent home available (being domiciled in a country) or having a physical presence in excess of 183 days during a 12-month period. See OECD 2023 <https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/> and OECD *Inheritance Taxation in OECD Countries* 73.

⁸⁴³ OECD *Estate Tax Model* 50.

⁸⁴⁴ OECD *Inheritance Taxation in OECD Countries* 73.

⁸⁴⁵ See para 6.2.1.2 below for a recommendation in this regard.

⁸⁴⁶ Rudnick and Gordon "Taxation of Wealth" 324.

⁸⁴⁷ From an international perspective, a "resident" for income tax purposes in comparison to estate or inheritance tax purposes are often differently determined. See Rudnick and Gordon "Taxation of Wealth" 324 and OECD *Inheritance Taxation in OECD Countries* 73.

⁸⁴⁸ Rudnick and Gordon "Taxation of Wealth" 324.

⁸⁴⁹ See para 6.2.1.2 below.

subjective intention.⁸⁵⁰ A clear distinction between "ordinarily resident" and "domicile" is that a person can cease to be ordinarily resident in one place without being resident somewhere else, but they cannot lose their domicile without obtaining another domicile elsewhere.⁸⁵¹ The question is therefore whether South Africa should consider including the concept of "domicile" in determining a person's residence for estate duty purposes or whether an alternative approach should be considered.

Although the basis of "domicile" is applied internationally, especially in the context of estate and inheritance tax, it has also been criticised due to the difficulty in making a determination based on various factors (including a person's intention), often limited to the knowledge of the deceased person.⁸⁵² It is therefore submitted that a move from an "ordinarily resident" test to a "domicile" test will not bring clarity but will merely provide the same challenges under a different concept.

The inclusion of specific and easily identifiable criteria to determine whether a person is a "resident" for estate duty purposes supports the tax canon to provide certainty and clarity to taxpayers.⁸⁵³ Therefore, the "ordinarily resident" approach should be reconsidered and a legislative meaning for a "resident" should be provided throughout the *Estate Duty Act*.⁸⁵⁴ Such definition should also cover the

⁸⁵⁰ Hardie *Analysis of the Expression "Ordinarily Resident"* 24-25. See also SARS *Interpretation Note No 35*.

⁸⁵¹ See Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 415 and *Estate Tax Model* 51-52. See also para 5.2.3.2.1 below.

⁸⁵² OECD *Inheritance Taxation in OECD Countries* 73. Rudnick and Gordon are also of the view that "domicile" is difficult to administer due to various complex factors that must be evaluated and there is objectively no clear-cut determination (see Rudnick and Gordon "Taxation of Wealth" 324). See also Ketchemin *Fiscal Jurisdiction in Income Tax Law* 597-98; paras 5.2.3.2.1 and 5.3.3.2.1 below for the application of "domicile" in the UK and the US and OECD *Estate Tax Model* 53-54, where the OECD caution that determining intention gives rise to endless disputes and may result in manipulation by executors or heirs who aim to establish the deceased person's intention.

⁸⁵³ See para 2.4.2.2 above.

⁸⁵⁴ This view is also supported by Roeleveld and Whitfield (see para 4.2.1.2.1.1 above). Also, Roeleveld 2015 *SAJAR* 153 and Whitfield *Tax Implications Arising for South African Residents* 121. A newly designed definition may also serve a dual purpose that could be considered for inclusion under the *Income Tax Act*.

circumstances and consequences when a person will cease to be a resident, for example, and will remain subject to tax for a period even after ceasing residence.

4.2.1.3 Conclusion relating to the concept of "ordinarily resident"

The approach under the *Estate Duty Act* to levy estate duty on a resident on a worldwide basis and for a non-resident on a source basis is internationally aligned.⁸⁵⁵ It does not incorporate the concept of "domicile" and has never done so. It has always relied on the "ordinarily resident" basis, even when South Africa moved to a residence-based tax system in 2001,⁸⁵⁶ it retained its "ordinarily resident" basis for estate duty purposes and did not widen its scope as per the *Income Tax Act* to also consider physical presence.⁸⁵⁷ The distinction between a "tax resident" for income tax and estate duty purposes may be internationally aligned, however, it has also been criticised on the basis that it results in administrative difficulties and inequity due to inconsistent tax consequences.⁸⁵⁸ The criticism against the concept of "ordinarily resident" was discussed⁸⁵⁹ and it was concluded that a statutory resident test based on facts and circumstances may provide clarity and certainty in determining residency without relying on a person's intention.⁸⁶⁰ A move away from the deceased person's intention will eliminate the predicament where a person's intention must be established without that person being alive to do so.⁸⁶¹

It is accepted that the meaning of "resident" for income tax and estate duty purposes may be different on the rationale that income tax looks at an annual determination whereas estate duty looks over a longer period.⁸⁶² However, in

⁸⁵⁵ Ketchemin *Fiscal Jurisdiction in Income Tax Law* 51. See also Baker "Some Thoughts on Jurisdiction and Nexus" 442; Nizamiev *The Main Characteristics of State's Jurisdiction to Tax in International Dimension* 24-31, s 2103 of the *Internal Revenue Code* and ss 5-6 of the *Inheritance Tax Act*.

⁸⁵⁶ The residence-minus-based tax system is where a resident is taxed on worldwide income and assets subject to a credit for any tax paid in a foreign country on income and assets from abroad.

⁸⁵⁷ Definition of "resident" in s 1 of the *Income Tax Act*.

⁸⁵⁸ See para 5.2.1 below where it was discussed that a legislative definition for the determination of a "resident" for estate duty purposes is required.

⁸⁵⁹ See para 4.2.1.2.1 above.

⁸⁶⁰ See para 4.2.1.2.2 above.

⁸⁶¹ See para 6.2.1.2 below.

⁸⁶² Rudnick and Gordon "Taxation of Wealth" 324.

defining a "resident" for estate duty purposes, concerns of inconsistency and inequality should be borne in mind to bring alignment as far as possible between the different tax types (including income tax, donations tax, capital gains tax and estate duty).⁸⁶³

It was suggested that the definition of a "resident" for estate duty purposes should include tail provisions for a person who ceases residence to serve as an anti-avoidance rule under the *Estate Duty Act*.⁸⁶⁴

The following section considers the different scope of property for a non-resident for CGT and estate duty purposes.

4.2.2 Scope of "property" and "deemed property" under the Estate Duty Act

4.2.2.1 Misalignment in the scope of "property" between CGT and estate duty for a non-resident

A misalignment arises in that indirect interests in the form of shares held in a foreign company that owns South African immovable property are included for CGT purposes for a non-resident,⁸⁶⁵ however, such indirect interest in South African property is not included for estate duty purposes. Similar to the mismatch for purposes of section 4(b) discussed above,⁸⁶⁶ a mismatch will arise in this instance where the CGT payable on the indirect interest will not be deductible for estate duty purposes as the indirect interest was not included in the non-resident's estate for estate duty purposes. Roeleveld⁸⁶⁷ stated that non-residents for CGT purposes are taxed on a wider range of assets in comparison to a non-resident for estate duty purposes. This may also open an opportunity to own South African immovable property indirectly without having such interest subject to estate duty. Roeleveld⁸⁶⁸

⁸⁶³ See para 6.2.1.2 below.

⁸⁶⁴ A recommendation for a definition for "resident" is set out para 6.2.1.2 below.

⁸⁶⁵ Paragraph 2(b) of the Eighth Schedule to the *Income Tax Act*. This includes a minimum shareholding by a non-resident of 20% in a foreign company that owns South African immovable property, provided 80% of the market value of the immovable property contributes towards the market value of the shares of the company. The sale of the shares attracts CGT.

⁸⁶⁶ See para 4.2.1.1 above.

⁸⁶⁷ Roeleveld 2015 *SAJAR* 153.

⁸⁶⁸ Roeleveld 2015 *SAJAR* 153.

further states that both the *Estate Duty Act* and the existing estate duty treaties do not adequately deal with this situation as such indirect interests are not covered.

Roeleveld⁸⁶⁹ further states that to address the misalignments under the *Estate Duty Act*, clarity must be provided through amendments to the Act by taking into account the *OECD Estate Tax Model* to adhere to international standards.

The different scope in property for purposes of CGT and estate duty, specifically regarding shares held by a non-resident in companies holding immovable properties, is noted by the OECD as an issue that receives different treatment by the different States.⁸⁷⁰ However, the OECD⁸⁷¹ is of the view that such indirect interest (shares held in a company owning immovable property) should form part of the estate of the deceased in their country of residence, irrespective of where the property is situated. This is currently the implied approach under the *Estate Duty Act* where the indirect interest is not subject to estate duty in South Africa as the country where the property is situated on the assumption it is included in the country of residence of the deceased. Due to conflict that often arises in this regard, the OECD recommends that countries may through estate tax treaties introduce specific provisions to address double tax implications that may arise. If a similar approach as CGT is followed and the indirect interest is included for estate duty purposes, it may result in double taxation due to the country of residence also taxing such interest. Any relief regarding double taxation is usually provided by the country of residence. In the case of a non-resident, South Africa as the country of source of the property will enjoy a taxing right and the deceased's country of residence should provide relief from double taxation (if any).⁸⁷²

The UK has undergone a similar change regarding UK residential property that is held indirectly through offshore structures. The reasoning for including the shares held in such offshore structures was because, for inheritance tax purposes, an individual who is not domiciled in the UK is not liable for inheritance tax on any

⁸⁶⁹ Roeleveld 2015 *SAJAR* 158.

⁸⁷⁰ Article 7 of the *Estate Tax Model*.

⁸⁷¹ OECD *Estate Tax Model* 70-71 and Article 7 of the *Estate Tax Model*.

⁸⁷² OECD *Estate Tax Model* 16, 74.

property situated overseas, while UK-domiciled individuals are liable for inheritance tax on their worldwide property. This treatment relevant to non-UK domiciled individuals led to schemes to avoid inheritance tax by holding UK residential properties indirectly through overseas structures such as companies, trusts and partnerships. This led to a change in policy where the definition of "excluded property" for inheritance tax purposes was amended to make such indirect interests held in UK residential properties subject to inheritance tax.⁸⁷³

A similar opportunity exists for non-residents for estate duty purposes by allowing a non-resident to own South African immovable property indirectly through offshore structures. If the OECD *Estate Tax Model's* approach is followed, no change is required as it is aligned. However, if Roeleveld's recommendation is followed to bring alignment between CGT and estate duty and to close potential gaps for estate duty avoidance, an amendment is required to the *Estate Duty Act*. An expansion of the scope of property of a non-resident can be considered by excluding from the exclusions under section 3(2) of the *Estate Duty Act* indirect interests in South African immovable property to align the scope of property for CGT and estate duty purposes. This will furthermore promote the canon of equity in that the scope of property for a non-resident for both CGT and estate duty purposes is aligned and any CGT liability that may arise regarding foreign property will be regarded as a debt due and allowed as a deduction for estate duty purposes.⁸⁷⁴

The next section will consider challenges identified in respect of life insurance policies that are included as "deemed property" under the *Estate Duty Act*.

⁸⁷³ HMRC *Explanatory Note for Inheritance Tax on Overseas Property Representing UK Residential Property* para 43. See also Schedule A1 to the *Inheritance Tax Act* setting out the non-excluded overseas property.

⁸⁷⁴ The inclusion of the foreign property may be due to the deceased being a resident by way of physical presence for CGT purposes or due to the deceased being a non-resident but the indirect interest in a company owning foreign immovable property (see para 4.2.2.1 above).

4.2.2.2 Life insurance policies

4.2.2.2.1 Scope of section 3(3)(a) of the *Estate Duty Act*

The estate of a deceased person is determined as at the date of death and consists of all vested proprietary rights and interests of the deceased as well as the property that is deemed to be property of the deceased according to the *Estate Duty Act*.⁸⁷⁵ Any proprietary rights the deceased had contracted into before death constitute property of the estate at the date of death.⁸⁷⁶ Therefore, any proceeds of a life insurance policy, provided it is a domestic policy,⁸⁷⁷ payable to the deceased estate constitutes property of the deceased. However, the proceeds payable to a nominated beneficiary are not regarded as property of the estate as the assets or proceeds were not received by the executor for the administration of estate purposes.⁸⁷⁸

To counter the possible abuse by merely nominating a beneficiary for the policy proceeds to fall outside the estate, the *Estate Duty Act* includes the proceeds of a domestic policy on the life of the deceased as "deemed property" for estate duty purposes.⁸⁷⁹

⁸⁷⁵ Section 3(1) of the *Estate Duty Act*.

⁸⁷⁶ *CIR v Estate Hersov* 1952 4 SA 559 (AD) para 568 where Centlivres CJ noted that when considering the proceeds of a life policy paid out to the deceased estate, the deceased is regarded as having a proprietary right in the policy that was transferred to the estate upon death. See also Meyerowitz *Administration of Estates* 27.21 and Cilliers *Administration of Estates* 513.

⁸⁷⁷ The term "domestic policy" is defined in s 1(1) of the *Estate Duty Act* to mean "any life policy as defined in section 1 of the Long-term Insurance Act, 1998 (Act No. 52 of 1998), issued anywhere upon an application made or presented to a representative of an insurer (or to any person on behalf of such a representative) at any place in the Republic, excluding a life policy which has been made payable at a place outside the Republic at the request of the owner, but including any life policy issued outside the Republic which has subsequently been made payable in the Republic at the request of the owner".

⁸⁷⁸ The position was confirmed in *Love v Santam Life Insurance* 2004 3 SA 425 (SCA). The court held that once the nominated beneficiary accepts the policy benefits, the right to the proceeds vests directly in the beneficiary and is not first routed through the deceased estate. The proceeds were considered to fall outside the deceased's estate. See also De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 141.

⁸⁷⁹ Section 3(3)(a) of the *Estate Duty Act* states property that is deemed to be property of the deceased includes "so much of any amount due and recoverable under any policy of insurance which is a 'domestic policy', upon the life of the deceased as exceeds the aggregate amount of any premiums or consideration proved to the satisfaction of the Commissioner to have been

The wide scope of the wording of section 3(3)(a) does not only include policies payable to a nominated beneficiary but also policies paid out to the deceased estate.⁸⁸⁰ Meyerowitz⁸⁸¹ states that although the proceeds payable to the deceased estate are regarded as property in the estate, it is also specifically included as deemed property of the estate. In practice, the proceeds are treated as deemed property under section 3(3)(a) and only included once in the estate.⁸⁸² Davis, Beneke and Jooste⁸⁸³ state that section 3(3)(a) should only deem property to be that of the deceased for purposes of the *Estate Duty Act* if it is not property of the deceased. However, they are of the view that the provision does not adhere to the canon of certainty as it is considered confusing in that the deeming provision relating to insurance policies should be limited to policies payable to third parties (excluding the deceased estate). The current inclusion of policy proceeds that is "property" in the deeming provision is not sound.⁸⁸⁴

Previously, domestic policies were dealt with under section 3(4)(a) of the *Death Duties Act* and included proceeds from a life insurance policy taken out on the life of the deceased and payable to a third party to the extent it was "kept up"⁸⁸⁵ by the deceased or if the deceased did not pay all the premiums, the amount proportionate to the sum of the premiums paid by the deceased. However, if the policy was paid out to the deceased estate, the full amount was included in the dutiable estate.⁸⁸⁶ However, when the *Death Duty Act* was replaced by the *Estate Duty Act*, the principle that the policy had to be "kept up" by the deceased was replaced with the principle that the policy was dutiable to the extent the proceeds exceeded the

paid by any person who is entitled to the amount due under the policy, together with interest at 6 % per annum calculated upon such premiums or consideration from the date of payment to the date of death...". See also Muller *Wealth Transfer Taxation* 190-191; Meyerowitz *Administration of Estates* 27.21 and Cilliers *Administration of Estates* 519.

⁸⁸⁰ Meyerowitz *Administration of Estates* 27.21. See also Cilliers *Administration of Estates* 513, 517.

⁸⁸¹ Meyerowitz *Administration of Estates* 27.21. See also Cilliers *Administration of Estates* 513, 517.

⁸⁸² Muller *Wealth Transfer Taxation* 191.

⁸⁸³ Davis, Beneke and Jooste *Estate Planning* 2.4.2.1.

⁸⁸⁴ Davis, Beneke and Jooste *Estate Planning* 2.4.2.1.

⁸⁸⁵ The term "kept up" was interpreted to mean contributed or paid premiums towards the policy. See Meyerowitz 1982 *The Taxpayer* 82.

⁸⁸⁶ Exclusions also existed where the policy was paid out to the spouse or child under a duly registered antenuptial or post-nuptial contract.

premiums paid by the beneficiary of the policy together with 6% interest per annum from the date of payment to the date of death.⁸⁸⁷

The impact of the different principles is explained by way of an example in the table below:

Table 4.2: Difference between section 3(4)(a) of the *Death Duties Act* and section 3(3)(a) of the *Estate Duty Act* regarding domestic policies

Example: Domestic Policies	
Assume that the policy proceeds are R200 000 on the life of the deceased for the benefit of the deceased's son. The premium per annum is R5 000 and the deceased paid the first premium and the deceased's son paid the second premium after which the deceased died. The impact under each provision is as follows:	
Section 3(4)(a) of the <i>Death Duties Act</i>	Section 3(3)(a) of the <i>Estate Duty Act</i>
$R200\ 000 \times R5\ 000/R10\ 000$ $= R200\ 000 \times 50\%$ $= R100\ 000$ is dutiable as the deceased paid 50% of the premiums.	$R200\ 000 - (R5\ 000 + R618)^{888}$ $= R200\ 000 - R5\ 618$ $= R194\ 382$ is dutiable as the beneficiary paid only R5 000 plus the notional interest.
If the deceased paid both premiums, 100% (R200 000) of the policy proceeds would be dutiable.	If the deceased paid both premiums, 100% (R200 000) of the policy proceeds would be dutiable.
If the beneficiary paid both premiums, none of the policy proceeds would have been dutiable.	If the beneficiary paid both premiums, the dutiable value of the policy would be: $R200\ 000 - (R10\ 000 + R1\ 218)^{889}$ $= R188\ 782$

What is clear from the above is that domestic policies are subject to more estate duty under the *Estate Duty Act* in comparison to the *Death Duties Act*. This is applicable under both scenarios where the deceased and the beneficiary paid any premiums or where the beneficiary paid all the premiums. The only instance where a similar outcome occurs is when the deceased paid all the premiums. Meyerowitz⁸⁹⁰ criticises the change from the principles laid down in respect of domestic policies

⁸⁸⁷ Section 3(3)(a) of the *Estate Duty Act*. See also Meyerowitz 1982 *The Taxpayer* 82. It should be noted that the interest rate remained at 6% and did not change to the official interest rate as contained in other fiscal legislation.

⁸⁸⁸ Interest calculated: $R5\ 000 \times 6\% = R300$ + $R5\ 300 \times 6\% = 318$. Thus, total interest is $R300 + R318 = R618$.

⁸⁸⁹ Interest on premiums: $R10\ 000 \times 6\% = R600$ + $R10\ 600 \times 6\% = R636$. Thus, the total interest = $R600 + R618 = R1\ 218$.

⁸⁹⁰ Meyerowitz 1982 *The Taxpayer* 82.

under the *Death Duties Act* to those under the *Estate Duty Act* on the basis that no sound reasons were provided to explain the reasons for the change.

The underlying principle of section 3(3)(a) of the *Estate Duty Act* is that the proceeds of a life policy are subject to estate duty, irrespective of whether the deceased paid any premiums towards the policy and only to the extent that a beneficiary profited.⁸⁹¹ Meyerowitz⁸⁹² also states that, except for the specific exclusions under section 3(3)(a)(i), (ii) and (iA), it is irrelevant by whom the policy was affected, whether the deceased paid any premiums or had a financial interest in the policy.⁸⁹³ For example, where a father takes out a life insurance policy on the life of his son and pays all the premiums, the policy proceeds paid out to the estate will be included as deemed property in the son's estate for estate duty purposes. However, if the father was the nominated beneficiary, the amount to be included in the estate as deemed property will only be so much of the proceeds as it exceeds the premiums paid by the beneficiary (the father) plus 6% per annum calculated on the premiums paid from the date of payment to the date of death. The following table illustrates the example:

Table 4.3: Calculating the extent proceeds are deemed property

Calculation	R
Policy proceeds qualifying as deemed property	200 000
Less: total premiums paid by the beneficiary	(34 000)
Less: 6% interest on R34 000 for 4 years ⁸⁹⁴ Year 1: R34 000 x 6% = R2 040 Year 2: R36 040 x 6% = R2 162 Year 3: R38 202 x 6% = R2 292 Year 4: R40 494 x 6% = R2 430	(8 924)
Portion included under s 3(3)(a)	157 076 ⁸⁹⁵

⁸⁹¹ This principle explains the rationale why the policy proceeds are reduced by any premiums paid by the beneficiary plus the notional interest thereon. See also Meyerowitz 1982 *The Taxpayer* 82.

⁸⁹² Meyerowitz *Administration of Estates* 27.29. See also Cilliers *Administration of Estates* 519.

⁸⁹³ Previously, s 3(4)(a) of the *Death Duties Act* only included life insurance policies if the policy was affected by the deceased and paid the premiums.

⁸⁹⁴ The interest is compounded annually. See Meyerowitz *Administration of Estates* 27.35; Stiglingh *et al Silke: South African Income Tax* 1035 and Cilliers *Administration of Estates* 521.

⁸⁹⁵ If compared to the instance where the estate is the beneficiary, the full R200 000 is included as deemed property with no deduction of the premiums paid by the father as the estate and not the father was the beneficiary of the life policy proceeds.

For purposes of calculating the reduction in the proceeds of premiums paid, the words "person who is entitled to the amount under the policy" do not include the deceased estate⁸⁹⁶ as the term "person" is not defined under the *Estate Duty Act* or the *Tax Administration Act* to apply for purposes of administering the *Estate Duty Act*. Although a "person" for purposes of the *Income Tax Act* is defined to include a deceased estate, the same does not apply under the *Estate Duty Act*. Therefore, on the basis that a deceased estate is not a "person"⁸⁹⁷ and the executor merely receives the policy in their capacity as the representative of the deceased estate and paid none of the premiums, the full amount of the policy is included as deemed property under section 3(3)(a) of the *Estate Duty Act*. No deduction regarding premiums paid by the deceased is allowed against the proceeds of the life insurance policy paid out to the estate. Meyerowitz⁸⁹⁸ states that this outcome correctly avoids the anomaly that the dutiable estate of the deceased is reduced by the premiums paid by the deceased.

Meyerowitz⁸⁹⁹ states that the proceeds of a life policy should not be taxed merely because the deceased's life is insured, but because the deceased had a financial interest in the proceeds of the policy or made contributions towards the policy. He further states that the *Estate Duty Act* is about the dutiable estate of the deceased and not about the benefits accruing to someone else due to the death of the deceased. In the absence of any reasoning provided with the change from the legal position under the *Death Duties Act* to the position under the *Estate Duty Act*, he proposes that section 3(3)(a) should revert to the position under the *Death Duties Act* where sound principles were in place and domestic policies were only included when the deceased contributed or had a financial interest in the policy. Muller⁹⁰⁰ supports Meyerowitz regarding the rationale to not include a policy payable to third parties to the extent that the deceased did not make any contributions.

⁸⁹⁶ Stiglingh *et al Silke: South African Income Tax* 1035.

⁸⁹⁷ *CIR v Emary* 1961 2 SA 621.

⁸⁹⁸ Meyerowitz *Administration of Estates* 27.34. See also Cilliers *Administration of Estates* 521.

⁸⁹⁹ Meyerowitz 1982 *The Taxpayer* 82.

⁹⁰⁰ Muller *Wealth Transfer Taxation* 236.

When considering the basis on which the estate duty is calculated based on the dutiable estate of the deceased person and not merely based on the benefit which may accrue to some other person, it is agreed with Meyerowitz⁹⁰¹ that the inclusion of the proceeds of life policies paid out to third parties in which the deceased person had no financial interest and made no contribution towards, is unjustifiable.⁹⁰²

The OECD,⁹⁰³ however, supports the taxation of life insurance pay-outs, to prevent tax planning opportunities. The OECD⁹⁰⁴ is of the view that the justification for excluding life insurance policies is limited as they are regarded as tax-efficient investment vehicles consisting of investment and savings products that can also be held directly by a person. Those benefitting from the preferential treatment are the wealthy which also negatively influences the equality principle.

Rudnick and Gordon⁹⁰⁵ argue that where a life insurance pay-out compensates for the loss of opportunity or represents a person's human capital that would have been consumed during the deceased person's life, it is regarded as unfair to include such benefit in the estate tax base. They further agree that it must be included where it represents the transfer of wealth, but when life insurance policies are excluded, it may be difficult to design rules to combat potential abuse.⁹⁰⁶ The exclusion of life insurance policies from the gross estate should be subject to certain conditions, for example, the estate must not be a beneficiary and the deceased person must not

⁹⁰¹ Meyerowitz 1982 *The Taxpayer* 83.

⁹⁰² Section 2(2) of the *Estate Duty Act*.

⁹⁰³ OECD *Inheritance Taxation in OECD Countries* 98, 125. The preferential treatment may result in estate planners directing more of their wealth into life insurance policies instead of other options to enjoy the exemption from estate tax.

⁹⁰⁴ OECD *Inheritance Taxation in OECD Countries* 125.

⁹⁰⁵ Rudnick and Gordon "Taxation of Wealth" 328.

⁹⁰⁶ Section 2042 of the *Internal Revenue Code* provides that proceeds of life insurance that is paid into an estate or where the deceased had an incident of ownership at death, the proceeds should be included in the estate for estate tax purposes. However, if it is directly paid to a beneficiary, it is not included in the estate. Similar rules apply for the UK, see OECD *Inheritance Taxation in OECD Countries* 98, s 2 of the *Inheritance Tax Act* and para 5.3.4(i) below.

be the owner for a period before death.⁹⁰⁷ Although conditions may result in complex administration, it is required to prevent estate tax avoidance.⁹⁰⁸

Therefore, considering the above, the general stance as per the OECD's recommendation to include life insurance policies in the estate for estate duty purposes is sound and should be retained. However, refined requirements as stipulated by Rudnick and Gordon, as well as Meyerowitz, should be considered to ensure that a life policy is only included where the deceased had either owned the policy, had a financial interest, or contributed to the policy. It is recommended that for the reasons discussed above the wording of section 3(4)(a) of the *Death Duties Act*, the predecessor of section 3(3)(a) of the *Estate Duty Act*, serve as a benchmark for enhancing the provisions on life policies.⁹⁰⁹

4.2.2.2.2 Life insurance policies excluded from the dutiable estate

Three exclusions exist under section 3(3)(a) where such policies will be excluded from the estate and not be deemed to be property for estate duty purposes.⁹¹⁰

The first exclusion excludes the policy proceeds paid to a surviving spouse⁹¹¹ or a child⁹¹² of the deceased person under a duly registered antenuptial or postnuptial contract.⁹¹³

The second exclusion⁹¹⁴ excludes policy proceeds in relation to a "buy-and-sell agreement" between partners (partnership) or shareholders (companies) or

⁹⁰⁷ Ownership entails the authority to change beneficiaries or the option to borrow against the surrender value of the policy.

⁹⁰⁸ Rudnick and Gordon "Taxation of Wealth" 329.

⁹⁰⁹ See para 6.2.2.2.2 below for a recommendation.

⁹¹⁰ See s 3(3)(a)(i), (iA) and (ii) of the *Estate Duty Act*.

⁹¹¹ Definition of a "spouse" is set out in s 1 of the *Estate Duty Act*. See also para 4.2.3.2 below for a detailed discussion of the definition of "spouse".

⁹¹² Section 1 of the *Estate Duty Act* defines a "child" to include any adopted child under the laws of South Africa or of another country, provided such an adopted child will also be regarded as a legitimate child of the deceased person according to the laws of that country and the adoption must have been done when the deceased was "ordinarily resident" in that country.

⁹¹³ Section 3(3)(a)(i) of the *Estate Duty Act* provides that "any amount due and recoverable under a policy of insurance, if – (i) the amount due under such policy is recoverable by the surviving spouse or child of the deceased under a duly registered ante-nuptial or post-nuptial contract;".

⁹¹⁴ Section 3(3)(a)(iA) of the *Estate Duty Act* further excludes from deemed property if "the Commissioner is satisfied that the policy was taken out or acquired by a person who on the date

members (close corporations).⁹¹⁵ It is agreed that when one of them dies, the deceased partner, shareholder or member undertakes to sell their share or like interest⁹¹⁶ and the remaining partners, shareholders or members undertake to buy the interest of the deceased. It is therefore required that the policy was taken out or acquired⁹¹⁷ by a person (the policyholder) who was a partner, a co-shareholder or a co-member at the date of death of the deceased.⁹¹⁸ The purpose of the arrangement must have been to enable the policyholder to acquire the whole or part of the deceased's interest in the partnership⁹¹⁹ or share in the company or member's interest in a close corporation and any claim the deceased had against the company,⁹²⁰ provided the deceased did not pay any premium regarding the policy.⁹²¹ The purpose for taking out the policy is determined at the time when the policy is taken out or acquired. The exclusion from deemed property for estate duty purposes is concerned with the "purpose" for which the policy was taken out or acquired and not what the proceeds were used for.⁹²²

The above exclusion is not without flaws which have been identified over time. Meyerowitz⁹²³ argues that an anomaly exists in that if the policy was taken out to acquire the deceased's interest, the exclusion will apply, irrespective if it was

of death of the deceased was a partner of the deceased, or held any share or like interest in a company in which the deceased on that date held any share or like interest, for the purpose of enabling that person to acquire the whole or part of – (aa) the deceased's interest in the partnership concerned; or (bb) the deceased's share or like interest in that company and any claim by the deceased against that company, and that no premium on the policy was paid or borne by the deceased; or".

⁹¹⁵ The reference to "held any share or like interest" includes a member's interest in a close corporation and therefore extends the application of s 3(3)(a) to close corporations. See Meyerowitz *Administration of Estates* 27.37; Cilliers *Administration of Estates* 525-526 and s 4(1)(a) of the *Revenue Law Amendment Act* 81 of 1985.

⁹¹⁶ The words "like interest" was included by s 4(1)(a) of the *Revenue Law Amendment Act* 81 of 1985 to specifically cater for the member's interest in a close corporation that was not previously included.

⁹¹⁷ These policies also include policies that have been acquired by cession. See SARS *Estate Duty Implications on Buy-and-Sell Arrangements* 3.

⁹¹⁸ If the policyholder and the deceased ceased to be partners/co-shareholders or co-members prior to the deceased's death, the exclusion under s 3(3)(a)(iA) of the *Estate Duty Act* does not apply.

⁹¹⁹ Section 3(3)(a)(iA)(aa) of the *Estate Duty Act*.

⁹²⁰ Section 3(3)(a)(iA)(bb) of the *Estate Duty Act*.

⁹²¹ Section 3(3)(a)(iA) of the *Estate Duty Act*.

⁹²² Delport *The Definition of Property for Estate Duty Purposes* 143.

⁹²³ Meyerowitz *Administration of Estates* 27.37. See also Cilliers *Administration of Estates* 525-526.

ultimately used to acquire the interest. On the contrary, if the policy was not taken out to acquire the deceased interest but for some other reason, the exclusion will not apply even if it was ultimately used to acquire the deceased's interest.

Regarding the requirement that no premium should be borne or paid by the deceased, Meyerowitz⁹²⁴ is of the view that where the premium is paid indirectly in that someone else paid the premiums on behalf of the deceased with funds supplied by the deceased, it will also be considered as paid or borne by the deceased. Meyerowitz⁹²⁵ refers to the example where a company pays the premiums of a policy on the deceased's life and debits the amount against the deceased's loan account, in which case the premiums will be deemed to be paid or borne by the deceased. SARS⁹²⁶ agrees with this view, however, Davis, Beneke and Jooste⁹²⁷ have a contrary view in that the mere provision of the funds for another to pay the premiums does not make a person the payer of the funds if it was not paid directly from the funds of the person concerned. It is, however, submitted that on the basis that the funds provided enabled the receiver to pay the premium, without which it would not have been paid, the provider of the funds should be considered the payer of the funds.

In determining the party liable for the premiums, Muller⁹²⁸ raises the questions on whether section 3(3)(a) of the *Estate Duty Act* solely considers the person who is obligated to pay the premiums under the insurance contract or whether it can also include the person who paid the premiums or supplied the funds for the premiums (irrespective of who was obligated under the policy). Meyerowitz,⁹²⁹ in addressing the same issue, refers to the repealed *Death Duties Act* where a policy was dutiable to the extent the policy was "kept up" by the deceased. In *Reynold's Estate v CIR*,⁹³⁰ where the deceased person created a trust fund that provided that the life policy premiums on the deceased's life should be paid from the trust fund's income, it was

⁹²⁴ SARS *Estate Duty Implications on Key Man Policies* 3.

⁹²⁵ Meyerowitz *Administration of Estates* 27.40.

⁹²⁶ SARS *Estate Duty Implications on Key Man Policies* 3.

⁹²⁷ Davis, Beneke and Jooste *Estate Planning* 2.4.2.1.

⁹²⁸ Muller *Wealth Transfer Taxation* 193.

⁹²⁹ Meyerowitz *Administration of Estates* 27.34. See also Cilliers *Administration of Estates* 522.

⁹³⁰ 1937 AD 57.

held that the premiums were "kept up" by the deceased as the real author of the premiums. Meyerowitz⁹³¹ states that the same meaning should be applied to section 3(3)(a) of the *Estate Duty Act* in that the real author should be considered and not merely the person liable under the policy. Meyerowitz's view is supported to consider the substance of an arrangement over its form which may also serve as an anti-avoidance measure where the deceased may be the funder of the premiums but disguising behind the person liable under the policy.

The third exclusion⁹³² relates to "key-person policies".⁹³³ The policy will be excluded if the Commissioner is satisfied that the policy was not effected by⁹³⁴ or at the instance⁹³⁵ of the deceased; no premium for the policy was borne or paid⁹³⁶ by the deceased;⁹³⁷ and provided no benefit under the policy will be paid to the deceased's estate,⁹³⁸ or be paid to or used for the benefit of any relative of the deceased, or a

⁹³¹ Meyerowitz *Administration of Estates* 27.34; Meyerowitz 1971 *The Taxpayer* 40 and Cilliers *Administration of Estates* 522.

⁹³² Section 3(3)(a)(ii) of the *Estate Duty Act* excludes from deemed property a policy that "... the Commissioner is satisfied and remains satisfied that such policy was not effected by or at the instance of the deceased, that no premium on such policy was paid or borne by the deceased, that no amount due or recoverable under such policy has been or will be paid into the estate of the deceased and that no such amount has been or will be paid to, or utilised for the benefit of, any relative of the deceased or any person who was wholly or partly dependent for his maintenance upon the deceased or any company which was at any time a family company in relation to the deceased;".

⁹³³ Also referred to as a key-man policy.

⁹³⁴ A policy is considered to be effected by the deceased if the deceased was the contracting party to the insurance contract with the insurer. See Meyerowitz *Administration of Estates* 27.39 and SARS *Estate Duty Implications on Key Man Policies* 3.

⁹³⁵ The phrase "at the instance of the deceased" has been given the meaning "at the request or suggestion" of the deceased person. See Meyerowitz *Administration of Estates* 27.39; Cilliers *Administration of Estates* 526-527 and SARS *Estate Duty Implications on Key Man Policies* 3.

⁹³⁶ The deceased would have "borne or paid" premiums if the deceased provided the fund indirectly, for example where a company paid the premium and debited the deceased's loan account. See SARS *Estate Duty Implications on Key Man Policies* 3.

⁹³⁷ Section 2(2) read with s 18 of the *Friendly Societies Act* provides that the member on whose life the death benefit is taken out and is to receive the benefit, subject to a nomination, is the one making the premium payments. See also Kilian 2021 *PELJ* 6-7.

⁹³⁸ Section 20(5)(d) of the *Friendly Societies Act* allows for a registered friendly society to take out an insurance policy on the lives of its employees and also pay such premiums, provided the rules of the friendly society allows for it and it is for the benefit of the employee or their dependants which implies that when the policy is paid out to the deceased estate, it will be included as a deemed asset and not qualify for the exclusions under s 3(3)(a) of the *Estate Duty Act*.

person who was wholly or partially dependent for his maintenance on the deceased or any company which was at any time a family company⁹³⁹ about the deceased.⁹⁴⁰

Muller⁹⁴¹ raises the question of whether a pro-rata exclusion is allowed if all the proceeds of the key-person policy are not paid to the deceased estate, a relative or a family company. SARS⁹⁴² states that the wording of section 3(3)(a)(ii) of the *Estate Duty Act* does not make any provision for apportionment and the view was supported by Joffe.⁹⁴³ It is an all-or-nothing approach in that either the full value of the proceeds is excluded or dutiable. Stein,⁹⁴⁴ however, is of the view that the balance should still be considered for the exclusion. It is implied that the actual use of the policy should be considered when determining whether the exclusion should apply and it should not merely be relied on the qualifying criteria. The OECD⁹⁴⁵ states that where preferential treatment, like the above exclusions, is provided regarding life insurance policies, there must exist strong justification for the preferential treatment, and capped amounts should be considered.

Considering the first exclusion about the child or surviving spouse, the justification is found in the maintenance and care of the remaining family in the event of the main breadwinner's death. Regarding the second and third exclusions where a third party takes out a policy on the deceased's life to protect a legitimate interest, Meyerowitz⁹⁴⁶ states that it would be illogical to subject such policy to estate duty where a third party simply insured the deceased's life to protect a legitimate interest (continuance of a business). This justification was also supported by the legislature when subparagraphs (iA) and (ii) were inserted under section 3(3)(a).

⁹³⁹ The term "family company" is defined in s 1 of the *Estate Duty Act* as any company (other than a listed company) which at any time was controlled or capable of being controlled directly or indirectly (by holding a majority of shares or other interest or any other way) by the deceased person or together with a relative of the deceased person.

⁹⁴⁰ Section 3(3)(a)(ii) of the *Estate Duty Act*.

⁹⁴¹ Muller *Wealth Transfer Taxation* 195-196.

⁹⁴² SARS *Estate Duty Implications on Key Man Policies* 4.

⁹⁴³ Joffe 2009 *De Rebus* 42.

⁹⁴⁴ Stein *Estate Duty: Principles and Planning* 42.

⁹⁴⁵ OECD *Inheritance Taxation in OECD Countries* 125.

⁹⁴⁶ Meyerowitz *Administration of Estates* 27.39. See also Cilliers *Administration of Estates* 525-526.

In 2009, the Minister of Finance⁹⁴⁷ noted the uncertainty and opportunity for estate planning and recommended an alternative as an exempt threshold for life insurance policies up to a certain amount. However, such an exemption is subject to the condition that the policy was not created shortly before death. Joffe⁹⁴⁸ criticises the proposal on the basis that the exclusion for buy-and-sell and key-person structures is aimed at benefitting small businesses to ensure continuity and was not designed to benefit the wealthy as stated by the Minister. Furthermore, due to the specific requirements laid down in the *Estate Duty Act*, no estate planning is involved to fall within the scope of the exclusion. Joffe⁹⁴⁹ also stated that the value of the exemption should not be too low where it serves no purpose in estates with a dutiable value of less than R3.5 million and considered a reasonable amount to be R1 million. The condition that the policy should not be taken out shortly before death was also criticised by Joffe⁹⁵⁰ on the basis that a person close to death would not be able to take out a policy due to the strict underwriting requirements of insurance companies. Furthermore, where a policy was taken out shortly before death, the policy would most likely also not be paid out if there was any non-disclosure of a serious illness. The proposal was subsequently withdrawn by National Treasury, as it was found to open a window for estate duty avoidance when making investments through one vehicle.⁹⁵¹

The following section considers the issue regarding the recipient-based approach regarding the payment of the estate duty liability on the proceeds of a life insurance policy.

4.2.2.2.3 Party liable for estate duty due

The estate duty liability on policies paid out to the estate are payable by the executor who is effectively paying the liability on behalf of the residue heirs of the estate

⁹⁴⁷ National Treasury *Budget Tax Proposals* 2008/09 30.

⁹⁴⁸ Joffe 2008 *Tax Breaks* 7-8.

⁹⁴⁹ Joffe 2008 *Tax Breaks* 8.

⁹⁵⁰ Joffe 2008 *Tax Breaks* 8.

⁹⁵¹ Hamlyn 2008 <https://mg.co.za/article/2008-10-20-treasury-changes-its-mind-on-estateduty-exemption/>.

without considering the heirs' circumstances. The estate duty payable on life policies paid out to a third party is subject to estate duty in the hands of the beneficiary.⁹⁵² This direct pay-out to beneficiaries in the existing estate duty regime creates difficulties in the collection of funds from beneficiaries as the funds are not received by the estate and fall outside the control of the executor.⁹⁵³ However, following a transferor-based approach and holding the executor liable in these instances will be problematic as the executor never receives any of the funds to settle the related liability. The residue heirs will be in an unequal position by having to pay a liability for a benefit they will never receive and therefore not adhering to the canon of equality. Therefore, the recipient basis of policies paid out to third parties is reasonable as the beneficiary receives the funds out of which the liability needs to be settled. Muller⁹⁵⁴ states that the recipient basis also explains the approach by legislation that the premiums payable by the beneficiary (plus 6% interest per annum) are allowed as a deduction when including the policy as deemed property in the estate.⁹⁵⁵

The issue regarding the recipient basis is that although it is included in the estate for estate duty purposes and the recipient of the funds is liable for the related estate duty liability, the liability is determined without considering any specific circumstances of the beneficiary. Muller⁹⁵⁶ states although it is understandable that life policies paid out directly to a beneficiary are treated on a recipient basis, it does not support the canon of equality as it lacks horizontal equity.⁹⁵⁷ The basis of her view is that as a rule, heirs are treated unequally as the main tax burden often falls on the residuary heir. This is because the legatees are given the assets as per the will and only after the estate's liabilities are settled from the residue of the estate (including the tax liability) will the residue heirs receive the remaining portion of the residue of the estate. Horizontal equity issues are amplified where estate duty is

⁹⁵² Section 3(3) read with s 11(b)(i) of the *Estate Duty Act*.

⁹⁵³ Muller *Wealth Transfer Taxation* 235.

⁹⁵⁴ Muller *Wealth Transfer Taxation* 235.

⁹⁵⁵ See para 4.2.2.2.1 above.

⁹⁵⁶ Muller *Wealth Transfer Taxation* 235.

⁹⁵⁷ Horizontal equity refers to equal taxpayers being treated equally. See also para 2.4.2.1.2(a) above for a detailed discussion on horizontal equity.

payable by specific beneficiaries, such as limited interest and life policies, without taking such beneficiaries' circumstances into account.⁹⁵⁸

A further issue may arise regarding non-resident beneficiaries who receive the funds and who are liable for the estate duty payable thereon, especially when they are situated outside South Africa and the funds are paid out directly to them. No provision under the *Estate Duty Act* deals with the instance of a non-resident beneficiary. A possible risk of avoiding estate duty may arise when the funds are paid and the executor cannot get hold of the beneficiary to pay over the necessary estate duty liability. A type of "withholding tax" may be considered to avoid the potential risk and to ensure the tax base is protected.⁹⁵⁹

It is submitted that to bring more equal treatment to paying beneficiaries, the current relief regarding the premiums paid may provide some relief. However, the recommendation to revert to the position under the *Death Duties Act*, as well as the consideration of an exempt threshold, may provide additional relief to the beneficiaries to lift the burden of harsh tax consequences.

4.2.2.3 Conclusion to the scope of "property" and "deemed property" under the *Estate Duty Act*

Given the above, it was discussed that the existing preferential treatment regarding life insurance policies is accompanied by various interpretational challenges.⁹⁶⁰ The existing uncertainty in the application of the exempt provisions may lead to tax planning opportunities and does not support the canon of certainty when determining an estate duty liability. It is concluded that on the basis that a life insurance policy is considered as a form of an investment vehicle, the general rule should prevail that it is included as property and deemed property in the estate and subject to estate duty. However, refined requirements should be considered to

⁹⁵⁸ Muller *Wealth Transfer Taxation* 235.

⁹⁵⁹ A similar approach is followed in Canada where a withholding tax is imposed for a life insurance policy is paid out to a non-resident beneficiary, see Desmarais 2018 <https://www.linkedin.com/pulse/life-insurance-non-resident-beneficiary-thorny-issue-desmarais>.

⁹⁶⁰ See para 4.2.2.2 above.

ensure that a life policy is only included where the deceased had either owned the policy, had a financial interest, or contributed to the policy. This position is also supported by the OECD and various commentators.⁹⁶¹

When considering the preferential treatment that is currently available⁹⁶² as well as the alternative to cater for an exempt threshold regarding all life insurance policies as previously noted by the National Treasury, the OECD's recommendation to make such preferential treatment subject to a threshold is relevant. A standard exempt threshold could be considered to make it easier to adhere to legislation, convenient to administer and provide certainty as to the treatment of life insurance policies.

Concerns raised regarding the recipient basis for the payment of the estate duty liability were discussed and potential risk in the instance of a non-resident beneficiary was raised that may be addressed through a form of a withholding tax.⁹⁶³

The following section will discuss the issues that arise in respect of the section 4(q) deduction about bequests made to a surviving spouse.

4.2.3 Spousal deduction

4.2.3.1 Introduction

Section 4(q) of the *Estate Duty Act* allows for a deduction on the value of any property⁹⁶⁴ that is included in the estate that accrues⁹⁶⁵ to the surviving spouse. The deduction is triggered by a bequest in terms of the will of the deceased or by intestate succession. The deduction is, however, subject to two limitations:

⁹⁶¹ See paras 4.2.2.2.1 and 4.2.2.2.2 above.

⁹⁶² Section 3(3)(a)(i), (iA) and (ii) of the *Estate Duty Act*.

⁹⁶³ See para 6.2.2.2.2 below for final recommendations regarding the provisions relevant to life insurance policies.

⁹⁶⁴ The reference to any property includes both property under s 3(2) and deemed property under s 3(3) of the *Estate Duty Act*.

⁹⁶⁵ See para 4.2.4 for a discussion on the meaning of accrual. In calculating the benefit that "accrues" to a residuary heir for purposes of determining the deduction under s 4(q) of the *Estate Duty Act*, the value of the deduction must be determined without taking into account the estate duty payable and based on the amount stipulated in the will and not the ultimate receipt by the surviving spouse. The same principle applies to s 4(h) in this regard. See *CSARS v Executor Frith's Estate* 2001 2 SA 261 (SCA) (the *Frith* case).

- (a) The deduction is reduced by any amount⁹⁶⁶ that the surviving spouse is required in terms of the will⁹⁶⁷ of the deceased person to dispose of to any other person or trust;⁹⁶⁸ and
- (b) No deduction shall be allowed where the deceased person established a trust that held property⁹⁶⁹ for the benefit of the surviving spouse subject to the discretion of the trustee.⁹⁷⁰

The original purpose of the provision was to ensure that the surviving spouse does not suffer any estate duty liability about any bequest or amount received from the first dying spouse, whether through testate or intestate succession.⁹⁷¹ In 1985 when section 4(q) was inserted into the *Estate Duty Act*, the meaning of the "spouse" was limited to a legal marriage between a man and a woman.⁹⁷² This also places the purpose of the provision in context as to whom was initially meant to benefit from the preferential treatment. The original purpose was therefore limited to a spousal relationship. The rationale behind the provision has been interpreted to support the surviving household in the case of death of the breadwinner,⁹⁷³ even though it was never stipulated by government in so many words. The provisos to section 4(q) confirm the purpose to benefit the surviving spouse because to the extent that the

⁹⁶⁶ The term "any amount" is wide in its meaning and can be interpreted to include the value of property, including money. Therefore, if the surviving spouse is required to pay a bequest price out of their own resources, it falls within the ambit of the proviso and the deduction under s 4(q) will be reduced.

⁹⁶⁷ The proviso applies when the will merely create the obligation in the hands of the surviving spouse to dispose of an amount. A surviving spouse who disposes of property at their own accord and not under an obligation imposed by the deceased's will, will not reduce the deduction under s 4(q).

⁹⁶⁸ First proviso to s 4(q) of the *Estate Duty Act*. The purpose of the proviso is to limit estate duty avoidance through the mechanism of a bequest to a surviving spouse who must channel the bequeathed property to others. See also Davis, Beneke and Jooste *Estate planning* 2.5.16.

⁹⁶⁹ The meaning attached to "property" under this proviso is aligned to the "property" under s 3 of the *Estate Duty Act* that is included in the estate.

⁹⁷⁰ Second proviso to s 4(q) of the *Estate Duty Act*. The proviso provides for an extension of the s 4(q) deduction in the case where the property accrues to a trust for the benefit of the surviving spouse. It should still be read in the narrow sense of the purpose of the provision, which is that if the property that vests in a trust or any income deriving therefrom does not vest in the surviving spouse, "no deduction" should be allowed.

⁹⁷¹ National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill, 1985* 4.

⁹⁷² Section 4(q) was inserted by s 5(1)(b) of the *Revenue Laws Amendment Act* 81 of 1985 with effect from 1 November 1984.

⁹⁷³ DTC *Final Estate Duty Report* 14.

surviving spouse does not enjoy a vested right, or is used as a conduit to transfer property to another person (for example a child), no deduction is allowed under section 4(q).⁹⁷⁴ It is therefore submitted that the original purpose was primarily introduced to benefit the surviving spouse.⁹⁷⁵

4.2.3.2 Meaning of "spouse"

The definition of "spouse" was inserted into the *Estate Duty Act* in 2000 with retrospective effect from 27 April 1994.⁹⁷⁶ Up to that point, the word "spouse" was not defined. The word "spouse" was, however, always interpreted by SARS to mean the surviving spouse in a legal marriage dissolved by death.⁹⁷⁷ This caused anomalies in the application of section 4(q) of the *Estate Duty Act* that allows for a deduction from the gross value of all property included in the estate regarding the value of any property that accrues to a surviving spouse of the deceased person.

Based on the narrow interpretation applied by SARS at the time, section 4(q) only allowed for a deduction for property that accrued to such a surviving spouse in a legal marriage. This resulted in unfair discrimination against same-sex life partners, which was inconsistent with the provisions of section 9(3) of the *Constitution*. This led to the inclusion of the definition of "spouse" in section 1 of the *Estate Duty Act*, to ensure that its meaning includes partners in a permanent same-sex life partnership, as well as spouses in marriages, concluded in terms of customary law or a recognised system of religious law.⁹⁷⁸

The definition of "spouse" inserted in 2000, however, excluded partners in a permanent heterosexual relationship, which National Treasury⁹⁷⁹ stated may be

⁹⁷⁴ National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 1986* 5-6.

⁹⁷⁵ The DTC, however, following an assumption that the purpose of s 4(q) is to reduce the hardship on the surviving household. The DTC in its *Final Estate Duty Report* stated that "[i]f the purpose of section 4(q) is to provide relief to families in the event of the premature death of a breadwinner, it is not achieving its purpose." See DTC *Final Estate Duty Report* 14.

⁹⁷⁶ Section 1 of the *Revenue Laws Amendment Act 59 of 2000*.

⁹⁷⁷ National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Act 59 of 2000* Clause 1.

⁹⁷⁸ National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Act 59 of 2000* Clause 1.

⁹⁷⁹ Section 3 of the *Taxation Laws Amendment Act 5 of 2001*. See also National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2001* 14.

unconstitutional, and the definition was amended to include a same-sex or heterosexual union which the Commissioner is satisfied is intended to be permanent.⁹⁸⁰ Marriages under any tenets of religion or a same-sex or heterosexual union confirmed by the Commissioner are deemed to be a marriage or union without community of property in the absence of any proof to the contrary.⁹⁸¹

In *Minister of Home Affairs v Fourie*,⁹⁸² the issue before the Constitutional Court was whether the common law and statutory definitions of "marriage" were unconstitutional. The Court concluded that the common law definition of "marriage" was unconstitutional by excluding same-sex partnerships and similarly, the *Marriage Act* failed to acknowledge same-sex marriages which was also rendered unconstitutional. The Court granted Parliament 12 months from 1 December 2005 to rectify the defect. If Parliament did not adhere to the instruction within the specified timeframe, the words "or spouse" would be automatically read into the *Marriage Act*.

Parliament responded with the introduction of the *Civil Union Act*. The preamble of the *Civil Union Act* sets out that its purpose is "to provide for the solemnisation of civil unions, by way of either a marriage or civil partnership; to provide for matters incidental thereto". Section 13 of the *Civil Union Act* equates civil marriages and civil unions. It deems any reference to "marriage" in any other law (other than the *Marriage Act* and the *Recognition of Customary Marriages Act* 120 of 1998) to include a "civil union" and any reference to "husband", "wife" or "spouse" to include a civil partner. The *Civil Union Act* came into effect on 30 November 2006.

⁹⁸⁰ Paragraph (c) to the definition of "spouse" in s 1 of the *Estate Duty Act*.

⁹⁸¹ Definition of "spouse" in s 1 of the *Estate Duty Act*. In *Bwanya v Master of the High Court, Cape Town* 2022 3 SA 250 (CC), the Constitutional Court held that s 1(1) of the *Intestate Succession Act* was unconstitutional and invalid for excluding a surviving life partner in a permanent opposite-sex life partnership from inheriting under that Act and that a "spouse" includes such a partner where the partners had undertaken reciprocal duties of support. The decision does not directly impact the application of s 4(q) under the *Estate Duty Act* as the the deduction remains available where an inheritance accrues to or is received by an opposite-sex life partner and the Commissioner is satisfied that it is intended to be a permanent life partnership.

⁹⁸² 2006 1 SA 524 (CC).

If one considers the development in the law regarding marriages and unions, the question can be asked as to whether the *Estate Duty Act* caters for the developments since 2006. The answer lies in the interpretation of paragraph (a) of the definition of a "spouse" in the *Estate Duty Act* read together with section 13 of the *Civil Union Act*. Paragraph (a) states "in a marriage ... recognised in terms of the laws of the Republic;". Applying the principle set out in section 13 of the *Civil Union Act*, a civil union is provided for in a "marriage" and therefore any partner in a civil union will also be regarded as a "spouse" for purposes of the *Estate Duty Act*. The definition of "spouse" in section 1 of the *Estate Duty Act* stipulates that for estate duty purposes, a civil union will be regarded as "out of community of property" unless otherwise stipulated. This implies that the civil partner obtains the same standing as a "spouse" in a civil marriage that is out of community of property and not subject to the accrual system.⁹⁸³ The above interpretation and application of the law result in the *Estate Duty Act* staying aligned with the *Constitution*.

Some problems regarding section 4(q) include the validity of retaining the deduction in light of the *Constitution*, an anomaly in applying the first proviso as well as uncertainty in the interpretation of the second proviso that are each set out below.

4.2.3.3 The validity of retaining the section 4(q) deduction

The validity of the deduction regarding a bequest made to a surviving spouse has been debated in the reviews conducted by each of the Commissions of Enquiry.⁹⁸⁴ The Margo Commission⁹⁸⁵ recommended that the deduction should be retained, despite the possible splitting of estates as a result of the disposals between spouses. The recommendation was aimed to provide a clear message that only the wealthy will be subject to estate duty, and they will be able to determine their estate duty liability with ease, thus adhering to the canon of certainty.⁹⁸⁶

⁹⁸³ Meyerowitz *Administration of Estates* 28.17. See also Cilliers *Administration of Estates* 549.

⁹⁸⁴ See paras 3.4.2.5, 3.5.2.6 and 3.6.2.1 above.

⁹⁸⁵ Margo Commission *Margo Report* 20.54. See also para 3.4.2.5 above.

⁹⁸⁶ See para 2.4.2.2 for a discussion on the canon of certainty.

The Katz Commission⁹⁸⁷ questioned the constitutionality of section 4(q) and whether there was any justification for retaining the deduction in the light of the equality provisions⁹⁸⁸ under the *Constitution*. The Katz Commission⁹⁸⁹ argued that the differentiation based on marital status is not justifiable as well as the different taxing units for income tax (being the single taxpayer) and estate duty (being the marital unit).⁹⁹⁰ In spite of the concerns raised, the Katz Commission⁹⁹¹ concluded that the section 4(q) deduction should be retained on pragmatic grounds. The public commentary both supported the retention of the deduction on sociological grounds⁹⁹² and the deletion thereof to improve the integrity of the tax system,⁹⁹³ but the issue of the provision's constitutionality was left aside.⁹⁹⁴

The DTC⁹⁹⁵ in its review of the estate duty system again raised the question of whether the section 4(q) deduction is constitutional and stated that pragmatic grounds are not a justifiable reason to retain the deduction. The DTC⁹⁹⁶ argued that since the deduction discriminates on the basis of marital status it is considered unconstitutional. The DTC⁹⁹⁷ further argued that the preferential treatment of a two-parent family compared to a single-parent family is not sound, especially considering the development of family structures in South Africa that are no longer based on a two-parent family. The DTC also pointed out the changes to family structures in South Africa where many families consist of single-parent families and families supported by grandparents, children, relatives, or friends, which means they fall

⁹⁸⁷ Katz Commission *Fourth Report* 11.2. See also para 3.5.2.6 above.

⁹⁸⁸ Section 9 of the *Constitution*.

⁹⁸⁹ Katz Commission *Fourth Report* 11.2(a).

⁹⁹⁰ Katz Commission *Fourth Report* 11.2(b).

⁹⁹¹ Katz Commission *Fourth Report* 11.3. See also para 3.5.2.6 above for a detailed discussion on the Katz Commission's recommendation on s 4(q) of the *Estate Duty Act*.

⁹⁹² Delport *The Definition of Property for Estate Duty Purposes* 186. See Katz Commission *Fourth Report* 1.11(b)-1.11(d). The sociological factors included difficulty to clearly demarcate the ownership of family assets; difficulty to distinguish between an outright donation and discharging "the duty of support". See also para 3.5.2.6 above.

⁹⁹³ Meyerowitz 1998 *The Taxpayer* 9.

⁹⁹⁴ See also para 3.5.2.6 above.

⁹⁹⁵ DTC *Final Estate Duty Report* 14. See para 3.6.2.1 above.

⁹⁹⁶ DTC *Final Estate Duty Report* 14.

⁹⁹⁷ DTC *Final Estate Duty Report* 14.

outside the scope of section 4(q). Similar to the Katz Commission, the DTC⁹⁹⁸ criticised the principle of "joint taxation" for estate duty purposes and supported the principle of a "single taxpayer" for income tax purposes.

FISA⁹⁹⁹ supports the retention of the deduction and its justification considering the *Constitution* on the basis that it provides financial stability to the survivor and is in line with spouses' legal responsibility to each other. The position taken by FISA however does not take cognisance of the fact that no relief is given to a surviving household of a single parent which may divert to less of whether the deduction is constitutional and more about whether it is achieving its purpose and whether it has kept up with the modern society.

SAIT¹⁰⁰⁰ supports the retention of the deduction based on international principles where spousal bequests are not subject to a wealth transfer tax on the basis that the deduction is justified as married couples operated as a single economic unit. This is also observed through the corresponding relief available between spouses for CGT, donations tax and transfer duty.¹⁰⁰¹

SAICA¹⁰⁰² responds to the question on whether section 4(q) is constitutional by stating that such a debate is too academic and technical in the context of the *Estate Duty Act*, and instead supports the pragmatic approach of the Katz Commission to retain the deduction as it ultimately does not avoid estate duty but merely delays the collection thereof.

Frantz and Fritz¹⁰⁰³ argue that the question on whether or not section 4(q) is constitutional is not merely an academic exercise as section 4(q) exempts any property that accrues to a surviving spouse from estate duty. In their analysis on

⁹⁹⁸ See para 3.6.2.1 above for a detailed discussion on the constitutionality of the s 4(q) deduction and the DTC's recommendation to abolish the deduction.

⁹⁹⁹ FISA *Comments on the First Interim Report on Estate Duty* 7. See para 3.6.2.1 above for a detailed discussion.

¹⁰⁰⁰ SAIT *Submission on The DTC First Interim Report on Estate Duty* 7. See para 3.6.2.1 above for a detailed discussion.

¹⁰⁰¹ See ss 9HA, 56(1)(a) and (b) of the *Income Tax Act* and s 9(1)(i) of the *Transfer Duty Act*.

¹⁰⁰² SAICA *Comments on The Davis Committee, First Interim Report on Estate Duty* 3. See para 3.6.2.1 above for a detailed discussion.

¹⁰⁰³ Frantz and Fritz 2022 *STELL LR* 639.

whether section 4(q) is regarded as constitutional, they focus on the scenario where the deceased was not in a spousal relationship but in a committed relationship of support, for example, the deceased's sibling.¹⁰⁰⁴ Frantz and Fritz¹⁰⁰⁵ interpret the purpose of section 4(q) to provide to the surviving family where the breadwinner dies, which is founded upon the view expressed by the DTC. Based on their analysis done on changing family structures found in society, they state that section 4(q) does not achieve its purpose to alleviate the hardship on all types of families when the breadwinner dies.¹⁰⁰⁶ They argue that the differentiation under section 4(q) is based on marital status which is prohibited under section 9(3) of the *Constitution*.¹⁰⁰⁷ Frits and Frantz¹⁰⁰⁸ argue that the differentiation based on marital status is not justified where a relationship, not being a spousal relationship, arises regarding a duty to support. It is stated that the differentiation is for no good reason and such treatment is not aligned to the purpose of section 4(q) to prevent hardship to families when a breadwinner dies. They argue that section 4(q) constitutes unfair discrimination and for a less disadvantageous outcome, section 4(q) should be extended to "persons who were in a relationship with reciprocal duties of support with the deceased".¹⁰⁰⁹ In light of section 36 of the *Constitution*, they state that when considering the importance of the limitation, section 4(q)'s purpose is to assist the surviving family when the breadwinner dies and by limiting it to a spouse has

¹⁰⁰⁴ Frantz and Fritz 2022 *STELL LR* 647.

¹⁰⁰⁵ Frantz and Fritz 2022 *STELL LR* 647 and DTC *Final Estate Duty Report* 14. It is submitted that this view is not based on the original intention expressed by National Treasury to reduce the financial hardship on the surviving spouse, irrespective of the family structure in place. See para 4.2.3.1 above and National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill, 1985* 4.

¹⁰⁰⁶ Frantz and Fritz 2022 *STELL LR* 648. Frantz and Fritz argue their views with reference to the UK court case, *Burden v United Kingdom* (GC) no 13378/05 ECHR 2008, where two sisters argued that the preferential treatment in respect of married couples and civil partners' spouse for inheritance tax purposes are discriminatory, however, they were not successful and Frantz and Fritz considered whether a different outcome would be reached in the South African estate duty context in light of s 4(q) of the *Estate Duty Act*. See also Frantz and Fritz 2022 *STELL LR* 637.

¹⁰⁰⁷ Frantz and Fritz 2022 *STELL LR* 649. It was also stated that the differentiation on marital status is prohibited in terms of the *Promotion of Equality and Prevention of Unfair Discrimination Act* 4 of 2000.

¹⁰⁰⁸ Frantz and Fritz 2022 *STELL LR* 649.

¹⁰⁰⁹ Frantz and Fritz 2022 *STELL LR* 650. This is recommendation is made on the basis that the purpose of s 4(q) is to assist the surviving family, moving away from the original purpose where it was to assist the surviving spouse. Furthermore, the recommendation must be measured against the corresponding administrative burden that will accompany such an approach to determine which relationships constitute ones where a reciprocal duty for support exists.

long-term benefits.¹⁰¹⁰ Although the collection of estate duty contributes to society, it is more important to ensure that people become self-sufficient than to rely on government's support.¹⁰¹¹ Regarding the nature and the extent of the limitation, the provision does not deal with families without a spousal relationship.¹⁰¹² The relationship between the purpose of section 4(q) and its limitation is considered disjointed as it only covers certain families and not all types of families where the breadwinner dies.¹⁰¹³ As mentioned above, they state that less restrictive means are available to achieve the same purpose of assisting the surviving family.¹⁰¹⁴ Frantz and Fritz,¹⁰¹⁵ therefore, conclude that section 4(q) should not be limited to a spousal relationship to assist a family when a breadwinner dies and that section 4(q) may possibly not survive a constitutional attack based on the right to equality.

In addition to the DTC's view that section 4(q) is unconstitutional due to the different treatment between married and single parent families,¹⁰¹⁶ as well as the argument set out above by Frantz and Fritz that the limitation of equal treatment imposed by section 4(q) is not considered justified in light of section 36 of the *Constitution*,¹⁰¹⁷ an alternative view is set out below. Section 36 allows for the limitation of a fundamental right (in this instance, the right to equality) by a law of general application where such limitation is reasonable and justifiable in an open and democratic society based on human dignity, quality and freedom. Each of the factors that need to be considered are discussed below in the context of section 4(q):

- (a) The nature of the right:¹⁰¹⁸ the provision entails a deduction regarding a bequest to a surviving spouse when determining the estate duty liability upon the death of the first-dying spouse which results in little or no estate

¹⁰¹⁰ Frantz and Fritz 2022 *STELL LR* 649. See also s 36(1)(a) of the *Constitution*.

¹⁰¹¹ Frantz and Fritz 2022 *STELL LR* 651. See also s 36(1)(b) of the *Constitution*.

¹⁰¹² Frantz and Fritz 2022 *STELL LR* 650-651. See also s 36(1)(c) of the *Constitution*.

¹⁰¹³ Frantz and Fritz 2022 *STELL LR* 652. See also s 36(1)(d) of the *Constitution*.

¹⁰¹⁴ Frantz and Fritz 2022 *STELL LR* 652. See also s 36(1)(e) of the *Constitution*. The less restrictive means entails a move away from the focus on a spousal relationship but instead a relationship exist on a reciprocal duty of support within a family.

¹⁰¹⁵ Frantz and Fritz 2022 *STELL LR* 653, 655.

¹⁰¹⁶ DTC *Final Estate Duty Report* 14.

¹⁰¹⁷ Frantz and Fritz 2022 *STELL LR* 652-653.

¹⁰¹⁸ Section 36(1)(a) of the *Constitution*.

duty payable, whereas, in the case of a single person, or a person who is not in a spousal relationship, the bequest remains subject to estate duty.

- (b) The importance of the purpose of the limitation:¹⁰¹⁹ the limited application to spouses is to lift the financial burden upon the surviving spouse and their household where the spouses are considered as an economic unit with pooled resources and shared ownership of assets. The same relief is not available to a single person on the assumption that they bear fewer responsibilities and expenses. Furthermore, the limited application to a spouse avoids making the exclusion too widely available defeating the objective of generating revenue through estate duty collections.
- (c) The nature and extent of the limitation:¹⁰²⁰ a complete deduction is allowed if the requirements of section 4(q) are met resulting in a bequest to a surviving spouse being free from estate duty, whereas a bequest to someone not being a spouse is subject to estate duty. It is accepted that the requirement to qualify for section 4(q) is that the bequest must accrue to a surviving spouse of the deceased and no consideration is provided regarding single-parent or alternative family structures.
- (d) The relation between the limitation and its purpose:¹⁰²¹ the spouses have a legal responsibility to maintain each other and are often in fiscal legislation considered as an economic unit.¹⁰²² The deduction is therefore limited to spouses to alleviate the burden of the responsibility of the provision for the surviving household that continues to rest on the surviving spouse.¹⁰²³

¹⁰¹⁹ Section 36(1)(b) of the *Constitution*.

¹⁰²⁰ Section 36(1)(c) of the *Constitution*.

¹⁰²¹ Section 36(1)(d) of the *Constitution*.

¹⁰²² It is acknowledged that a relationship based on a reciprocal duty of support may arise which is not in relation to a "spouse" which may be considered discriminatory but the courts will need to weigh that against the purpose of s 4(q) that have been to look after a spouse and indirectly the hardship to the household. Extending the application of s 4(q) should carefully be considered to not result in the estate duty impact being defeated.

¹⁰²³ In a relationship based on a reciprocal duty of support, it is submitted that in the event of death, such recipient of the support may not have the same responsibility to support towards the deceased's surviving household as a surviving spouse will have. It is therefore submitted that the limitation under s 4(q) may be justified.

Similar preferential treatment applies to transfers between spouses regarding CGT, donations tax and transfer duty.¹⁰²⁴ It is furthermore a common principle in the case of inheritance taxes that the tax is applied only when assets are transferred from one generation to the next and not for interspousal transfers. Bequests between spouses are considered completely different and should not be confused with the issue to support parents and/or children.¹⁰²⁵

- (e) Less restrictive means to achieve the purpose:¹⁰²⁶ to achieve the purpose of alleviating the estate duty liability regarding a bequest to the surviving spouse, a limitation to the deduction available under section 4(q) can be considered, however, it will mean deviating from the existing purpose of the provision to provide unlimited tax relief to a surviving spouse. It will also deviate from the international standard in this regard.¹⁰²⁷ The potential constitutional concern may, however, be limited with an amendment to section 4(q).¹⁰²⁸

Given the above, the limitation of the equal treatment between taxpayers based on their marital status is considered reasonable and justified for the following reasons:

- (a) Spouses have a legal responsibility to maintain each other and together are considered an economic unit with pooled resources and joined ownership over assets.¹⁰²⁹

¹⁰²⁴ See ss 9HA, 56(1)(a) and (b) of the *Income Tax Act* and s 9(1)(i) of the *Transfer Duty Act*.

¹⁰²⁵ SAIT *Submission on The DTC First Interim Report on Estate Duty* 7. See also OECD *Inheritance Taxation in OECD Countries* 77-79.

¹⁰²⁶ Section 36(1)(e) of the *Constitution*.

¹⁰²⁷ See SAIT *Submission on The DTC First Interim Report on Estate Duty* 8 and OECD *Inheritance Taxation in OECD Countries* 73.

¹⁰²⁸ A withdrawal of the s 4(q) deduction as recommended by the DTC will ignore its purpose and deviate from international standards. If the purpose is to provide assistance to the surviving household when the breadwinner dies, the proposal by Frantz and Fritz to extend the scope of section 4(q) to not only spousal relationships but also to relationships based on a reciprocal duty of support may also be considered for a wider scope of section 4(q)'s application. However, it is submitted that such proposal will mean a deviation from the original purpose of the provision.

¹⁰²⁹ SAIT *Submission on The DTC First Interim Report on Estate Duty* 7.

- (b) Similar preferential treatment regarding interspousal transfers exists for donations tax,¹⁰³⁰ CGT,¹⁰³¹ and transfer duty¹⁰³² purposes.
- (c) Estate duty, similar to other succession taxes, should be imposed when an inheritance is passed from one generation to the next and not for interspousal transfers.¹⁰³³
- (d) Internationally, preferential treatment is found for transfers between spouses in every country levying an inheritance or estate tax.¹⁰³⁴ It is noted that especially in developing countries, like South Africa, the unlimited spousal exemption is still the norm.¹⁰³⁵

It is therefore concluded that, on the basis that the limitation found in section 4(q) may pass the constitutionality test for the reasons provided above, the issue rather turns on the purpose of section 4(q) and whether it is still relevant in the modern context.

The scope and purpose of the deduction should be clarified. When considering the wording of section 4(q), it is clear that a deduction is allowed for a bequest that accrues to the surviving spouse. The purpose of the provision has also been to encourage the bequest of sufficient resources to the surviving spouse to make provisions for the surviving household through the surviving spouse.¹⁰³⁶

In the case of intestate succession, the distribution of the estate takes place in terms of the *Intestate Succession Act* and, depending on the structure of the deceased

¹⁰³⁰ Section 56(1)(a) and (b) of the *Income Tax Act*.

¹⁰³¹ Sections 9HA(1), 9HB of the *Income Tax Act*.

¹⁰³² Section 9(1)(i) of the *Transfer Duty Act*.

¹⁰³³ SAIT *Submission on The DTC First Interim Report on Estate Duty* 7.

¹⁰³⁴ OECD *Inheritance Taxation in OECD Countries* 78. See also Copenhagen Economics *Survey on the Domestic Rules on Taxes levied upon Death* 3-34. Countries that provide preferential treatment to spouses in respect of inheritance or estate taxes include Denmark, France, Hungary, Ireland, Japan, Lithuania, Luxembourg, Poland, Portugal, Slovenia, Switzerland, the United Kingdom, the United States, Finland, Germany, Korea and the Netherlands.

¹⁰³⁵ Copenhagen Economics *Survey on the Domestic Rules on Taxes levied upon Death* 3-34. Developing countries include Bulgaria, Chile and Poland.

¹⁰³⁶ SAICA 2015
https://www.saica.co.za/integritax/2015/2461._Estate_duty_and_capital_gains_tax.htm.

person's family, the surviving spouse may receive the entire estate or share it with the children. Little scope is available to abuse the provisions of section 4(q). In the case of testate succession, it is accepted that a bequest to a surviving spouse is free of estate duty, and such relief remains in line with its purpose. Considering the extent of persons dying without a will where their estates are distributed intestate, the abuse is considered limited in the South African context.¹⁰³⁷

Under the *Death Duties Act* where a succession duty was levied on the benefit received by an heir, any spousal transfers were fully exempt and the rate of succession duty was based on the blood relation between the deceased person and the heir or legatee.¹⁰³⁸ However, this was repealed with the introduction of the *Estate Duty Act* and an abatement of R100 000 was available for a surviving spouse;¹⁰³⁹ and R80 000 for each surviving child of the deceased person.¹⁰⁴⁰ However, these abatements were repealed at the same time when section 4(q) was introduced,¹⁰⁴¹ which indicated a move away from the separate forms of relief and limiting it to the surviving spouse, not making further distinctions between other family members. Another change that went hand in hand with the replacement was a lump sum section 4A abatement of R1 million. The different abatements in respect of family members were limited to the spouse and to keep a form of relief, the remaining forms of relief were combined into an increased primary abatement.

The OECD¹⁰⁴² supports the preferential treatment of a spousal bequest and such treatment applies in all estate tax systems. The OECD¹⁰⁴³ acknowledges the justification for the exemption based on pooled resources and shared ownership of assets by spouses and the exemption assists in reducing undue hardship on the surviving spouse. The exemption also prevents double taxation in that, in the absence of the exemption, the transfer to the spouse is taxable as well as when the

¹⁰³⁷ See para 3.6.2.1 above for a detailed discussion.

¹⁰³⁸ Section 8 of the *Death Duties Act*.

¹⁰³⁹ Section 4A(d) of the *Estate Duty Act*.

¹⁰⁴⁰ Section 4A(b) of the *Estate Duty Act*.

¹⁰⁴¹ See ss 5(1)(b) and 6(1) of the *Revenue Laws Amendment Act* 81 of 1985.

¹⁰⁴² OECD *Inheritance Taxation in OECD Countries* 78.

¹⁰⁴³ OECD *Inheritance Taxation in OECD Countries* 82.

transfer goes to the children or other heirs. However, the OECD¹⁰⁴⁴ states that where a concern of abuse exists, a limitation of preferential treatment can be considered to limit the potential abuse.

The OECD¹⁰⁴⁵ cautions against preferential treatment of only certain types of unions that may have serious tax and discrimination implications. This issue has already been addressed in the *Estate Duty Act* through the widening of the meaning of a "spouse" that caters for all types of unions.¹⁰⁴⁶ Accordingly, the deduction under section 4(q) therefore applies equally to all spousal unions.

Although various OECD countries, in addition to the spousal relief, allow for more preferential treatment of bequests made to close family members in comparison to more distant or unrelated beneficiaries, the OECD¹⁰⁴⁷ recommends that, apart from the spousal relief, such differences in tax treatment due to the relationship to the deceased person should be avoided. The various types of preferential treatment of different family members may encourage donors to concentrate their wealth transfers among close family members. However, if the difference in tax treatment is removed, the donor will be encouraged to spread their wealth and reduce the concentration of wealth. The structure of family units has evolved significantly over time and is currently quite blended where close or direct descendants, and distant and unrelated family members all form one unit.¹⁰⁴⁸ The differentiation in the tax treatment among family members, therefore, becomes questionable and should be eliminated as far as possible.¹⁰⁴⁹ It should be noted that the recommendation made by the OECD regarding bequests to family members was made in addition to the retention of the spousal relief. The OECD, therefore, seems to be still favourable

¹⁰⁴⁴ OECD *Inheritance Taxation in OECD Countries* 77-78, 81. The OECD also notes that where wealth is transferred to a spouse, estate or inheritance tax avoidance is limited in that it is eventually taxed when the wealth is passed to the children.

¹⁰⁴⁵ OECD *Inheritance Taxation in OECD Countries* 82.

¹⁰⁴⁶ See the definition of "spouse" in s 1 of the *Estate Duty Act* and para 4.2.3.2 above.

¹⁰⁴⁷ Such preferential treatment is often in the form of large exemptions or low tax rates (see OECD *Inheritance Taxation in OECD Countries* 75).

¹⁰⁴⁸ Amatho 2019 <https://www.wits.ac.za/news/latest-news/research-news/2019/2019-07/the-shape-of-the-south-african-family.html>. See also Hall and Mokomane *The Shape of Children's Families and Households: A Demographic Overview* 32.

¹⁰⁴⁹ OECD *Inheritance Taxation in OECD Countries* 124.

towards a spouse and to treat other family members without making a distinction regarding their relation to the deceased person.

As mentioned above, the *Estate Duty Act*, apart from the special treatment towards a spouse, makes no distinction between bequests made to close relatives in comparison to more distant or unrelated beneficiaries. The policy has moved away from such distinction and is justified today by the structure of family units that have evolved significantly over time where close and direct descendants as well as distant and unrelated family members all form one unit.¹⁰⁵⁰ The OECD's recommendation to eliminate such differentiation as far as possible is already reflected in the *Estate Duty Act*.

From an international perspective, the preferential relief primarily remains focused on the surviving spouse, despite the change in family structures, and any relief available for family members is recommended to be rather limited than to be widened in its application. Based on the purpose of section 4(q) to provide relief for bequests to the surviving spouse, together with international principles, it is recommended that section 4(q) is justified and should be retained.¹⁰⁵¹ The retention of section 4(q) is also supported by Ingram¹⁰⁵² who found that, although the deletion of section 4(q) may result in the adherence to the canon of equality, it did not support that canon due to the different estate duty liabilities that may arise depending on the type of marital property regime involved. Hence, the retention of section 4(q) was also supported.¹⁰⁵³

¹⁰⁵⁰ Amatho 2019 <https://www.wits.ac.za/news/latest-news/research-news/2019/2019-07/the-shape-of-the-south-african-family.html>. See also Hall and Mokomane *The Shape of Children's Families and Households: A Demographic Overview* 32.

¹⁰⁵¹ The majority of OECD countries allowed for a complete exemption regarding the spousal bequest (including Denmark, France, Hungary, Ireland, Japan, Lithuania, Luxembourg, Poland, Portugal, Slovenia, Switzerland, United Kingdom and United States). See OECD *Inheritance Taxation in OECD Countries* 77.

¹⁰⁵² Ingram *Davis Tax Committee's Proposals on Inter-Spousal Transactions* 63.

¹⁰⁵³ See paras 3.6.2.1.1-3.6.2.1.3 above for a detailed discussion on the analysis done by Ingram. Currently, where there is more than one spouse at the time of the deceased's death, the bequest to each of the surviving spouses qualifies for the s 4(q) deduction as the law does not state anything to the contrary. It is submitted that this eliminates possible discrimination between spouses. Since the s 4(q) deduction is unlimited, the unlimited application applies regarding each surviving spouse. This should be distinguished from the application of s 4A where there is

However, the impact on a family where no surviving spouses are involved is acknowledged and should instead be catered for through a means other than the repeal or retention of section 4(q). Although the international trend in developing countries like South Africa is to provide unlimited relief to the surviving spouse, a limitation in the form of a capped amount in respect of section 4(q) can be considered to avoid any abuse¹⁰⁵⁴ or to reduce the loss of revenue due to the preferential treatment. It is recommended to not make provision for a fixed capped threshold, but instead to introduce a relief in the form of a percentage based on the net value of the estate, without taking the section 4(q) into account. This will ensure that a large estate will not be discriminated against where section 4(q) may become superfluous due to the minimal amount allowed as a deduction. For example, instead of limiting the deduction to R1 million, it could be limited to 50% of the net value excluding the deduction. The greater the estate value, the greater the deduction and *vice versa*.

Following the conclusion that section 4(q) should remain, further issues that should be addressed regarding its application are discussed below.

4.2.3.4 Problems concerning proviso (i) of section 4(q)

The first proviso to section 4(q) provides that if the surviving spouse is required by the will of the deceased person to dispose of any amount to any "other person" or a trust, the deduction under section 4(q) must be reduced by such amount.

The first proviso's scope is wide. It does not require the will of the deceased person to stipulate that the asset inherited from the deceased must be passed on to another person.¹⁰⁵⁵ It merely states that "any amount" the surviving spouse is required to dispose of reduces the section 4(q) deduction, on the basis that a lesser amount is considered to accrue to the surviving spouse. The word "amount" in the larger

more than one spouse where the limited abatement is apportioned among the surviving spouses. See De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 45.

¹⁰⁵⁴ Abuse may occur in that an estate planner bequeaths all property to a surviving spouse to make use of the preferential treatment, which prevents them from spreading the wealth to alternative beneficiaries if it was not for the special treatment.

¹⁰⁵⁵ Davis, Beneke and Jooste *Estate Planning* 2.5.16.

context of section 4 and more specifically section 4(q)(i) should be interpreted as the value of property, including money.¹⁰⁵⁶ Therefore, if the surviving spouse is required to pay a bequest price out of their resources, it falls within the ambit of the proviso and the deduction under section 4(q) will be reduced. The will must merely create the obligation in the hands of the surviving spouse to dispose of an amount for the proviso to apply. A surviving spouse who disposes of property of their own accord and not under an obligation imposed by the deceased's will, will not reduce the deduction under section 4(q). The following example illustrates the application of the first proviso.

Example 1 – Bequest to surviving spouse is subject to a condition to pay a bequest price to another person

Person B dies and the surviving spouse (C) receives a bequest (immovable property) worth R1 million, subject to the condition in B's will that C must pay a cash amount of R100 000 as a bequest price to their son (D).

If C accepts the inheritance, the condition must be met and C's own resources must be used to pay the bequest price. There will be a disposal of an amount for the bequest price under the terms of the will to any other person. A deduction under section 4(q) is allowed. The difference between the value of the immovable property (R1 million) and the bequest price (R100 000) qualifies as a deduction under section 4(q), which is R900 000 (R1 million less R100 000).

The disposal must be made to any "other person" or a trust. Meyerowitz¹⁰⁵⁷ states that in the context, the word "other" has no meaning as the reference to a "person" is sufficient. The word "person" is defined in the *Income Tax Act* and includes the deceased estate but no corresponding definition is provided for in the *Estate Duty Act* or the *Tax Administration Act* and therefore includes a juristic person.¹⁰⁵⁸ Therefore, on the basis that a deceased estate is not a person¹⁰⁵⁹ under the *Estate*

¹⁰⁵⁶ The wider meaning to the word "amount" is in line with the purpose of the proviso, which is to limit estate duty avoidance through the mechanism of a bequest to a surviving spouse who must channel the bequeathed property to others.

¹⁰⁵⁷ Meyerowitz *Administration of Estates* 28.18. See also Cilliers *Administration of Estates* 549-552.

¹⁰⁵⁸ Definition of "person" in section 2 of the *Interpretation of Statutes Act* 33 of 1957.

¹⁰⁵⁹ *Emery v CIR* 1961 2 SA 621 (A).

Duty Act, a bequest price payable to the deceased estate does not fall within the proviso and will therefore not reduce the section 4(q) deduction.

If the surviving spouse disposes of an amount to the executor, in their representative capacity, it does not fall within the scope of the proviso. The executor in their personal capacity would be regarded as any "other person", however, in the representative capacity of the deceased estate; any receipt would be under the umbrella of the deceased estate and not as any "other person". This outcome creates an anomaly and possibility to avoid estate duty as the amount paid into the estate will not reduce the section 4(q) deduction. Meyerowitz¹⁰⁶⁰ also states that such an outcome is not within the "spirit" of the proviso unless the executor could be seen as the "other person" which is not the case. A recommendation for a specific exclusion regarding a bequest price payable to the deceased estate will ensure that the "spirit" of the proviso is upheld and that the avoidance of estate duty is limited.¹⁰⁶¹

4.2.3.5 Problems concerning proviso (ii) of section 4(q)

The purpose of the proviso is to prohibit the deduction under section 4(q) where the deceased person established a trust that held property for the benefit of the surviving spouse subject to the discretion of the trustee.

The purpose of section 4(q), which is to allow the deduction for property that accrues to the surviving spouse, should be emphasised. Section 4(q)(ii) provides for an extension of the deduction in the case where the property accrues to a trust for the benefit of the surviving spouse. It should still be read in the narrow sense of the purpose of the provision, which is that if the property vests in a trust or any income derived therefrom does not vest in the surviving spouse, "no deduction" should be allowed. The proviso was introduced to prevent estate duty avoidance. The reason for allowing the deduction is not to circumvent the estate duty liability in its entirety, but to merely delay the taxing event to the death of the surviving

¹⁰⁶⁰ Meyerowitz *Administration of Estates* 28.18.

¹⁰⁶¹ See para 6.2.3.2 below.

spouse.¹⁰⁶² The different application of the second proviso regarding a vested and discretionary right is illustrated through the examples below.

Example 2 – A surviving spouse is the sole beneficiary of a discretionary trust

A testator created a discretionary trust where the surviving spouse is the sole income beneficiary. The trust deed provides that, subject to the trustees' discretion, the trust income shall only be payable to the testator's wife as the sole income beneficiary.

In terms of the trust deed, the distribution to the surviving spouse remains subject to the trustee's discretion and therefore, following the narrow interpretation of the proviso, a deduction under section 4(q) is prohibited because under a discretionary trust, the surviving spouse does not acquire a vested right in the trust property or the income.

Example 3 – A surviving spouse with a vested right

A testator created a trust where the surviving spouse is one of many beneficiaries to the trust and has a vested right in two properties of the trust.

The section 4(q) deduction is allowed to the extent of the value of the two properties in which the surviving spouse has a vested right, which is fixed and determinable, as to its content and accordingly as to its value. The discretion of the trustees cannot alter or diminish the surviving spouse's right.

Davis, Beneke and Jooste¹⁰⁶³ state that the wording of the second proviso is not clear to determine when a trustee's discretion will fall within the proviso and when not. They are of the view that the proviso will not apply where the trustee has no discretion regarding a certain amount of trust income that must be paid to the surviving spouse or to pay so much of an amount not required by the surviving spouse for their needs, to a third party. In such a case, the discretion is considered to not fall within the proviso. However, if the will provides that all the trust's income should be paid to the spouse, subject to the trustee's sole discretion to pay half of

¹⁰⁶² National Treasury *Explanatory Memorandum to the Taxation Laws Amendment Act, 1987* 5-6.

¹⁰⁶³ Davis, Beneke and Jooste *Estate planning* 2.5.16.

the income to any other person, it is argued that such a discretion falls within the proviso and no section 4(q) deduction will be allowed.¹⁰⁶⁴

Meyerowitz¹⁰⁶⁵ is of the view that the surviving spouse's right to income (in whole or in part) from a trust that cannot be defeated by a trustee's discretion, (including the allocation of the capital), the proviso should not prevent the surviving spouse's vested right from being deductible under section 4(q). However, due to the uncertainty within the wording of the proviso, the questions that arise in the application of the proviso include:

- (a) Can section 4(q) be allowed if most of the trust income does not vest in the surviving spouse?
- (b) If the surviving spouse enjoys a vested right to a part of the trust income, does the mere existence of a discretion regarding the balance of the income prevent the section 4(q) deduction?
- (c) Where a surviving spouse is entitled to all the trust income during their lifetime and when they die, the trustee has the discretion to allocate the income or capital to other beneficiaries, does the existence of the trustee's discretion nullify the deduction or must the discretion exist during the lifetime of the survivor?

SARS¹⁰⁶⁶ is of the view that the proviso should only apply if any right of the surviving spouse can be affected by the trustee's discretion. This implies that to the extent that the surviving spouse has a vested right,¹⁰⁶⁷ the section 4(q) deduction should be allowed but if the surviving spouse has no vested right, no section 4(q) deduction should be allowed. However, due to the fact that the wording of the second proviso to section 4(q) does not provide certainty in its application, and in order to promote

¹⁰⁶⁴ Davis, Beneke and Jooste *Estate planning* 2.5.16. See also Le Roux 2019 *Insurance and Tax Journal* 3.

¹⁰⁶⁵ Meyerowitz *Administration of Estates* 28.18.

¹⁰⁶⁶ SARS *Practice Note: No. 35: Estate Duty* 1.

¹⁰⁶⁷ A vested right refers to the unconditional entitlement to property without being subject to a condition, whereas a contingent right refers to a conditional right. See para 4.2.4.2 below for a detailed discussion in this regard.

adherence to the canon of certainty, it is recommended that clarity should be provided through the wording of section 4(q). The clarity should address the uncertainty as to what extent the trustee's discretion can prevent the deduction of section 4(q) as well as the type of right to be enjoyed by the surviving spouse.

Principles that will be considered in providing clarity are briefly set out below for further consideration in making a recommendation to section 4(q) in Chapter 6:

- (a) The meaning attached to "property" under the proviso should be aligned to the "property" that is included in the estate. If a narrow interpretation is followed in the spirit of the provisos to deter estate duty avoidance, the connecting factor to the section 4(q) deduction is the "property" that is held by the trust or any income derived therefrom and not the income in isolation. It is the property and the income that are derived from such property that must be considered. Where the surviving spouse merely receives income without having a vested right in the underlying property, the deduction under section 4(q) should not be allowed.
- (b) The benefit accruing to the surviving spouse should not be based on the trust that must be established for the benefit of the surviving spouse, but rather the property that is held in the trust, established by the deceased, must be held for the benefit of the surviving spouse.
- (c) The nature of the surviving spouse's right is important to determine whether a deduction is allowed under section 4(q). The surviving spouse must have a vested right in the property of the trust that will be included in the surviving spouse's estate upon death. The trustee's discretion must not allow the property to be distributed to another beneficiary of the trust, whether during or after the surviving spouse's death. If the trustee's discretion allows for the dissolution of the trust upon the death of the surviving spouse and the disposal or distribution of the property to someone else, the section 4(q) deduction should not be allowed.

- (d) The surviving spouse does not have to be the sole beneficiary and can be one of many beneficiaries. The determining factor must be whether the surviving spouse has a vested right in the property of the trust for the deduction to apply. The deduction under section 4(q) should be allowed on a pro-rata basis to the extent that the surviving spouse has a vested right in the trust property or the income derived therefrom.
- (e) Instances where the surviving spouse has a vested right in certain property and the balance of the capital or income in the trust is subject to the discretion of the trustees; the trustee's discretion should not automatically nullify the deduction under section 4(q). The trustee's discretion would nullify the deduction if the surviving spouse had no vested right to the property of the trust. If the surviving spouse does not have a vested right in the property and, due to the exercise of the trustee's discretion in terms of the trust deed, is entitled to income during the surviving spouse's lifetime, no deduction should be allowed. The vested right must be stipulated in the will of the deceased and no discretion should be provided for to the trustee in the trust deed to change or influence the surviving spouse's right or entitlement. Therefore, the mere existence of the trustee's discretion should only prevent the section 4(q) deduction if the surviving spouse has no vested right to the property in the trust or the income derived therefrom.

It is clear from the above that the provisos to section 4(q) require clarity to ensure certainty in its application. The existence of a vested right by the surviving spouse in property is important to prevent the application of the provisos to reduce or eliminate the deduction under section 4(q).

The following section will consider the application of section 4(q) to a non-resident spouse.

4.2.3.6 Application of section 4(q) to a non-resident spouse

The application of section 4(q) is currently available to a "spouse", irrespective of whether the surviving spouse is a resident or non-resident for estate duty purposes.

This treatment is different in the context of capital gains tax where the preferential treatment regarding roll-over relief is limited to disposals by the deceased person to a *resident* surviving spouse.¹⁰⁶⁸ This means any deemed disposals by the deceased person at death to a non-resident surviving spouse is subject to capital gains tax. Therefore, the disposal to a non-resident surviving spouse does not enjoy the same preferential treatment as per the *Estate Duty Act*. The limitation for capital gains tax purposes is considered to be sound on the basis that when the asset is disposed to a non-resident and such property is situated outside South Africa, the capital gains is levied at the point of the deemed sale because when the actual sale takes place at a later point, South Africa will not have a taxing right regarding foreign-sourced property of a non-resident. Whereas, in the case of a resident spouse, when the actual sale takes place, South Africa will enjoy a taxing right on the basis of the spouse being a resident.

The same situation arises for estate duty purposes. Considering the purpose of section 4(q) which is not to avoid estate duty in its entirety but to merely delay the imposition thereof to the death of the surviving spouse, its purpose is not achieved in the case of a non-resident surviving spouse owning property situated outside South Africa. The same applies to property that is removed from South Africa prior to the non-resident surviving spouse's death. The bequest to the surviving spouse will not be subject to estate duty and, upon the death of the non-resident surviving spouse,¹⁰⁶⁹ South Africa will not have a taxing right in respect of property situated outside South Africa, resulting in a complete avoidance of estate duty. It is submitted that if a property is situated in South Africa, that property may become subject to estate duty upon the death of a non-resident spouse only if that property remains in South Africa. It is therefore submitted that a similar approach as in the case of capital gains tax should be considered by limiting the deduction under section 4(q) to a resident spouse.

¹⁰⁶⁸ Section 9HA(2) of the *Income Tax Act*.

¹⁰⁶⁹ Section 4(q) of the *Estate Duty Act* does not provide any limitation regarding a non-resident surviving spouse.

The US takes a strict approach to not allow any spousal exemption or deduction for bequests made to a non-resident surviving spouse.¹⁰⁷⁰ The UK applies a limitation in respect of bequests to a non-UK domiciled surviving spouse by limiting the deduction equal to the inheritance tax exemption (the equivalent of the section 4A abatement in South Africa).¹⁰⁷¹ It is therefore submitted that, in order to protect the potential revenue loss where bequests are made to a non-resident surviving spouse, a limitation should be considered to align with the approach for CGT purposes and to protect the taxing rights while South Africa can still exercise a taxing right.

4.2.3.7 Conclusion to the spousal deduction

The deduction under section 4(q) regarding spousal bequests has been questioned about its fairness between single-parent families and married couples and whether it is constitutional or not.¹⁰⁷² It has been discussed above¹⁰⁷³ that although arguments have been made for and against its constitutionality, it was found to be constitutional as any limitation therein is justified and the application thereof is aligned with international standards. However, the greater issue is rather whether the provision is still serving its intended purpose of providing financial stability to the surviving spouse. To avoid abuse and reduce the disparity between married couple households and single-parent/person households, preferential treatment may be made subject to a limitation. The OECD also supports the retention of preferential treatment, subject to a limitation.¹⁰⁷⁴

Anomalies in the application of the first proviso to section 4(q), where a surviving spouse is requested to make a payment to the deceased estate that requires clarity to avoid absurd results where a deduction is allowed for a spousal bequest subject to a payment to the deceased estate, were discussed. It was recommended that a specific exclusion should be considered regarding a bequest price payable to the

¹⁰⁷⁰ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 480. See also paras 5.3.6.4.3 and 5.3.6.4.4.

¹⁰⁷¹ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 462. See also para 5.2.6.3.2(a).

¹⁰⁷² See para 4.2.3.3 above.

¹⁰⁷³ See para 4.2.3.3 above.

¹⁰⁷⁴ See para 4.2.3.3 above.

deceased estate to ensure the "spirit" of the proviso is upheld and that the avoidance of estate duty is limited.¹⁰⁷⁵

The uncertainty in the wording of the second proviso to section 4(q) was discussed, especially regarding the impact that the trustee's discretion may have on the application of the proviso and the allowance of the section 4(q) deduction. Difficulties were highlighted and principles were laid down that could be considered in making recommendations to address the issues and anomalies pointed out above in the search for a revised *Estate Duty Act*.¹⁰⁷⁶

As a final point, the application of section 4(q) to a non-resident spouse was discussed and it was concluded that, due to the possible avoidance of estate duty in respect of a non-resident surviving spouse where South Africa may end up enjoying no taxing right, the deduction should be limited to a resident spouse.¹⁰⁷⁷

The following section will discuss the importance of and challenge in determining the meaning of "accrual" for estate duty purposes.

4.2.4 The meaning of "accrual" under the Estate Duty Act

4.2.4.1 Introduction

Under the *Estate Duty Act*, the concept of "accrual" and the timing thereof is not defined and has relevance in determining when an inheritance accrues to a beneficiary to determine the allowable deductions in calculating the estate duty liability. More specifically, deductions that are based on the accrual thereof to a beneficiary are the deductions under section 4(h) and (q) of the *Estate Duty Act*. For purposes of section 4(h), the timing of the accrual is important and in the context of section 4(q), the meaning of "accrual" is important, especially where a bequest is made to a trust to determine to what extent it can be argued that the

¹⁰⁷⁵ See para 4.2.3.4 above.

¹⁰⁷⁶ See para 4.2.3.5 above.

¹⁰⁷⁷ See para 4.2.3.6 above.

benefit accrued to the surviving spouse to qualify for the deduction.¹⁰⁷⁸ The concept of "accrual" is equated to a "vested right" and has been given a meaning under the *Income Tax Act* as the time "when a person becomes unconditionally entitled to an amount".¹⁰⁷⁹

Considering the meaning of "accrual" laid down for income tax purposes, the question that arises is when does accrual (unconditional entitlement) take place for estate duty purposes considering the principles laid down under the common law. In essence, the point at which a beneficiary becomes unconditionally entitled to an inheritance must be established.

4.2.4.2 Vesting of rights

The terms "vesting" and "unconditional" have been used to explain the meaning of an "accrued right".¹⁰⁸⁰ Cowen¹⁰⁸¹ also states that although it is accepted that legal rights can be classified as vested rights or otherwise, a definitive meaning of a "vested right" is not easy as it bears a different meaning depending on its context in both the general and legal sense.

For income tax purposes the determination of a vested right often depends on the impact of a contractual agreement, whereas the law of succession influences the tax implications regarding limited rights such as *usufructs* and a *fideicommissum*, which are often relevant in a deceased estate.¹⁰⁸²

¹⁰⁷⁸ It is argued that for a bequest to a trust to qualify for a deduction under s 4(q), the surviving spouse must have enjoyed a vested right in the capital and/or income of the trust (see Davis, Jooste and Beneke *Estate Planning* 2.5.16).

¹⁰⁷⁹ *Lategan v Commissioner for Inland Revenue* 1926 CPD 203; *Mooi v Secretary for Inland Revenue* 1972 1 SA 675 (A) and *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* 1990 2 SA 353 (A). The words "entitled", "acquired", "vested" and "accrued" are used as synonyms and accrual takes place when a taxpayer becomes entitled to a right once it vested (see Van der Merwe 2000 *SAMLJ* 325-326). See also Davis, Jooste and Beneke *Estate Planning* 2.5.16.

¹⁰⁸⁰ *Income Tax Case 398* 1937 10 SATC 96 para 97 stated: "It was unconditional, and the right vested in him as the payee of the promissory note. Therefore, the right accrued." *Income Tax Case 1552* 1989 55 SATC 82 para 87 also stated that for income tax purposes a vested right was an accrued right. See also Van der Merwe 2000 *SAMLJ* 319, 326.

¹⁰⁸¹ Cowen 1949 *SALJ* 404.

¹⁰⁸² Van der Merwe 2000 *SAMLJ* 319-320. In *CSARS v Thistle Trust* (516/2021) [2022] ZASCA para 153 the conduit-pipe principle was in dispute regarding an amount that was not taxed in the

The meaning of a "vested right" is often discussed in light of case law relevant to the law of succession, namely *Jewish Colonial Trust Ltd v Estate Nathan*.¹⁰⁸³ Watermeyer JA distinguished between two usages of a "vested right", namely ownership (including the enjoyment of a right) or an unconditional right:

Unfortunately, the word "vest" bears different meanings according to its context. When it is said that a right is vested in a person, what is usually meant is that such person is that owner of that right — that he has all rights of ownership in such right including the right of enjoyment ... But the word is also used in another sense, to draw a distinction between what is certain and what is conditional; a vested right as distinguished from a contingent or conditional right.¹⁰⁸⁴

A disposition under a will does not consist of an outright transfer of property to a beneficiary but only entails the disposal of a right in favour of beneficiaries, which can be either vested (unconditional) or conditional.¹⁰⁸⁵ Vesting does not necessarily mean that ownership is obtained. A legatee is also not considered to acquire the dominium of property upon the death of the deceased person but acquires a vested right to claim¹⁰⁸⁶ from the executor at a future point in time, usually after the confirmation of the L & D account.¹⁰⁸⁷ Ownership should not be limited to the real right in the benefit itself but can also include the holding of a real or personal right.¹⁰⁸⁸

Thistle Trust (a second-tier trust) but in the beneficiaries who have a vested right to the income and capital of the trust. SARS challenged the application of the conduit-pipe principle and taxed the capital gains. The Supreme Court of Appeal upheld the additional assessments issued by SARS on the basis that the vesting of the capital gain by the Thistle Trust did not arise from the disposal of a capital asset by the Thistle Trust and, therefore, para 80(2) of the Eighth Schedule to the *Income Tax Act* did not apply. The case was decided in the context of the *Income Tax Act* and for capital gains tax purposes where the issue of vesting was not in dispute but only the object of the vested rights, being the income and capital of the Thistle Trust.

¹⁰⁸³ 1940 AD para 163 (the *Jewish Colonial Trust case*). See also Barker 1997 *De Rebus* 351, Gildenhuis 2020 *PELJ* 10 and Cowen 1949 *SALJ* 406.

¹⁰⁸⁴ *Jewish Colonial Trust case* para 175. See also Cowen 1949 *SALJ* 406.

¹⁰⁸⁵ *Commissioner for Inland Revenue v Estate Crewe* 1943 AD 656 para 667 (*Estate Crewe case*). See also Van der Merwe 2000 *SAMLJ* 320 and Sonnekus 2000 *TSAR* 794.

¹⁰⁸⁶ The moment of *dies cedit*. The right is also referred to as a personal right to claim the inheritance as opposed to the right to the inheritance itself at *dies venit* (see Gildenhuis 2020 *PELJ* 15). See para 4.2.4.3 below for a discussion on the moments of *dies cedit* and *dies venit*.

¹⁰⁸⁷ Moment of *dies venit*. *Income Tax Case 816* 1955 20 SATC 496 (T) para 496; *Greenberg case* para 364 and *Estate Crewe case* 667.

¹⁰⁸⁸ Van der Merwe 2000 *SAMLJ* 320 and Gildenhuis 2020 *PELJ* 10. See para 4.2.4.3 below for a discussion on the moments of *dies cedit* and *dies venit*.

The vesting of an interest may or may not coincide with its enjoyment. In the case of an unconditional bequest, the vesting of the right takes place upon the death of the deceased, however, its enjoyment is deferred until later.¹⁰⁸⁹ Under the administration of deceased estates, section 35(12) of the *Administration of Estates Act* provides that although a right is vested, it can only be enforced and enjoyed once the L & D account is confirmed by the Master.¹⁰⁹⁰ Conditional rights always result in a delay in the vesting, enjoyment and enforceability of the right.¹⁰⁹¹ For example, a testator may bequeath a farm to child A, but subject to A obtaining a degree in agriculture. Until A has obtained the necessary qualification, A's right to inherit the farm is subject to an uncertain future event coming to pass. In such a case, *dies cedit* does not occur until the degree is obtained, which may never occur, which results in no vesting. When Watermeyer JA referred to the second usage of "vesting" being a conditional right, he had a suspensive condition in mind, where the entitlement or vesting of the right depends on the happening of an uncertain future event.¹⁰⁹² If it is merely the enjoyment of the right that is postponed to a future time, it does not mean it is a conditional right.¹⁰⁹³ For example, if a testator bequeaths a farm to A without any condition attached to the bequest, *dies cedit* occurs immediately upon the testator's death. The fact that *dies venit* (the ability to enforce the inheritance) is postponed until the L & D account is approved by the Master, does not affect *dies cedit* and vesting as *dies venit* is a certain future event that will eventually take place, merely subject to time.

¹⁰⁸⁹ *Jewish Colonial Trust* case para 175.

¹⁰⁹⁰ *De Leef Family Trust v Commissioner for Inland Revenue* 1993 55 SATC 207 para 215 (*De Leef case*). See also Meyerowitz *Administration of Estates* 18.12 where he explained that although reference is made to the confirmation of an account, the *Administration of Estates* does not have a specific reference in that regard but merely provides that the account must lie open for inspection under s 35(12) and "confirmation" would therefore refer to the account laid open for inspection without any objections. See also Cilliers *Administration of Estates* 334.

¹⁰⁹¹ Van der Merwe 2000 *SAMLJ* 321.

¹⁰⁹² Van der Merwe 2000 *SAMLJ* 322-323, 326. Silke also states that a "conditional" or "contingent" right is not a vested right (See Stiglingh *Silke: South African Income Tax* 42).

¹⁰⁹³ *Jewish Colonial Trust* case para 176.

A "vested right" can in simple terms be seen as one in which the title is complete and unconditional,¹⁰⁹⁴ whereas a conditional or contingent right is one where a person's title is subject to a condition.¹⁰⁹⁵

In the context of the law of succession, the point at which a beneficiary obtains a vested right is relevant for estate duty purposes and is reliant on the happening of moments of *dies cedit* and *dies venit* that will be discussed below.

4.2.4.3 Dies cedit and dies venit

Before the death of a deceased person, no beneficiary has any right to any bequest or inheritance (an inheritance) from the deceased estate, only an expectation or *spes*.¹⁰⁹⁶ Once the deceased person dies, the estate "falls open" and the deceased estate commences, known as *delatio*.¹⁰⁹⁷ This is the moment when a beneficiary's rights to an inheritance can become "vested", also referred to as the moment of *dies cedit*.¹⁰⁹⁸

Vesting of rights under the law of succession is not a straightforward issue. Vesting, in the context of the law of succession, means –

a right that has become unconditionally fixed and established in a beneficiary, as opposed to a merely contingent or conditional right.¹⁰⁹⁹

Jamneck¹¹⁰⁰ states that vesting means that "a person becomes the holder of a right".

In the *Greenberg* case, Centlivres CJ¹¹⁰¹ made the following statement:

The position under our modern system of administering deceased estates is that when a testator bequeaths property to a legatee the latter does not acquire the

¹⁰⁹⁴ Cowen 1949 *SALJ* 406.

¹⁰⁹⁵ *Durban City Council v Association of Building Societies* 1942 AD 27 para 33; *Estate Crewe* case para 667 and *Jewish Colonial Trust* case para 175.

¹⁰⁹⁶ De Waal and Schoeman-Malan *Law of Succession* 7; De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 53.

¹⁰⁹⁷ De Waal and Schoeman-Malan *Law of Succession* 7; De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 53 and Sonnekus 1987 *De Jure* 361.

¹⁰⁹⁸ De Waal and Schoeman-Malan *Law of Succession* 7.

¹⁰⁹⁹ *Jewish Colonial Trust* case para 175. See also Barker 1997 *De Rebus* 351.

¹¹⁰⁰ Jamneck *et al*, *The Law of Succession in South Africa* 134, also quoting *Jewish Colonial Trust* case as authority.

¹¹⁰¹ *Greenberg* case para 364G.

dominium in the property immediately on the death of the testator but what he does acquire is a vested right to claim from the testator's executors at some future date delivery of the legacy, i.e. after confirmation of the liquidation and distribution account in the estate of the testator.¹¹⁰²

Dies cedit occurs first and is the moment that a beneficiary's right to an inheritance comes into existence, that is, the moment of vesting of the right.¹¹⁰³ Where there is no condition attached to the inheritance, *dies cedit* occurs at the moment of the deceased person's death. *Dies cedit*, or the moment of vesting, must be distinguished from the moment such a right becomes enforceable.¹¹⁰⁴

Dies venit is the moment that the right held by the beneficiary to an inheritance becomes enforceable.¹¹⁰⁵ *Dies cedit* and *dies venit* can coincide but due to the administration of estates process, there is often a time delay, for example, *dies cedit* takes place at death, however, such right only becomes enforceable once the Master approves the L & D account.¹¹⁰⁶

Under the law of testate succession, the moment of *dies cedit* and *dies venit* depends on the testator's intention transpired from their will.¹¹⁰⁷ If there is no condition attached, *dies cedit* takes place at death. *Dies venit* is also considered to coincide with *dies cedit* in such an unconditional bequest, but as mentioned above, due to the administration of estates process, *dies venit* takes place once the L & D account is confirmed at which point *dies venit* can be enforced.¹¹⁰⁸ A person who dies without leaving a will or leaves no valid will, dies intestate.¹¹⁰⁹ *Dies cedit* occurs at the time of death and the same rule as per the law of testate succession applies to *dies venit* being delayed due to the administration of deceased estate process.¹¹¹⁰

¹¹⁰² Although the case dealt with a legatee, the same principle applies to a testamentary bequest as well as an intestate inheritance. See Gildenhuis 2020 *PELJ* 10.

¹¹⁰³ De Waal and Schoeman-Malan *Law of Succession* 7-8, *Estate Crewe* case para 692, *Greenberg* case para 364G and Barker 1997 *De Rebus* 351.

¹¹⁰⁴ De Waal and Schoeman-Malan *Law of Succession* 7, Sonnekus 2000 *TSAR* 794, Sonnekus 1987 *De Jure* 361 and Gildenhuis 2020 *PELJ* 12.

¹¹⁰⁵ De Waal and Schoeman-Malan *Law of Succession* 8, *Greenberg* case para 364G.

¹¹⁰⁶ De Waal and Schoeman-Malan *Law of Succession* 8, Sonnekus 1987 *De Jure* 361, *De Leef* case paras 358D-E, Gildenhuis 2020 *PELJ* 12 and Sonnekus 2000 *TSAR* 795.

¹¹⁰⁷ De Waal and Schoeman-Malan *Law of Succession* 8.

¹¹⁰⁸ De Waal and Schoeman-Malan *Law of Succession* 8, Sonnekus 1987 *De Jure* 361, *De Leef* case paras 358D-E, Gildenhuis 2020 *PELJ* 12 and Sonnekus 2000 *TSAR* 795.

¹¹⁰⁹ *Intestate Succession Act* 81 of 1987; De Waal and Schoeman-Malan *Law of Succession* 13.

¹¹¹⁰ De Waal and Schoeman-Malan *Law of Succession* 9.

An exception to the general rule under the law of intestate succession applies where a person dies with a valid will that later becomes inoperative, at which point the beneficiaries' right will vest. *Dies cedit* and *dies venit* will only occur at the time the will becomes inoperative.¹¹¹¹

The distinction between the conditions for *dies cedit* and *dies venit*, respectively, is important. An inheritance subject to a suspensive condition, delays the moment of *dies cedit* until the condition (uncertain future event) is met.¹¹¹² This may never occur and results in no vesting taking place. On the other hand, if a person bequeaths an inheritance to a beneficiary unconditionally, with no other requirements or conditions, *dies cedit* occurs immediately upon the person's death.¹¹¹³

The fact that *dies venit*, the ability to enforce and enjoy the inheritance, is postponed until the Master has approved the L & D account, does not affect *dies cedit* and vesting: *dies venit* is not an uncertain future event, but a certain one – it is bound to occur.¹¹¹⁴ It makes no difference that, by the time *dies venit* arrives, there may be very little by way of an *amount* left in the estate for the beneficiary to enforce. The right itself (to enforce the inheritance at the time *dies venit* arrives) exists at the time of *dies cedit*.¹¹¹⁵

A question that arises is whether it can be argued that the inheritance is conditional because the right obtained under *dies cedit* at the time of death can only be enforced once the L & D account is approved by the Master. If that is the case, even if the bequest is not made subject to any condition, all bequests may be regarded as conditional as all bequests can only be enforced once the L & D account is approved and creditors are settled. As already mentioned above, the personal right

¹¹¹¹ *Harris v Assumed Administrator Estate MacGregor* 1987 3 SA 563 (A).

¹¹¹² *Jewish Colonial Trust case* para 175. See also Barker 1997 *De Rebus* 351. See also the example provided under para 4.2.4.2 above.

¹¹¹³ De Waal and Schoeman-Malan *Law of Succession* 8, 134-135; De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 66. See also the example provided under para 4.2.4.2 above.

¹¹¹⁴ Section 35(12) of the *Administration of Estates Act* and De Waal and Schoeman-Malan *Law of Succession* 139.

¹¹¹⁵ Meyerowitz *Administration of Estates* 18.12; Cilliers *Administration of Estates* 334 and Barker 1997 *De Rebus* 351.

obtained at *dies cedit* is not conditional but rather a bequest subject to a *dies* or a time clause.¹¹¹⁶ It refers to an event (the approval of the L & D account) that will definitely occur, but there is merely uncertainty as to when it will occur.¹¹¹⁷ With a suspensive time clause, it is not a condition as the beneficiary's right vests (*dies cedit*) at the time of the deceased's death, however, they become enforceable (*dies venit*) only after the occurrence of the future event (the approval of the L & D account).¹¹¹⁸ Thus, even if an heir passes away prior to the approval by the Master, any final distribution will still fall within the heir's estate.¹¹¹⁹

An opposing view is expressed by SARS in its *Comprehensive Guide to Capital Gains Tax (Issue 9)* in the context of capital gains tax, where it is stated that an heir or legatee only becomes unconditionally entitled to an inheritance once the L & D account is confirmed.¹¹²⁰ The view by SARS is based on the fact that the confirmation of the L & D account is regarded as a suspensive condition instead of a mere time clause, which means *dies cedit* and *dies venit* are considered to only take place at the confirmation of the L & D account.¹¹²¹

Following from the discussion on when a right accrues under the law of succession, the occurrence of adiation or repudiation in relation to the vesting of a right to inherit may also impact the accrual of an inheritance which will be briefly discussed below.

¹¹¹⁶ Section 35(12) of the *Administration of Estates Act*, De Waal and Schoeman-Malan *Law of Succession* 139 and Barker 1997 *De Rebus* 351.

¹¹¹⁷ De Waal and Schoeman-Malan *Law of Succession* 7-8.

¹¹¹⁸ De Waal and Schoeman-Malan *Law of Succession* 139 and *Greenberg* case para 364G.

¹¹¹⁹ Meyerowitz *Administration of Estates* 15.6; Cilliers *Administration of Estates* 222 and De Waal and Schoeman-Malan *Law of Succession* 8.

¹¹²⁰ SARS *Comprehensive Guide to Capital Gains Tax (Issue 9)* 680.

¹¹²¹ SARS *Comprehensive Guide to Capital Gains Tax (Issue 9)* 680.

4.2.4.4 Adiation and repudiation

It is vital for an executor to establish whether beneficiaries accept their benefits.¹¹²²

As soon as the estate falls open, a beneficiary can elect to accept (adiate) the benefits or reject (repudiate) the benefit.¹¹²³

De Waal and Schoeman-Malan¹¹²⁴ state:

... a beneficiary's right vests automatically when the moment of vesting concerned occurs. But this does not mean that a beneficiary must inherit, no matter what. A beneficiary always has the right either to accept the benefit (adiate) or to reject it (repudiate) ... Should a beneficiary decide for whatever reason to repudiate the benefit, however, the repudiation will be effective with retrospective force from the moment of vesting. Formal adiation will have the same retrospective effect.

Cronje¹¹²⁵ states the following:

... before they adiate, heirs have *no rights*. In *Wessels v De Jager* 2000 4 SA 924 (SCA) the supreme court of appeal held that upon the death of a testator beneficiaries only acquire a competence to accept a benefit and not a right. ... They only obtain a right once they accept the bequeathed benefit. They then get a vested personal right to claim from the executor delivery or transfer of the benefit when the accounts have lain for inspection.¹¹²⁶

There are no formal statutory requirements for adiation or repudiation. The various Masters' offices, however, require certain formalities to take place. If a beneficiary accepts a benefit subject to a burden, the acceptance must be in writing; and repudiation without a burden must also be in writing.¹¹²⁷ Unless a beneficiary repudiates a benefit, they are accepted to have adiated. In *Crookes v Watson*,¹¹²⁸ Van den Heever JA stated the following:

[T]he oft-repeated saying that a legatee does not acquire a legacy unless he accepts it, misplaces the stress; it would be more correct to say that he acquires a right to the subject-matter of the bequest unless he repudiates it.

¹¹²² De Waal and Schoeman-Malan *Law of Succession* 191.

¹¹²³ De Waal and Schoeman-Malan *Law of Succession* 191-192.

¹¹²⁴ De Waal and Schoeman-Malan *Law of Succession* 9-10.

¹¹²⁵ Cronje and Roos *Casebook on the Law of Succession* 470.

¹¹²⁶ See also *Kellerman v Van Vuuren* 1994 4 SA 336 (T).

¹¹²⁷ Jamneck "Testate Succession" 55 and De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 71.

¹¹²⁸ 1956 1 SA 277 (A) para 298A.

It is thus clear that, although a beneficiary is only able to adiate *after* the death of the deceased, the vesting that takes place as a result of such acceptance is considered to take place *before* actual physical adiation, that is, at the date of the death when *dies cedit* occurs.¹¹²⁹

4.2.4.5 Effect of vesting

Where a beneficiary receives a conditional right and is deceased before the suspensive condition has been met, nothing passes into their estate.¹¹³⁰ However, if *dies cedit* has taken place (notwithstanding that *dies venit* may not yet have occurred) the vested right is transmitted to the beneficiary's estate and may, in turn, be inherited by the beneficiary's heirs.¹¹³¹

Once vesting under *dies cedit* occurs, a personal right which is the same as any other asset in the beneficiary's estate, and which may be alienated or encumbered like any other patrimonial asset, accrues to the beneficiary.¹¹³²

The position under the law of succession may thus be concluded that when a person dies and leaves a benefit to a beneficiary, *dies cedit* occurs as at the moment of death (whether testate or intestate), unless a benefit is made subject to a suspensive condition.¹¹³³ That is when "vesting" of the right occurs. Under *dies cedit*, the beneficiary obtains an unconditional personal right against the executor to claim delivery of the inheritance when *dies venit* arrives. The personal right obtained under *dies cedit* is an asset in the beneficiary's estate and is dealt with in the same manner as other property.¹¹³⁴

¹¹²⁹ De Waal and Schoeman-Malan *Law of Succession* 194; *Swift v Pichanick* 1982 1 SA 904 (Z); *Kellerman v Van Vuuren* 1994 4 SA 336 (T) and *Theart v Wolfgang* 2011 ZAWCHC 138.

¹¹³⁰ De Waal and Schoeman-Malan *Law of Succession* 139; Meyerowitz *Administration of Estates* 15.6 and Cilliers *Administration of Estates* 222.

¹¹³¹ Jamneck *et al The Law of Succession in South Africa* 134. See also *Samaradiwakara v De Saram* 1911 AD 465 (PC) and *Commissioner for Inland Revenue v Sive's Estate* 1955 1 SA 249 (A) as authority that a vested right is normally transmissible to a beneficiary's heirs and forms an asset in the beneficiary's estate. See also Barker 1997 *De Rebus* 351.

¹¹³² Cowen 1949 *SALJ* 417-420 and Gildenhuys 2020 *PELJ* 15.

¹¹³³ See para 4.2.4.3 above.

¹¹³⁴ Jamneck *et al The Law of Succession in South Africa* 134. See also *Samaradiwakara v De Saram* 1911 AD 465 (PC) and *Commissioner for Inland Revenue v Sive's Estate* 1955 1 SA 249 (A) as

Van der Merwe¹¹³⁵ recommended a definition for the phrase "vested right" to align its meaning under the law of contract and the law of succession for purposes of income tax as both fields impact the income tax aspects. Van der Merwe¹¹³⁶ advanced the following definition of a "vested right":

A vested right indicates that its beneficiary is the holder of a complete real or personal right. A complete right is one that has all the parts necessary to allow for its full operation and for all consequences flowing from it. A right will not be complete when it is subject to a suspensive condition. However, ownership of the benefit, and the transmissibility and immediate enjoyment of the right are not requirements for its vesting.

It is submitted that a definition of a "vested right" or "accrual" will bear equal importance for estate duty purposes due to the influence the law of succession has on the application of the *Estate Duty Act*, especially regarding the accrual of an inheritance in the hands of a beneficiary. The above definition provides a useful benchmark in defining the concept of "accrual" under that Act. For example, stipulating that, in the context of an unconditional bequest, the accrual thereof for estate duty purposes is considered the date of death. Furthermore, the unconditional entitlement (as at the date of death and not only when the L & D account is approved) will provide clarity in taking into account the available deductions under section 4 of the *Estate Duty Act* and calculating the ultimate estate duty liability.

A definition or rule stipulating the meaning and time of accrual of a bequest for purposes of the *Estate Duty Act*, provided the bequest is unconditional, will provide clarity to determine the available deductions and calculate the final estate duty liability. The canon of certainty will also be promoted as reliance will no longer need to be sought from common law, the law of succession, or extensive academic literature, but through clear context within the *Estate Duty Act* in determining the estate duty liability. The section below will discuss the relevance of the meaning of

authority that a vested right is normally transmissible to a beneficiary's heirs and forms an asset in the beneficiary's estate. See also Barker 1997 *De Rebus* 351.

¹¹³⁵ Van der Merwe 2000 *SAMLJ* 329.

¹¹³⁶ Van der Merwe 2000 *SAMLJ* 329.

"accrual" under the *Estate Duty Act* in order to consider a recommendation for purposes thereof.

4.2.4.6 Relevance of "accrual" under the *Estate Duty Act*

The concept of "accrual" under the *Estate Duty Act* has relevance as it determines when the property bequeathed to a beneficiary vest in such beneficiary. It specifically has an impact on the allowance of deductions under section 4(h) and (q). Each provision is discussed separately below.

4.2.4.6.1 Section 4(h)

Section 4(h)(i)¹¹³⁷ allows for a deduction of the value of any property included in the estate, which has not been allowed as a deduction under any other provision and *accrues or accrued* to a public benefit organisation (PBO) that is exempt under section 10(1)(cN) of the *Income Tax Act*.

The *Explanatory Memorandum to the Taxation Laws Amendment Bill, 2001*¹¹³⁸ stated that only after the Commissioner approved a PBO can it be exempt from income tax under section 10(1)(cN). The consequential amendment to section 4(h)(i) of the *Estate Duty Act* used similar wording, "any public benefit organisation which is exempt from tax in terms of section 10(1)(cN) of the Income Tax Act, 1962 ...". The wording confirmed the policy intention for purposes of section 4(h)(i) of the *Estate Duty Act* that a deduction is only allowed if a PBO is an approved PBO that is exempt under section 10(1)(cN), at the time the value of the property accrues to the PBO. This generally includes bequests to an existing PBO but may also include a PBO that is created in terms of the deceased person's will.

It can therefore be argued that the property that accrues to a PBO must be to an approved PBO at the date of death when accrual takes place (*dies cedit*). On the

¹¹³⁷ Section 4(h)(i) of the *Estate Duty Act* states, "[T]he value of any property included in the estate which has not been allowed as a deduction under any other provision of this section which accrues or accrued to—(i) any public benefit organisation which is exempt from tax in terms of section 10(1)(cN) of the Income Tax Act, 1962 (Act No. 58 of 1962); or..."

¹¹³⁸ National Treasury *Explanatory Memorandum to the Taxation Laws Amendment Bill, 2001* Clause 10.

basis that section 4(h) refers to PBOs approved at the time of accrual, it is doubtful whether PBOs created in terms of a will were included in the initial scope of section 4(h)(i) of the *Estate Duty Act*. When considering a PBO that is established in a will, section 4(h)(i) does not merely require the PBO to have been established as it would have been in terms of a will, but it must be an approved PBO under section 10(1)(cN) of the *Income Tax Act* that is exempt at the time of the accrual.

For purposes of the deduction, it is important to determine when the bequest accrues to the beneficiary, because at that point the PBO must be approved, whether it is at the date of death (*dies cedit*) or some future point in time (*dies venit*). For an already established and approved PBO, the timing of accrual is less of an issue because whenever the accrual takes place, the PBO is registered and the deduction under section 4(h) is allowed. For example, where a testator's will provides that R500 000 must be bequeathed to the SPCA, the conditions of section 4(h)(i) will be met whether accrual is considered to take place at death or once the L & D account is approved and the deduction under section 4(h) is allowed.

However, in the case of a PBO that is created in a will, such PBO will not be registered and approved at the time of death to qualify for the deduction under section 4(h)(i), unless such registration is made retrospectively to the date of death. This view is because inheritance accrues to the beneficiary (PBO) *at the time of death*.¹¹³⁹ Alternatively, if the confirmation of the L & D account is regarded as a suspensive condition resulting in the vesting of the inheritance only taking place once the confirmation is received, the deduction under section 4(h) may be applicable, provided the PBO is approved by the latter date.¹¹⁴⁰

In conclusion, having considered the law and literature regarding the vesting of a right under the law of succession, it is submitted that a strong argument exists, subject to adiation of the benefit, that the accrual of a right takes place at the time of death when it vests, even though it is only enforceable once the L & D account

¹¹³⁹ Section 3(1) of the *Estate Duty Act*. The moment of vesting (*dies cedit*) is considered to be at death. See discussion under para 4.2.4.2 above.

¹¹⁴⁰ De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 134-135.

is approved. This seems to be aligned with the policy intention of section 4(h)(i) that a PBO must be approved at the time of death for the bequest to be deducted under that section. It is concluded that for the deduction to apply under section 4(h)(i), the PBO must be approved at the time of death when the value of the property accrues to the PBO.

This creates an anomaly in respect of a PBO created in a will. It is therefore recommended that the wording of section 4(h)(i) of the *Estate Duty Act* be amended to also provide for an exception regarding the time of accrual regarding bequests made to a PBO established in a will, by the addition of the underlined wording:

any public benefit organisation which is exempt from tax in terms of section 10(1)(cN) of the Income Tax Act, 1962 as at the date of death; or in the case of a public benefit organisation created in the will of a deceased person that is only approved after the date of death but before the liquidation and distribution account becomes distributable in terms of section 35(12) of the Administration of Estates Act, 1965, is for purposes of this Act deemed to be exempt as at the date of death.

The above recommendation is considered to provide clarity as to when accrual is considered to take place as well as certainty to determine the correct qualifying section 4(h) deduction.

4.2.4.6.2 Section 4(q)

When section 4(q) was added in 1985, the *Explanatory Memorandum on the Revenue Laws Amendment Bill, 1985*¹¹⁴¹ stated that the accruals were bequests and amounts intended for the surviving spouse under the law of intestate succession. Davis, Jooste and Beneke¹¹⁴² state that the meaning of the word "accrues" is important for purposes of determining the section 4(q) deduction, especially regarding bequests to a trust where a vested right must be present for the deduction to apply.

¹¹⁴¹ National Treasury *Explanatory memorandum on the Revenue Laws Amendment Bill, 1985* 4.

¹¹⁴² Davis, Jooste and Beneke *Estate Planning* 2.5.16.

In *ITC 1520*,¹¹⁴³ the court considered whether an amount accrued to a surviving spouse where the deceased had left the residue of his state in trust subject to the conditions that the trustees must apply the income of the trust to the surviving spouse's maintenance as and when they consider it fit to do so. The court concluded that the trustees' discretion was limited to the method they applied to use the income regarding the surviving spouse's maintenance and not as to whether they should use any of the income therefor. Accordingly, a section 4(q) deduction was allowed on the basis that the surviving spouse enjoyed a vested right to the trust income.¹¹⁴⁴

Section 4(q) of the *Estate Duty Act* only applies where an amount accrues to the surviving spouse of the deceased. Davis, Jooste and Beneke¹¹⁴⁵ state that the meaning of the word "accrues" is considered problematic for the following reasons:

- (a) The first proviso to section 4(q)¹¹⁴⁶ limits the section 4(q) deduction where the property is bequeathed to the surviving spouse, subject to a requirement that a part of it must be disposed to a third person. It is therefore considered debatable whether the property in question has accrued to the surviving spouse in the first place.¹¹⁴⁷ However, Davis, Jooste and Beneke¹¹⁴⁸ state that, due to the wide interpretation of the proviso, it covers a situation where the surviving spouse is required to pay a bequest price which limits the ultimate section 4(q) deduction and simultaneously serves as an anti-avoidance measure.

¹¹⁴³ 1991 54 SATC 168.

¹¹⁴⁴ Although the decision applied regarding the application of s 4(q) prior to the inclusion of the two provisos, the decision would probably have been the same if decided upon the current wording due to the nature of the right enjoyed by the surviving spouse (see Davis, Jooste and Beneke *Estate Planning* 2.5.16).

¹¹⁴⁵ Davis, Jooste and Beneke *Estate Planning* 2.5.16.

¹¹⁴⁶ Proviso (i) to s 4(q) states, "the deduction allowable under the provisions of this paragraph shall be reduced by so much of any amount as the surviving spouse is required in terms of the will of the deceased to dispose of to any other person or trust;".

¹¹⁴⁷ Davis, Jooste and Beneke *Estate Planning* 2.5.16.

¹¹⁴⁸ Davis, Jooste and Beneke *Estate Planning* 2.5.16. See also Meyerowitz 1989 *The Taxpayer* 229.

- (b) The second proviso¹¹⁴⁹ also creates a problem to determine to what extent an amount can be considered to have accrued to a surviving spouse where the bequest is made to a trust and the surviving spouse is a beneficiary of the trust.¹¹⁵⁰ Davis, Jooste and Beneke¹¹⁵¹ state that the proviso will not apply if the trustees have no discretion or if the trustees are specifically instructed in the trust deed regarding the benefit to the surviving spouse. They are further of the view that the proviso will apply where any benefit to the surviving spouse is subject to the trustees' discretion as the surviving spouse has no vested right and their right can be defeated by the trustees' discretion. The section 4(q) deduction will only apply to the extent that the surviving spouse has a vested right.¹¹⁵²

SARS¹¹⁵³ is of the view that the proviso should only apply where the trustee's discretion can affect any of the rights of the surviving spouse, which implies the surviving spouse had no vested right. Furthermore, the surviving spouse is considered to enjoy a vested right where they had a right to benefit during their lifetime, and only after the surviving spouse's death does the trustee's discretion applies.

Meyerowitz¹¹⁵⁴ states that the wording of the proviso is not clear and to arrive at the interpretation by SARS certain words must be implied in the proviso, which creates uncertainty.¹¹⁵⁵ Hence, clarity should be provided as to when an amount is considered to accrue to the surviving spouse.

¹¹⁴⁹ Proviso (ii) to s 4(q) states, "no deduction shall be allowed under the provisions of this paragraph in respect of any property which accrues to a trust established by the deceased for the benefit of the surviving spouse, if the trustee of such trust has a discretion to allocate such property or any income therefrom to any person other than the surviving spouse."

¹¹⁵⁰ Davis, Jooste and Beneke *Estate Planning* 2.5.16.

¹¹⁵¹ Davis, Jooste and Beneke *Estate Planning* 2.5.16. See also para 4.2.3.5 above for a detailed discussion regarding issues identified under proviso (ii) of s 4(q) of the *Estate Duty Act*.

¹¹⁵² Meyerowitz 1992 *The Taxpayer* 162.

¹¹⁵³ SARS *Practice Note: No. 35: Estate Duty* 1 and Meyerowitz 1989 *The Taxpayer* 232.

¹¹⁵⁴ Meyerowitz 1989 *The Taxpayer* 232.

¹¹⁵⁵ See also para 6.2.3.2 below for recommendations regarding s 4(q).

The concerns regarding the timing of accrual will first be addressed before a recommendation for the meaning of "accrue" for purposes of a revised *Estate Duty Act* is provided.

Furthermore, where an amount accrues to a surviving spouse as a residuary heir, the time of accrual is important. The debate has been about whether the deduction allowed under section 4(q) is the amount stipulated in the will at the date of death (prior to taking into account the estate duty liability), or whether it is the amount ultimately distributed to the heir once the L & D account is approved and all liabilities have been settled. In the *Frith* case¹¹⁵⁶ the court dealt with the issue where it effectively addressed the valuation of the bequest under section 4(h) and (q) of the *Estate Duty Act*. The court held that the deduction under section 4(h) and (q) are valued as per the bequest in terms of the will and not the ultimate cash receipt received by the heir.¹¹⁵⁷ To draw a connection between the value and the time of accrual, it can be said that the value in terms of the will is the value at the date of death in comparison to the ultimate receipt that will be aligned to a future point in time when the L & D account is approved and available for distribution. Although the timing of the accrual is implied from the *Frith* case to be the date of death, making provision under the *Estate Duty Act* will provide certainty and ensure consistent application.

The point of accrual will dictate for purposes of section 4(h) when the PBO must be registered as an approved PBO to be exempt under section 10(1)(cN) of the *Income Tax Act* and qualify for the deduction under section 4(h)(i) of the *Estate Duty Act*, as well as when calculating the deduction under section 4(q) should occur. Such clarity will enhance legal certainty by aligning with the valuation rule laid down in the *Frith* case with the timing of accrual under the *Estate Duty Act*.¹¹⁵⁸

¹¹⁵⁶ *Frith* case 83.

¹¹⁵⁷ *Frith* case 83. See also Rabinowitz *et al* (eds) *South African Financial Planning Handbook* 822.

¹¹⁵⁸ Clarifying the time of accrual rule will furthermore have an impact on donations tax and capital gains tax implications, which however fall outside the scope of this thesis.

Based on the above discussion, and using the definition proposed by Van der Merwe¹¹⁵⁹ as a benchmark in defining a "vested right", the following definition is recommended for "accrual" in the search for a revised *Estate Duty Act*:

"accrual" is defined to mean a vested right in respect of which a beneficiary is unconditionally entitled to a complete real or personal right as at the date of death as the approval of the liquidation and distribution under section 35(12) of the Administration of Estate Act, 1965 is not considered a suspensive condition but a mere time clause. The ownership of the benefit, and the transmissibility and immediate enjoyment of the right are not requirements for it to be considered to have accrued. A right subject to a suspensive condition is only considered to accrue when all restrictions are lifted, or conditions are met.¹¹⁶⁰

The above recommendation provides that, in the absence of a suspensive condition attached to a bequest, the accrual takes place at death when the beneficiary enjoys an unconditional entitlement even though it will only be enjoyed at a later point in time when the L & D account is approved. It is made clear that the approval of the L & D account is not a suspensive condition but a time clause that still implies a certain event bound to occur at some point in the future.

4.2.4.7 Conclusion to the concept of "accrual"

The concept of "accrual" has been defined to mean the vesting of an unconditional right.¹¹⁶¹ Although the existence of an unconditional entitlement is applicable for estate duty purposes, it is important to determine at what point in time unconditional entitlement takes place considering the moment of *dies cedit* and *dies venit* under the law of succession. It is seen from the discussion under paragraphs 4.2.4.1 to 4.2.4.5 that, provided an heir or legatee adiated the benefit, such benefit is deemed to vest (*dies cedit*) unconditionally on the date of death, provided no suspensive condition is attached to the benefit.¹¹⁶² The fact that the benefit only becomes enforceable (*dies venit*) once the L & D account is approved does not make the personal right obtained at death a conditional right.¹¹⁶³ The relevance of the meaning of "accrual" for purposes of the *Estate Duty Act* was discussed and

¹¹⁵⁹ See para 4.2.4.5 above.

¹¹⁶⁰ Underlining indicates recommended wording.

¹¹⁶¹ See para 4.2.4.2 above.

¹¹⁶² See para 4.2.4.3 above.

¹¹⁶³ See paras 4.2.4.3 and 4.2.4.4 above.

recommendations were made to clarify when a bequest accrues, and a new definition for "accrual" was recommended.¹¹⁶⁴

The following section will consider the concerns raised in the application of the primary abatement under section 4A of the *Estate Duty Act*.

4.2.5 Primary abatement

4.2.5.1 Introduction

A primary abatement of R3.5 million is allowed as a deduction against the net value of every estate.¹¹⁶⁵ The abatement has undergone numerous amendments over time. The single abatement was introduced in 1988 to the value of R1 million to replace various abatements regarding specific beneficiaries regarding their relation to the deceased.¹¹⁶⁶ The abatement was increased to R1.5 million in 2001, and in 2006 it was increased to R2.5 million. Since 2007, the rebate has been R3.5 million.¹¹⁶⁷

The section 4A abatement applies irrespective of whether the deceased was a resident or not. There is no limitation of the R3.5 million in the case where the deceased was a non-resident. The US applies a limited abatement to non-residents on the basis that their estate is not taxed on a worldwide basis but on a source basis limited to US-sourced property.¹¹⁶⁸ This will be considered in more detail in the comparative study in Chapter 5 to seek guidance for possible recommendations.¹¹⁶⁹

¹¹⁶⁴ See paras 4.2.4.5 and 4.2.4.6 above.

¹¹⁶⁵ Section 4A(1) of the *Estate Duty Act*.

¹¹⁶⁶ Section 16(1) of the *Taxation Laws Amendment Act* 87 of 1988. See also para 3.4.2.4 above for the reasoning behind the change following the Margo Commission's review of the estate duty system.

¹¹⁶⁷ See Borman *The Impact of Estate Duty and Capital Gains Tax on Offshore Assets* 12.

¹¹⁶⁸ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 479. See also para 5.3.6.1 below. US residents are allowed an estate tax exemption of \$12.92 million whereas as non-residents are only allowed an estate tax exemption of \$60 000.

¹¹⁶⁹ See paras 5.2.6.1 and 5.3.6.1 below.

4.2.5.2 Impact of inflation

The primary abatement itself has never been scrutinised and the principle to allow a certain amount free from estate duty is aligned to international standards.¹¹⁷⁰ However, the debate on the value attached to the abatement and the increase thereof over time has been criticised to a large extent.¹¹⁷¹

The Margo Commission supported a lump sum abatement.¹¹⁷² The value of the abatement was questioned by the Katz Commission¹¹⁷³ on the basis that it did not take into account inflation and resulted in many estates becoming subject to estate duty that was never intended to be included.¹¹⁷⁴ The same issue was highlighted by the DTC¹¹⁷⁵ that the primary abatement was outdated as it remained unchanged since 1 March 2007 at a value of R3.5 million that resulted in a major fiscal drag to enter the estate duty system.¹¹⁷⁶

The OECD¹¹⁷⁷ recommends that tax-free thresholds should be aimed at exempting small inheritances to reduce unnecessary administrative burdens and promote an equalising effect on small inheritances on the distribution of wealth. Furthermore, tax exemption thresholds should be indexed to inflation to ensure they maintain their real value.

In view of the above, it is clear that the important point of clarity is the size of an estate that is seen as small enough to be excluded for estate duty purposes as that will influence the justified amount of the abatement. The indexing of the section 4A abatement against inflation is important, especially from an equity perspective, as it is ensured through the adjustment of inflation that the relevant group of taxpayers are subject to estate duty. The single abatement also promotes the canons of

¹¹⁷⁰ OECD *Inheritance Taxation in OECD Countries* 82. See also paras 3.4.2.4, 3.5.2.3 and 3.6.2.2 and paras 5.2.6.1 and 5.3.6.1 above.

¹¹⁷¹ See paras 3.4.2.4, 3.5.2.3 and 3.6.2.2 above.

¹¹⁷² See para 3.4.2.4 for a discussion on the Margo Commission's recommendation.

¹¹⁷³ Katz Commission *Fourth Report* 6.7.

¹¹⁷⁴ See para 3.5.2.3 above for a discussion on the Katz Commission's recommendation.

¹¹⁷⁵ DTC *Final Estate Duty Report* 14.

¹¹⁷⁶ See para 3.6.2.2 above for a discussion on the DTC's recommendation.

¹¹⁷⁷ OECD *Inheritance Taxation in OECD Countries* 82.

simplicity and certainty in comparison to the different abatements previously applicable under the *Estate Duty Act*.

4.2.5.3 Portable abatement

From 1 January 2010, so much of the R3.5 million that is not used by the first-dying spouse is rolled over to the estate of the surviving spouse.¹¹⁷⁸ The effect of the rollover is that the second-dying spouse can have a maximum abatement of R7 million.¹¹⁷⁹ If the deceased person was one of the surviving spouses of a previously deceased person, the rollover abatement will be calculated by apportioning the R3.5 million available to the deceased person among the surviving spouses to determine what portion is available to be used by each of the surviving spouses.¹¹⁸⁰ The rollover of the abatement can never be more than R3.5 million.¹¹⁸¹

The rollover abatement will only be allowed if the executor provides the necessary supporting documents to claim the rebate.¹¹⁸² Where spouses die simultaneously, the spouse whose estate has the smallest net value will be deemed to have died immediately prior to the other spouse.¹¹⁸³

The portable abatement was introduced to avoid the design of complex trust structures entered into by married couples to ensure that R7 million of assets (i.e. R3.5 million per spouse) can be passed to heirs, like the children, without any estate duty implications.¹¹⁸⁴ The compliance costs and administrative burdens involved with such structures were raised as a concern as well as the fact that it involves the use of an estate planning expert which is not always available to all taxpayers.¹¹⁸⁵ The canons of convenience and cost efficiency were not adhered to which led to the

¹¹⁷⁸ Section 4A(2) of the *Estate Duty Act*.

¹¹⁷⁹ Section 4A(2) of the *Estate Duty Act*.

¹¹⁸⁰ Section 4A(3) of the *Estate Duty Act*.

¹¹⁸¹ Section 4A(4) of the *Estate Duty Act*.

¹¹⁸² Section 4A(5) of the *Estate Duty Act*. Such documents include a copy of the predeceased spouse's estate duty return (the REV267 form) or other relevant material the Commissioner may regard as reasonable to be proof of the amount used or not in calculating the dutiable amount of the predeceased spouse's estate.

¹¹⁸³ Section 4A(6) of the *Estate Duty Act*.

¹¹⁸⁴ See Nel 2009 *Insurance and Tax Journal* 1.

¹¹⁸⁵ National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2009* 89-90.

introduction of the portable abatement to allow for the unused portion of the primary abatement to be transferrable between spouses.

However, when the portable abatement was introduced, Meyerowitz¹¹⁸⁶ criticised the amendment on the basis that it lacked principle, logic and its formulation was regarded as discriminatory. Meyerowitz¹¹⁸⁷ supports the section 4(q) deduction for bequests to a surviving spouse but stated that no rationale exists for the inherited estate to pass to the surviving spouse's heirs with the benefit of an additional R3.5 million. Meyerowitz¹¹⁸⁸ further argued that the provision discriminates between a surviving spouse who inherits only a portion of the estate, no matter how large the value of the inheritance in comparison to a surviving spouse who inherits everything no matter how small in value.

The DTC¹¹⁸⁹ in its *First Estate Duty Report* favoured the withdrawal of section 4A(2) and instead allowed the surviving spouse's primary abatement as a deduction from the first dying spouse's estate. Any portion of the surviving spouse's abatement that was used in the estate of the first-dying spouse will reduce the primary abatement available to the surviving spouse upon their death. However, the recommendation received extensive criticism and was not sustained in the final recommendations made by the DTC. The final recommendation was a complete withdrawal of section 4A together with section 4(q) to give adherence to the canon of equality so that no favourable treatment is provided to bequests to a surviving spouse.¹¹⁹⁰ Claiming the portable abatement may result in an administrative burden and inconvenience in finding the necessary supporting documents to substantiate the available amount regarding the portable abatement to the surviving spouse.¹¹⁹¹

It is submitted and agreed with Meyerowitz that the section 4(q) deduction may be justified, however, the rationale of the additional portable abatement seems lacking

¹¹⁸⁶ Meyerowitz 2009 *The Taxpayer* 149.

¹¹⁸⁷ Meyerowitz 2009 *The Taxpayer* 149.

¹¹⁸⁸ Meyerowitz 2009 *The Taxpayer* 149.

¹¹⁸⁹ DTC *First Estate Duty Report* 51 and see also para 3.6.2.3 above.

¹¹⁹⁰ DTC *Final Estate Duty Report* 14.

¹¹⁹¹ Section 4A(5) of the *Estate Duty Act*.

and may result in revenue loss and an opportunity to avoid estate duty, even though within the parameters of the law. The concern of complex trust structures to make use of the most available exemption can be addressed through an increase in the primary abatement without differentiating between married and single persons. Such a recommendation promotes the canon of equality by not limiting the preferential treatment to a married person but to allow it for all deceased persons equally. It would also lift the administrative burden to prove the available portable abatement and thereby make it more convenient to calculate the estate duty liability. Furthermore, if the section 4A abatement is increased by taking into account the impact of inflation it may further ensure that the correct group of taxpayers, being the wealthy,¹¹⁹² are subject to estate duty.

From an international perspective, a portable abatement is only found in the United Kingdom and the United States in addition to a complete deduction regarding a transfer to a spouse. The remainder of the countries' provisions are limited to relief for a spousal transfer, without portable transfers. It is therefore concluded that there is merit in the DTC's recommendation to withdraw the portable abatement and instead address concerns of abuse and avoidance through an increase in the primary abatement under section 4A of the *Estate Duty Act*.¹¹⁹³

¹¹⁹² A person's wealth may be determined by various factors, for example all forms of marketable assets that accumulated (see DTC *Wealth Tax Report* 12). It may also be measured based on the extent that all assets (including non-financial assets like immovable property and financial assets (including policies, shares and equity) exceed liabilities (mortgages and other debt). See Chatterjee, Czajka and Gethin *Estimating the Distribution of Household Wealth in South Africa* 9. The level of income is also a factor that may be considered (OECD *Inequalities in Household Wealth Across OECD Countries* 6). The banking industry, has classified their clients as wealthy if they earn an average annual salary ranging between R800 000 and R2.5 million a year (Business Tech 2021 <https://businesstech.co.za/news/wealth/487545/heres-how-much-money-you-need-to-be-considered-super-rich-in-south-africa/>). According to the 2023 Wealth Report by Knight Frank, a high net-worth individual is a person who has a net worth of more than \$1 million (R19 million), whereas an ultra high net-worth individual has a net worth of \$30 million (R575 million) or more, including their primary residence (see Frank *The Wealth Report 2023* 1 and Fraser 2023 <https://businesstech.co.za/news/finance/690945/south-africa-is-bleeding-millionaires/>).

¹¹⁹³ See para 6.2.5.2 below for recommendations on s 4A of the *Estate Duty Act*.

4.2.5.4 Conclusion to the primary abatement

The section 4A abatement is supported by the Margo Commission, the Katz Commission, the DTC, as well as the OECD. Such a tax-free threshold should be indexed against inflation to ensure they maintain their real value.¹¹⁹⁴ This will ensure that small estates are not subject to estate duty, unnecessary administrative burdens are reduced and an equalising effect on small estates on the distribution of wealth are created. The recommendation regarding the value of the abatement to be considered in the search for a revised *Estate Duty Act* will be set out in Chapter 6.¹¹⁹⁵ A further recommendation regarding the portable abatement is to withdraw it and enhance the canon of equality by making a larger primary abatement available to all deceased persons equally.¹¹⁹⁶

The following section will consider challenges identified in the valuation rules set out in section 5 of the *Estate Duty Act*.

4.2.6 Valuation rules

4.2.6.1 Introduction

Section 5 of the *Estate Duty Act* sets out the different valuation methods that must be applied regarding the different types of property and deemed property in the estate. The *Estate Duty Act* differentiates between property that is sold during the course of the administration of the estate and unrealised property.¹¹⁹⁷

For property that is sold by way of a *bona fide*¹¹⁹⁸ purchase and sale, during the course of the liquidation of the estate,¹¹⁹⁹ the selling price will be the value of the

¹¹⁹⁴ See para 4.2.5.4 above.

¹¹⁹⁵ See para 6.2.5.2 below.

¹¹⁹⁶ See para 4.2.5.4 above.

¹¹⁹⁷ Stocks or shares of unlisted entities are excluded from the provisions of s 5(1)(a) and must be dealt with under the specific provisions of s 5(1)(f)*bis* of the *Estate Duty Act*, whether or not they were realised.

¹¹⁹⁸ The opinion of the Commissioner is conclusive on whether a sale is considered a *bona fide* sales agreement. The decision is subject to review under limited circumstances. See *CIR v City Deep Ltd* 1924 AD para 298 and *Holden's Estate v CIR* 1960 3 SA 497 AD.

¹¹⁹⁹ A sale agreement for property that was entered into by the deceased person during their lifetime but where no delivery took place at death, such agreement will not constitute a sale in the

property included for estate duty purposes, excluding unlisted shares valued under section 5(1)(f)*bis* of the *Estate Duty Act*.¹²⁰⁰ For unlisted shares, the market value at the date of death (instead of the selling price at the date of sale) must be calculated, irrespective of the shares being sold in the course of the liquidation of the estate (that is, selling the assets).¹²⁰¹ The valuation is done without considering any limitations, arrangements or restrictions in respect of the control or ownership of the shares held by the deceased.¹²⁰²

In the case of unrealised property, a general rule applies where the "fair market"¹²⁰³ value at the date of death must be used for estate duty purposes.¹²⁰⁴ The general rule is subject to the proviso that, if the value of the property may be reduced for any reason upon or after death due to a condition imposed on the property, the value of the property shall be determined as if the conditions were not imposed unless the Commissioner otherwise directs.¹²⁰⁵ The general rule for unrealised property is further subject to specific rules for *usufructuary*, *fiduciary* or other like interests, annuities, property included in a *donatio mortis causa*, the *bare dominium* of property and deemed property under section 3(3)(d) of the *Estate Duty Act*.

In the search for a revised *Estate Duty Act*, the valuation of certain assets for estate duty purposes sold after the date of death and the deductibility of CGT will be

course of liquidation. See *CIR v Estate Kirsch* 1951 3 SA 496 (A), although decided under the *Death Duties Act* it is still instructive). Also see *CIR v Estate Streicher* 2004 (SCA), 66 SATC 282, where it was held that an heir who entered into a sales agreement prior to receiving transfer from the estate does not constitute a sales agreement entered into during the liquidation of the estate.

¹²⁰⁰ Section 5(1)(a) of the *Estate Duty Act*. See also McAllister 2022 *Integritax* 98.

¹²⁰¹ Section 5(1)(f)*bis* of the *Estate Duty Act*.

¹²⁰² See s 5(1)(f)*bis*(i)-(v) of the *Estate Duty Act*. Section 38(2) of the *Friendly Societies Act* provides at where the deceased was a shareholder of a friendly society with share capital in liquidation, the value of the shareholder's share that will constitute a liability shall be limited to the unpaid amount (if any) regarding any share held by the deceased, unless the rules of the society allows for an unlimited liability.

¹²⁰³ The term "fair market value" is defined in s 1 of the *Estate Duty Act* to mean the price obtained in the sale of a property between a willing buyer and a willing seller dealing at arm's length in an open market.

¹²⁰⁴ Section 5(1)(g) of the *Estate Duty Act*. The general rule according to OECD principles are that the "fair market value" must be used, however because it may be complex regarding certain assets, for example unlisted shares, artwork or high-value jewellery, specific methods may be required in such instances (see OECD *Inheritance Taxation in OECD Countries* 101-102).

¹²⁰⁵ Proviso to s 5(1)(g) of the *Estate Duty Act*.

discussed as well as the challenges that arise in the valuation of limited interests. Each issue is addressed separately below.

4.2.6.2 The valuation of unlisted shares

The *Estate Duty Act* contains specific rules for the valuation of assets when they are sold.¹²⁰⁶ Section 5(1)(a)¹²⁰⁷ caters for the selling price on the sale of any asset, except if it relates to unlisted shares in which case the market value as at the date of death should be used. The rule under section 5(1)(a), except for the exclusion regarding unlisted shares, is aligned with the valuation rules under the *Administration of Estates Act* for purposes of drawing up the L & D account to be approved by the Master. For example, the selling price is used for all assets (including listed and unlisted shares) sold in the course of the liquidation of the estate. This is also a true reflection of the amount available in the estate for purposes of calculating the amount available for distribution to the heirs. No distinction is made between assets (including listed and unlisted shares).¹²⁰⁸

The exclusion of unlisted shares from the valuation rules when they are sold by the executor after the date of death creates a problem. The question that arises is whether the CGT payable by the deceased estate can be deducted for estate duty purposes, taking into account that the CGT liability was incurred by the deceased estate and not the deceased person. These are regarded as separate taxpayers for CGT purposes.¹²⁰⁹

The deceased person is deemed to dispose of all their assets at market value on the date of death for CGT purposes.¹²¹⁰ A deceased person and the deceased estate are

¹²⁰⁶ Sections 5(1)(a) of the *Estate Duty Act* read with s 5(1)(f)*bis* of the *Estate Duty Act*.

¹²⁰⁷ Section 5(1)(a) of the *Estate Duty Act* states that "in the case of property, other than such property as is referred to in paragraph (f)*bis* or the proviso to paragraph (g), disposed of by a purchase and sale which in the opinion of the Commissioner is a *bona fide* purchase and sale in the course of the liquidation of the estate of the deceased, the price realized by such sale;".

¹²⁰⁸ De Clercq, Schoeman-Malan and Van der Spuy *Deceased Estates* 140, 157.

¹²⁰⁹ McAllister 2022 *Integritax* 99.

¹²¹⁰ Section 9HA(1) of the *Income Tax Act*, subject to exceptions, for example disposals to the surviving spouse.

also regarded as separate taxpayers for income tax purposes,¹²¹¹ therefore, the deemed disposal taking place at the date of death is accounted for in the hands of the deceased person's last income tax return. Any disposals taking place after the date of death are accounted for in the return of the deceased estate as a separate taxpayer.¹²¹²

The following table illustrates the different valuation methods to be applied in the different contexts for the sale of assets after the date of death:

Table 4.4: Valuation method of assets after the date of death

Context	Assets (other than unlisted shares)	Unlisted shares
Administration of Estates (L & D account)	Selling price	Selling price
Capital Gains Tax (Deceased estate)	Selling price	Selling price
Estate Duty (Deceased person)	Selling price	Market value (at death)

Where an asset (other than an unlisted share) is sold during the administration of an estate, the deceased person will be subject to estate duty on the selling price of the asset, but the deceased estate will be liable for the CGT for the sale post-death. It is noted that the valuation for both tax purposes is done on the selling price when the asset is sold. In the case of unlisted shares, the deceased person will be subject to estate duty on the market value of the unlisted shares as at the date of death, however, the deceased estate will be liable for the CGT on the selling price on the date of sale. Hence, in the latter instance, the estate duty and CGT liabilities are calculated on different values.

To determine whether a deduction can be allowed for estate duty purposes regarding the CGT liability that arises after the date of death and paid by the deceased estate, section 4(b) and (c) of the *Estate Duty Act* becomes relevant.

¹²¹¹ Section 25(5)(a) of the *Income Tax Act*. See also McAllister 2022 *Integritax* 99; Stiglingh *et al Silke: South African Income Tax* 1026 and Haupt *Notes on South African Income Tax* 796.

¹²¹² Section 25 of the *Income Tax Act*.

Section 4(b) of the *Estate Duty Act* allows for a deduction regarding all debts due¹²¹³ by the deceased person to persons who are ordinarily resident in South Africa, which the Commissioner is satisfied to have been discharged from the property included in the estate.¹²¹⁴ Any income tax liability incurred by the deceased person up to the date of death will be allowed as a deduction for estate duty purposes under section 4(b). However, the CGT liability incurred after the date of death and due by the deceased estate is not regarded as a debt due by the deceased person and can therefore not fall within the ambit of section 4(b). However, section 4(c) allows for a deduction of all costs which have been allowed by the Master in the administration and in the course of selling assets of the deceased estate, but excluding expenses incurred in the management and control of income accruing after the date of death.¹²¹⁵

For the CGT liability to fall within section 4(c), it must be regarded as a "cost of administration and liquidation". In *van Zyl v CIR*,¹²¹⁶ the court supported the practice

¹²¹³ See Meyerowitz *Administration of Estates* 28.3-28.6 where it is submitted that a "debt due" includes a debt that was incurred by the deceased person prior to their death but is only due and payable after the date of death. See also *Myer v CIR* 1956 4 SA 342 (T) and *ITC 1773* 2003 66 SATC 251. See also Cilliers *Administration of Estates* 537-541.

¹²¹⁴ Claims against an estate regarding property donated by the deceased person under s 56(1)(c) or (d) of the *Income Tax Act* is specifically excluded as a deductible expense against the estate. Proviso to s 3(3)(b) of the *Estate Duty Act*. An amendment was effected to s 3(3)(b) by the *Revenue Laws Amendment Act* 31 of 2005 to counter schemes where a donation is made during the lifetime of the deceased person, subject to the condition that the donee does not enjoy any benefit until the death of the donor. The property is included in the estate of the deceased person while the donee claims the donation as a debt against the estate. A corresponding amendment to s 4 of the *Estate Duty Act* was inserted that donations made under s 56(1)(c) and (d) of the *Income Tax Act* must be specifically excluded from the deduction under s 4(b) and (f) of the *Estate Duty Act*. See *CSARS v Marx* 2006 4 SA 195 (C) and National Treasury *Explanatory Memorandum to the Taxation Laws Amendment Bill, 2005* 3-4.

¹²¹⁵ Section 4(c) of the *Estate Duty Act*. See Meyerowitz *Administration of Estates* 28.8-28.11 where the scope of the expenses is discussed to include usual charges such as advertisement costs, costs regarding security furnished by the executor, executor's commission, the Master's fees, valuation costs, legal and accounting fees, realisation costs, transfer costs and costs incurred in maintaining the estate's assets. See also Cilliers *Administration of Estates* 541-543.

¹²¹⁶ 1997 1 SA 883 (C), 59 SATC 105 para 113. "The answer to the point raised by the applicant to the effect that the Insolvency Act makes no provision for the ranking of income tax which accrues post-liquidation, is that post-liquidation income tax falls within the rubric 'all other costs of administration and liquidation' in s 97(2)(c) of the *Insolvency Act*. (See *In re Beni-Felkai Mining Co Ltd* (1934) 1 Ch 406 at 417-419 and *Re Mesco Properties Ltd* (1979) 1 All ER 302 (Ch) at 305 b-306 h.) And there can be no objection to this state of affairs, for where the liquidator causes liabilities to be incurred by the company in the course of winding-up he must pay them in full. Where he invests money or carries on business during winding-up, the liquidator causes the company to earn income which, if it attracts tax, is payable in full as a cost

that income tax liabilities incurred post- liquidation fall within the scope of "cost of administration and liquidation" under section 97(2)(c) of the *Insolvency Act*, while winding up an estate. McAllister¹²¹⁷ states that, although the case is decided within the context of the liquidation of a company, the same principle should apply regarding a CGT liability incurred by the executor after the date of death as a "cost of administration and liquidation" in winding up a deceased estate and therefore fall within section 4(c). Meyerowitz¹²¹⁸ also supported this approach that has been applied by SARS in the administration of deceased estates. Therefore, on the basis that the CGT liability incurred post-death is regarded as a "cost of administration and liquidation" that is allowed by the Master, it is deductible under section 4(c) of the *Estate Duty Act*. This position would be applicable on any asset (other than unlisted shares) sold by the executor after the date of death.¹²¹⁹ Furthermore, on the basis that a capital gain is not income,¹²²⁰ it is not excluded from section 4(c) as an expense incurred in the management and control of income accruing after the date of death.¹²²¹

However, a distinction should be drawn in the case of unlisted shares where the market value at the date of death is taken into account for estate duty purposes and not the post-death growth value on which the CGT liability is payable by the executor on behalf of the deceased estate. In such a case the CGT liability will not qualify for a deduction under section 4(c), as the value in respect of which the

of administration and liquidation. (cf *De Wet & Andere NNO v Stadsraad van Verwoerdburg* 1978 (2) SA 86 (T) at 98A–F.)".

¹²¹⁷ McAllister 2022 *Integritax* 99. See also Meyerowitz *Administration of Estates* 28.8 and See also Cilliers *Administration of Estates* 541.

¹²¹⁸ Meyerowitz *Administration of Estates* 28.4, 28.8; See also Cilliers *Administration of Estates* 537–541 and McAllister 2022 *Integritax* 99.

¹²¹⁹ Section 5(1)(a) of the *Estate Duty Act*.

¹²²⁰ The word "income" is not defined in the *Estate Duty Act* and therefore follows its ordinary meaning and not the meaning ascribed to it in the *Income Tax Act* (gross income less exempt income). In *CIR v Visser* 1937 TPD 77, 8 SATC 271 para 276, Maritz J stated: "If we take the economic meaning of "capital" and "income" the one excludes the other. "Income" is what "capital" produces, or is something in the nature of interest or fruit as opposed to principal or tree." Income should therefore be seen as the fruit from the tree and not the proceeds from the sale of the tree. This approach confirms the principle that income after the date of death in the form of interest and rent which does not form part of the net value of the estate are excluded from the deduction under s 4(c). See also McAllister 2022 *Integritax* 99–100.

¹²²¹ McAllister 2022 *Integritax* 99–100.

liability was calculated was not included in the estate for estate duty purposes. McAllister¹²²² argues that this is a lacuna in the law that should be corrected.

The above misalignment is best illustrated by way of the example below.

Example 4: CGT on post-death sale of asset and estate duty

Person A held listed shares with a base cost of R10 000 and a market value at the date of death of R100 000. The executor sold the shares for R140 000 in the course of the liquidation of the estate. The CGT rate applicable to person A and the deceased estate is 18% (45% x 40% inclusion rate). The annual exclusion for death is not taken into account and the estate duty implications are as follows:

CGT at death (deceased)	CGT post-death (estate)	Estate Duty
Base cost: R10 000 Proceeds: R100 000 (MV) Gain: R90 000 CGT: R16 200 ¹²²³	Base cost: R100 000 Proceeds: R140 000 Gain: R40 000 CGT: R7 200 ¹²²⁴	Asset value: R140 000 ¹²²⁵ Section 4(b): R16 200 Section 4(c): R7 200 Net value: R116 600 ¹²²⁶

If the same facts are taken as above but in the case of unlisted shares, the estate duty impact is as follows:

CGT at death (deceased)	CGT post-death (estate)	Estate Duty
Base cost: R10 000 Proceeds: R100 000 (MV) Gain: R90 000 CGT: R16 200 ¹²²⁷	Base cost: R100 000 Proceeds: R140 000 Gain: R40 000 CGT: R7 200 ¹²²⁸	Asset value: R100 000 ¹²²⁹ Section 4(b): R16 200 Section 4(c): R0 ¹²³⁰ Net value: R83 800 ¹²³¹

¹²²² McAllister 2022 *Integritax* 99.

¹²²³ R90 000 x 18%.

¹²²⁴ R40 000 x 18%.

¹²²⁵ Section 5(1)(a) of the *Estate Duty Act*.

¹²²⁶ R140 000 – R16 200 – R7 200.

¹²²⁷ R90 000 x 18%.

¹²²⁸ R40 000 x 18%.

¹²²⁹ Section 5(1)(a) of the *Estate Duty Act*.

¹²³⁰ The post-death CGT liability cannot be allowed as the growth of the asset on which the CGT is payable was not included as an asset in the estate for estate duty purposes.

¹²³¹ R100 000 – R16 200.

Based on the above, it can be seen that for assets (other than unlisted shares) sold after the date of death, the post-death asset value for CGT purposes is the same as the asset value for estate duty purposes (R140 000), however, in the case of unlisted shares, it differs (R140 000 vs R100 000). In the latter instance, the CGT value at death is aligned with the asset value for estate duty purposes (R100 000), however, the post-death CGT liability is calculated on the growth of the asset post-death (R40 000) that is not deductible under section 4(c), as the growth was not included for estate duty purposes even though it is a cost incurred by the executor.

McAllister¹²³² states that an amendment to clarify the deductibility of post-death taxes would be welcome. He proposes that the provisions of section 5(1)(a) of the *Estate Duty Act* should be reconsidered regarding the inclusion of post-death growth of an asset for estate duty purposes as the value of these assets is taken into account upon death for CGT purposes. Following this approach, section 5(1)(a) should be deleted, which will have to be followed by a consequential amendment to section 4(c) to exclude any deduction for capital gains tax purposes. It is submitted that the approach will be aligned with section 9HA of the *Income Tax Act* regarding the deemed disposal at the date of death. The effect thereof would be that no post-death growth in the value of assets will be taken into account for estate duty purposes in calculating the value of the asset when sold after the date of death or in allowing a deduction for post-death taxes incurred.

An alternative approach, that is aligned with the actual values used for the sale of the asset as well as the approach taken by the Master for purposes of the L & D account, would be to amend section 5(1)(a) of the *Estate Duty Act* to apply to the sale of *all* assets (including unlisted shares) when sold in the liquidation of an estate. This will ensure that the post-death CGT value and the asset value for estate duty are aligned as well as the value reflected in the L & D account which in turn reflects the true value that will be available on the estate to distribute. The latter approach

¹²³² McAllister 2022 *Integritax* 100.

does however deviate from the principle that estate duty is calculated on the value of the estate as at the date of death.

Internationally, most OECD countries use the fair market value of an asset as at the date of death. A similar differentiation in the method is found in respect of listed shares where the market price is used, but as at the date of death.¹²³³ It is submitted that the recommendation by McAllister is more aligned with the policy behind estate duty to determine the liability at the date of death and to bring alignment in the valuation for estate duty and CGT purposes.¹²³⁴

The following section will analyse the challenges in respect of the valuation when a limited interest is terminated.

4.2.6.3 Termination of limited interests

A limited interest can cease due to the passing of time, death, or renunciation. For estate duty purposes a limited interest ceases upon the death of the interest holder or due to the lapse of time.¹²³⁵ The termination of a limited interest constitutes property in the estate.¹²³⁶ The termination of a limited interest while the interest holder is alive is terminated through the renunciation of the right,¹²³⁷ and such a transfer of the enjoyment to the property owner constitutes a taxable transfer for donations tax purposes.¹²³⁸ Although both death and renunciation consist of taxable events, the calculation of the ceasing interest upon death is determined on a completely different basis in comparison to the renunciation of a limited interest.¹²³⁹

For estate duty purposes, the ceasing interest on death is calculated from the perspective of the beneficiary as it is calculated over the life expectancy of the beneficiary unless a shorter fixed period applies and the corresponding estate duty

¹²³³ OECD *Inheritance Taxation in OECD Countries* 101-103.

¹²³⁴ See para 6.2.6.2.1 below for recommendations regarding the valuation rules for unlisted shares.

¹²³⁵ Section 5(1)(b) of the *Estate Duty Act*.

¹²³⁶ Section 3(2)(a) of the *Estate Duty Act*.

¹²³⁷ Muller *Wealth Transfer Taxation* 241.

¹²³⁸ The definition of a "donation" in s 54 of the *Income Tax Act* includes the renunciation of a right.

¹²³⁹ Muller *Wealth Transfer Taxation* 241.

liability is payable by the beneficiary.¹²⁴⁰ The *Estate Duty Act*, therefore, follows a recipient-based approach when calculating the value of the limited interest.¹²⁴¹ On the contrary, the value of a renounced interest is determined from the transferor's perspective on what was "given up" (thus following a transferor-based approach).¹²⁴² The comparison between the ceasing of a limited interest upon death and the renunciation of a limited interest during the interest holder's lifetime is relevant when the valuation methods are considered, specifically, distinguishing between a transferor-based versus recipient-based approach.

For example, a husband grants a 15-year *usufruct* to his wife for no consideration and transfers the *bare dominium* to his son for an adequate consideration. If his wife renounces the *usufruct* 10 years later, the renounced interest is calculated over the unexpired five-year period.¹²⁴³ If instead, the wife died 10 years later, the ceasing *usufruct* is calculated over the son's life expectancy (the *bare dominium* holder to whom the full ownership reverts due to the ceasing *usufruct*).¹²⁴⁴ The younger the beneficiary, the higher the value for estate duty purposes, the older the beneficiary, the lower the value for estate duty purposes.¹²⁴⁵ Since the son is younger, his life expectancy for purposes of calculating the value of the ceasing *usufruct* will result in a higher value when compared to the age of his mother (the interest holder) prior to her death. When the valuation of a limited interest is viewed from a consistency perspective for taxes applicable to transfers; CGT, transfer duty and donations tax consider the value of the limited interest over the life expectancy of the transferor, whereas estate duty takes into account the life expectancy of the beneficiary.¹²⁴⁶

¹²⁴⁰ Section 11(a)(i) read with s 5(1)(b) of the *Estate Duty Act*.

¹²⁴¹ This approach differs from the overall structure of estate duty as a transferor-based wealth transfer tax.

¹²⁴² Section 59 read with s 62(1)(a) of the *Income Tax Act*.

¹²⁴³ Section 62(1)(a) of the *Income Tax Act*.

¹²⁴⁴ Section 5(1)(b) of the *Estate Duty Act*.

¹²⁴⁵ Davis, Beneke and Jooste *Estate Planning* 12.2.

¹²⁴⁶ SAICA 2021 *Integritax* 93.

Two provisos apply under section 5(1)(b) to alleviate the hardship on the *bare dominium* holder when the full ownership accrues upon the ceasing *usufruct*. The provisos consist of the following limitations:

- (a) The value of the ceasing *usufruct* may be reduced by any consideration paid by the beneficiary when the *bare dominium* holder was initially acquired. Interest at 6% per annum from the date of payment to the date of death further reduces the value.¹²⁴⁷
- (b) The value of the ceasing *usufruct* may not exceed the full value of the property less the value of the *bare dominium* when it was first acquired when the *usufruct* was created.¹²⁴⁸

The two provisos only find application in the case of a ceasing *usufruct*. Even though the *bare dominium* holder of the property burdened with an annuity becomes the owner of the full property when the annuity ceases, the limitations do not apply. Furthermore, when the fiduciary interest never becomes the *bare dominium* owner and therefore the fiduciary interest ceases, the limitations do not apply.¹²⁴⁹

The following examples will illustrate the effect of the provisos to section 5(1)(b) as well as the impact on the valuation of a ceasing *usufruct* when it is done on a transferor basis¹²⁵⁰ in comparison to the existing recipient basis.¹²⁵¹ For the sake of simplicity, any exemptions and abatement are ignored. The effectiveness of the existing provisos will be illustrated to establish whether it eliminates the inequities. The transferor-based approach will be compared with the existing recipient-based

¹²⁴⁷ First proviso to s 5(1)(b) of the *Estate Duty Act*. See also Meyerowitz *Administration of Estates* 29.12; Cilliers *Administration of Estates* 578-580 and Muller *Wealth Transfer Taxation* 242.

¹²⁴⁸ Second proviso to s 5(1)(b) of the *Estate Duty Act*. See also Meyerowitz *Administration of Estates* 29.12 where it is stated that for the second proviso to apply, the acquisition of the *bare dominium* should coincide with the instance when the *usufruct* was created. See also Cilliers *Administration of Estates* 578-580.

¹²⁴⁹ See Davis, Beneke and Jooste *Estate Planning* 12.2; Meyerowitz *Administration of Estates* 29.12; Cilliers *Administration of Estates* 578-580; Muller *Wealth Transfer Taxation* 243 and Haupt *Notes on South African Income Tax* 879.

¹²⁵⁰ This refers to the calculation being done over the life-expectancy of the interest-holder.

¹²⁵¹ This refers to the calculation being done over the life-expectancy of the *bare dominium* holder (recipient).

approach for purposes of finding solutions for existing discrepancies under the *Estate Duty Act* regarding the valuation of a ceasing limited interest.

Example 5: The cessation of a *usufructuary* interest shortly after creation

Person A (male, age at next birthday 70) sells during his life the *bare dominium* at R1.5 million to person C (male, age at next birthday 35) subject to a lifelong *usufruct* to person B (female, age at next birthday 65). Person C paid adequate consideration of R268 510¹²⁵² for the *bare dominium* acquired. B passes away two weeks after the *usufruct* was created. Person C will become the owner of the full title of the property. The calculation is as follows:

- The transferor-based approach *over the life expectancy of the interest holder* person B: $R1\ 500\ 000 \times 12\% \times 6.84161 = \mathbf{R1\ 231\ 490\ (a)}$ ¹²⁵³
- The recipient-based approach *over the life expectancy of the beneficiary*, person C *without applying the provisos*: $R1\ 500\ 000 \times 12\% \times 8.15536 = \mathbf{R1\ 467\ 965\ (b)}$
- The recipient-based approach over the *life expectancy of the beneficiary, person C with the provisos*:

Value of the <i>usufructuary</i> interest:	R1 467 965 ¹²⁵⁴
Less first proviso less consideration paid:	(R268 510)
Value after first proviso:	R1 199 455
Limited to second proviso:	R1 231 490 ¹²⁵⁵
Estate duty liability calculated on	R1 199 455 (c)

If the taxable values are compared between the cessation of the *usufruct* calculated over the life expectancy of the interest holder [(a) of R1 231 490] and the interest calculated over the life expectancy of the beneficiary, taking into account the provisos to section 5(1)(b) of the *Estate Duty Act* [(c) of R1 199 455], the values are close with a difference of only R32 035 [(a)–(c)].

¹²⁵² The *bare dominium* at the time of creation is calculated under s 62 of the *Income Tax Act* over the life expectancy of the donor, $A = R1\ 500\ 000 - (R1\ 500\ 000 \times 12\% \times 6.84161) = R268\ 510$.

¹²⁵³ Same calculation that are done for donations tax purposes for a renounced limited interest.

¹²⁵⁴ $R1\ 500\ 000 \times 12\% \times 8.15536$.

¹²⁵⁵ $R1\ 500\ 000 - R268\ 510$. Interest at 6% on the consideration paid is calculated per annum and due to the deceased passing shortly after the creation of the *usufruct*, no interest was added.

Example 6: The cessation of a lifelong *usufructuary* interest after 12 years

The same facts are taken as per Example 5, except that person B (female, age at next birthday 77) passes away 12 years after the creation of the *usufruct* when the value of the *bare dominium* is R2 million. Person C (age at next birthday 47) becomes the owner of the full title of the property. The calculation is as follows:

- The transferor-based approach *over the life expectancy of the interest holder* person B: $R2\ 000\ 000 \times 12\% \times 5.04679 = \mathbf{R1\ 211\ 230\ (a)}$ ¹²⁵⁶
- The recipient-based approach *over the life expectancy of the beneficiary, person C without applying the provisos*: $R2\ 000\ 000 \times 12\% \times 7.77109 = \mathbf{R1\ 865\ 062\ (b)}$
- The recipient-based approach *over the life expectancy of the beneficiary, person C with the provisos*:

Value of the <i>usufructuary</i> interest:	R1 865 062 ¹²⁵⁷
Less first proviso less consideration paid plus interest:	(R461 837) ¹²⁵⁸
Value after first proviso:	R1 403 225
Limited to second proviso:	R1 731 490 ¹²⁵⁹
Estate duty liability calculated on	R1 403 225 (c)

If the taxable values are compared between the cessation of the *usufruct* calculated over the life expectancy of the interest holder [(a) of R1 211 230] and the interest calculated over the life expectancy of the beneficiary, subject to the provisions to section 5(1)(b) of the *Estate Duty Act* [(c) of R1 403 225], the values are close with a difference of R191 995 [(a)–(c)].

It can be seen from the above calculations that the provisos to some extent limit the harsh consequences on the *bare dominium* owner that obtains the full title upon the cessation of the *usufruct*. For example, in Example 5, the value without the provisos is R1 467 965 (b) and the value subject to the provisos is R1 199 455 (c). The same applies in Example 6, the value without the provisos is R1 865 062 (b) and the value subject to the provisos is R1 403 225 (c).

¹²⁵⁶ Same calculation that are done for donations tax purposes for a renounced limited interest.

¹²⁵⁷ $R2\ 000\ 000 \times 12\% \times 7.77109$. Similar calculation for donations tax purposes in calculating the value of the renounced limited interest.

¹²⁵⁸ Consideration paid plus 6% per annum = $R268\ 510 + (R268\ 510 \times 6\% \times 12\ \text{years})$.

¹²⁵⁹ $R2\ 000\ 000 - R268\ 510$.

Furthermore, based on the examples, it is noted that the value of the ceasing *usufruct* after applying the provisos (the value of (c) in the examples) based on the current legislation is close to the value if it were to be calculated over the life expectancy of the deceased (immediately prior to death) (the value of (a) in the examples).

Muller,¹²⁶⁰ based on a study where she compared the transferor-based approach under the donations tax regime and the recipient-based approach for estate duty, is of the view that the value of the ceasing interest for estate duty purposes should be determined based on the life expectancy of the deceased in the case of a lifelong *usufruct* or the unexpired period, if applicable. Muller¹²⁶¹ further states that it would create neutrality between the different tax types, for example, a renounced *usufruct* for donations tax purposes and a ceasing *usufruct* from estate duty purposes without the application of complicated provisos.¹²⁶² Muller's view is supported as an alignment across taxes in calculating the taxable value of the same asset provides more certainty and equity by not creating different values simply due to different tax types.

Davis, Beneke and Jooste¹²⁶³ are of the view that most of the problems arising from limited interests and the valuations thereof under the *Estate Duty Act* are due to the estate duty liability that is placed on the beneficiary that benefits from the cessation of the limited interest.¹²⁶⁴ If the beneficiary dies early, such beneficiary's estate receives less of a benefit although the full estate duty liability was settled for a benefit they never enjoyed. Due to the fact that the value of the ceasing limited interest is calculated over the life expectancy of the beneficiary, it is only if the beneficiary outlives the life expectancy according to the tables that the valuation

¹²⁶⁰ Muller *Wealth Transfer Taxation* 245.

¹²⁶¹ Muller *Wealth Transfer Taxation* 245.

¹²⁶² SAICA also states that due to the different valuation method for estate duty purposes in comparison to the opposite approach taken for donations tax, transfer duty and CGT, it creates a door for tax planning opportunities (see SAICA 2021 *Integritax* 93).

¹²⁶³ Davis, Beneke and Jooste *Estate Planning* 12.2.

¹²⁶⁴ Section 11(a)(i) of the *Estate Duty Act*. The benefit lies in the unencumbered asset for the *bare dominium* owner once the *usufruct* ceases.

would not be considered detrimental.¹²⁶⁵ Adherence to the canon of equity is questioned as the beneficiary is required to pay for benefits prior to having the enjoyment thereof, which may never be received in the event of an early death.

Muller¹²⁶⁶ also states that the argument to value a ceasing *usufruct* over the life expectancy of the interest holder instead of the beneficiary is strengthened by the fact that the underlying theory regarding the provisos of section 5(1)(b) of the *Estate Duty Act* lacks justification. Muller¹²⁶⁷ questions the justification for deducting the consideration paid when the *bare dominium* was first acquired against the value of the ceasing *usufruct*. The reason being that such consideration was already taken into account to determine whether the initial acquisition amounted to a donation. The same can be seen from Example 5 above where the initial *bare dominium* value that was acquired by A amounted to R268 510, which was also the consideration paid by A, which results in no donation taking place. This provides the basis for Muller's argument¹²⁶⁸ that the deduction lacks justification as to what basis should such consideration paid again be allowed as a deduction to determine the estate duty consequences upon death.

Regarding the second proviso, Muller¹²⁶⁹ states that the limitation of the value of the ceasing *usufruct* in the beneficiary's hands to the growth in the value of the *bare dominium* on the initial acquisition to the value of full ownership is justified if the *bare dominium* owner was liable for any tax liability on the initial acquisition or paid the full consideration. However, for donations tax purposes, if any donations tax liability arises regarding the acquisition of the *bare dominium*, the donations tax would be payable by the donor. If it was obtained by way of an inheritance, any estate duty liability was that of the previous owner's estate. The rationale behind the proviso is therefore questioned, and seems to only serve as an artificial measure to minimise the impact on the *bare dominium* owner that arises due to the recipient-based approach regarding limited interest in a transferor-based estate duty system.

¹²⁶⁵ Davis, Beneke and Jooste *Estate Planning* 12.2.

¹²⁶⁶ Muller *Wealth Transfer Taxation* 245.

¹²⁶⁷ Muller *Wealth Transfer Taxation* 245.

¹²⁶⁸ Muller *Wealth Transfer Taxation* 246.

¹²⁶⁹ Muller *Wealth Transfer Taxation* 246.

It is submitted, as analysed by Muller, that little rationale exists for the different valuation methods under the donations tax and estate duty systems. It is accepted that, due to the complexities that are found in valuing usufructs, artificial measures were reverted to in an attempt to seek a reasonable method, however, it is agreed with Muller that their application lacks justification. A transferor-based approach may provide a simplified method and even be more justified regarding the benefit that ceased in the hands of the deceased. The transferor-based approach may even enhance the canons of certainty and equity.

The following example will aim to illustrate the ineffectiveness of the proviso in determining the value of the ceasing *usufruct*.

Example 7: The inequality of the second proviso of section 5(1)(b)

Person A (male, age next birthday 65) grants a *usufruct* for eight years over a property valued at R2 million to person B (female, age next birthday 60) and one year later person A transfers the *bare dominium* to person C (male, age next birthday 40). Person C pays a consideration of R904 688¹²⁷⁰ for the *bare dominium*. Person B passes away seven years after the creation of the *usufruct* when person C (male, age next birthday 40) becomes the owner of the full title of the property valued at R3 million. The calculation is as follows:

- The transferor-based approach *over the life expectancy of the interest holder* person B or the remaining period of the *usufruct*, whichever is the smallest (5.04679 *versus* 0.8929): $R3\ 000\ 000 \times 12\% \times 5.04679 = \mathbf{R1\ 816\ 844\ (a)}$
- The recipient-based approach *over the life expectancy of the beneficiary*, person C *without applying the provisos*: $R3\ 000\ 000 \times 12\% \times 7.77109 = \mathbf{R2\ 797\ 592\ (b)}$
- The recipient-based approach over the *life expectancy of the beneficiary*, person C *with the provisos*:

¹²⁷⁰ $R2\ 000\ 000 - (R2000\ 000 \times 12\% \times 4.5638)$. The factor to be used is for a seven-year period when the *bare dominium* was acquired, one year after the creation of the *usufruct*. The factor for the fixed period is smaller than the factor for the life expectancy of A when the *bare dominium* was created (6.00726 for age 66).

Value of the <i>usufructuary</i> interest:	R2 797 592 ¹²⁷¹
Less first proviso less consideration paid, plus interest:	(R1 230 376) ¹²⁷²
Value after the first proviso	R1 567 216
Second proviso of section 5(1)(b) not applicable: ¹²⁷³	R Nil
Estate duty liability calculated	R1 567 216 (c)

If the taxable values are compared between the cessation of the *usufruct* calculated over the life expectancy of the interest holder [(a) of R1 816 844] and the interest calculated over the life expectancy of the beneficiary, subject to the provisos [(c) of R1 567 216], the values are close with a difference of R249 628.

The above example illustrates that the second proviso only applies where the *bare dominium* and the *usufruct* were created simultaneously, which may create even more hardship on the beneficiary as no limitation is allowed regarding the growth in the value of the *bare dominium*.

In conclusion, the proposition by Muller¹²⁷⁴ to consider a transferor-based approach in the valuation of a ceasing *usufructuary* interest for estate duty purposes will be calculated over the life expectancy of the deceased immediately prior to death or the shorter remaining period for which the interest was given and be payable by the deceased estate.¹²⁷⁵ This same result will follow to the limited interest or the period applicable no matter the beneficiary. Any estate planning is minimised and, more importantly, will bring alignment of tax principles in the treatment of *usufructuary* interests for donations tax, CGT, transfer duty and estate duty purposes. This will further support the canon of certainty as the same taxable value

¹²⁷¹ R3 000 000 x 12% x 7.77109.

¹²⁷² Consideration paid plus 6% per annum = R904 688 + (R904 688 x 6% x 6 years). Interest is calculated from the date of payment of the consideration (one year after the creation of the *usufruct*) to the date of cessation (one year before the expiration of the *usufruct* = six years).

¹²⁷³ The second proviso does not apply because the *bare dominium* was not acquired at the same time that the *usufruct* was created.

¹²⁷⁴ Muller *Wealth Transfer Taxation* 245.

¹²⁷⁵ Muller *Wealth Transfer Taxation* 252. This will require amendments to s 11(a)(i) of the *Estate Duty Act* dealing with the parties liable for the estate duty.

is used across the different tax types and it is made easier to calculate the estate duty liability without making use of complicated provisos.

The artificial way of valuing limited interests has given rise to estate planning opportunities where successive *usufructs* are used to create mechanisms to save estate duty. The resulting scheme is commonly referred to as the "one-year *usufruct* scheme" which will be discussed in the following section.

4.2.6.4 One-year usufruct schemes

The "one-year *usufruct* scheme" is an estate planning tool which has been utilised by many estate planners where one spouse bequeaths a *usufruct* to a surviving spouse (first *usufructuary*) in a will (the value of which is deductible under section 4(q) of the *Estate Duty Act*), while the children or a discretionary trust receives the *bare dominium*. The will of the first-dying spouse further stipulates that upon the death of the surviving spouse, the *usufruct* passes to another person for one year (the interim *usufructuary*, for example, a qualifying charity), before it is permanently transferred to the real heir (*bare dominium* owner).¹²⁷⁶

The value of the ceasing *usufruct* of the first *usufructuary* is calculated over the limited period during which the interim *usufructuary* was enjoyed and not over the life expectancy of the person in whom the *usufruct* will ultimately vest to achieve a reduction in estate duty.¹²⁷⁷ The effect of the scheme is illustrated in the example below.

¹²⁷⁶ Davis, Beneke and Jooste *Estate Planning* 12.3; van Gijsen 2014 *The Taxpayer* 64 and National Treasury *Budget Review, 2009: Annexure C: Summary of additional tax proposals for 2009/2010* 185.

¹²⁷⁷ *Basset v CIR* 1961 4 SA 769 (D) (the *Basset* case); Albertse *Die Boedelbelastingimplikasies van die Aanwending van Opeenvolgende Beperkte Regte* 1; Davis, Beneke and Jooste *Estate Planning* 12.3; van Gijsen 2014 *The Taxpayer* 64 and Stein *Estate Duty Principles and Planning* 43.

Example 8: One-year *usufruct* scheme

Person A (male, age next birthday 70) bequeaths a property valued at R1.5 million to BC Family Trust, subject to a lifelong interest to person A's surviving spouse, person B (female, age next birthday 65). Person A's will further stipulate that when person B dies, their son, person C (male, age next birthday 30) is entitled to a successive *usufruct* for one year.

The full value of the property of R1.5 million will form part of person A's deceased estate upon death, but the value of the *usufruct* to B (valued over person B's life expectancy) is allowed as a deduction under section 4(q) of the *Estate Duty Act*. When person B dies 10 years later (age next birthday 75) when the property is worth R2 million, the value of the ceasing *usufruct* will not be calculated over the life expectancy of person C, but only over the one-year period of the *usufruct* in person C's hands. Estate duty is payable on R214 296.¹²⁷⁸ Upon the lapse of the one-year *usufruct*, there will not be any estate duty consequences under the *Estate Duty Act*.¹²⁷⁹ If no successive *usufruct* was provided for, the ceasing *usufruct* in person B's estate would be calculated regarding the trust as the ultimate beneficiary (valued over 50 years for a person other than a natural person)¹²⁸⁰ and amounted to R1 993 080.¹²⁸¹ This illustrates that the estate duty liability upon person B's death has been significantly reduced by the successive one-year *usufruct* that reduced the dutiable amount by R1 778 784.¹²⁸²

Davis, Beneke and Jooste¹²⁸³ acknowledge the estate duty benefit that arises through the nomination of a successive *usufructuary* for a short period over which

¹²⁷⁸ R2 000 000 x 12% x 0.8929.

¹²⁷⁹ The valuation clause under s 5(1)(b) of the *Estate Duty Act* does not make provision of the cessation of an interim limited right due to the passage of time. Section 11(a)(i) also does not make provisions as to whom the benefit of the ceasing interim limited right accrues as a result of the death of a deceased person. The benefit arises due to the cessation of the interim limited right due to the passage of time as provided for in terms of the will of the deceased. There arises therefore no liability under s 11(a)(i). Even if there was a liability, s 5(1)(b) does not contain any guidance regarding the capitalisation of the right of enjoyment of a ceasing limited right due to the passage of time. There is therefore no estate duty payable on the cessation of an interim *usufruct* due to the passage of time. See also Albertse *Die Boedelbelastingimplikasies van die Aanwending van Opeenvolgende Beperkte Regte* 19, 27.

¹²⁸⁰ Third proviso of s 5(1)(b) of the *Estate Duty Act*.

¹²⁸¹ R2000 000 x 12% x 8.3045.

¹²⁸² R1 993 080 - R214 296.

¹²⁸³ Davis, Beneke and Jooste *Estate Planning* 12.3.

such *usufruct* is to be valued resulting in significant estate duty savings.¹²⁸⁴ However, they also caution against the scheme for example where the interim *usufructuary* dies out of time within the one-year period before the right is transferred to the ultimate beneficiary. The ceasing *usufruct* is included in the interim *usufructuary's* estate, and it may have a detrimental effect if the *usufruct* passes to a trust valued over a 50-year period (as can be inferred from the above).¹²⁸⁵

Albertse¹²⁸⁶ states that the one-year *usufruct* scheme is a workable estate duty saving mechanism that is applied within the parameters of the *Estate Duty Act*. However, Albertse¹²⁸⁷ further states that there is a gap in the legislation that can be exploited through the use of interim *usufructuaries* that should be addressed through a legislative amendment to the *Estate Duty Act*.

Van Gijsen¹²⁸⁸ questions the efficacy of the one-year *usufruct* scheme as a successful method to save the overall tax liability. He is of the view that the estate duty saving should not be looked at in isolation but in combination with the CGT liability. The bequest of the property, subject to a *usufruct*, reduces the base cost of the *bare dominium* which does not increase over time as a property's value increase over time together with the cessation of the *usufruct*.¹²⁸⁹ This may lead to an increased CGT liability when the property is later disposed of. Van Gijsen¹²⁹⁰ acknowledges the estate duty saving that may arise in applying the scheme. He also points out that such savings will ultimately be recouped through the increased CGT liability upon the disposal of the property.

A proposal was made in the *Draft Taxation Laws Amendment Bill, 2009*, to counter the one-year *usufruct* scheme where the ceasing *usufruct* should be valued over

¹²⁸⁴ *Basset* case para 7.

¹²⁸⁵ See also *Basset* case para 7 and *SBI v Jordaan* 1967 3 SA 329 A, 29 SATC 81.

¹²⁸⁶ Albertse *Die Boedelbelastingimplikasies van die Aanwending van Opeenvolgende Beperkte Regte* 33.

¹²⁸⁷ Albertse *Die Boedelbelastingimplikasies van die Aanwending van Opeenvolgende Beperkte Regte* 41.

¹²⁸⁸ Van Gijsen 2014 *The Taxpayer* 66.

¹²⁸⁹ Paragraphs 33(1)(a) and 40(2)(a) and (b) of the Eighth Schedule to the *Income Tax Act*.

¹²⁹⁰ Van Gijsen 2014 *The Taxpayer* 66.

the life expectancy of the beneficiary and not the shorter period.¹²⁹¹ Meyerowitz¹²⁹² states that although the proposal is intended to combat estate duty avoidance, it will not succeed in its aim as the enjoyment of the successive *usufruct* will just be conferred on a public benefit organisation or the State for a short period before it is transferred to the ultimate beneficiary. This will result in the value of the ceasing *usufruct* to qualify for a deduction under section 4(h) of the *Estate Duty Act* in the estate of the deceased *usufructuary*. The proposed amendment will therefore have no effect on the estate. The Standing Committee of Finance¹²⁹³ subsequently withdrew the proposed amendment for reconsideration on the basis that it may unfairly penalise all other *usufructs* unrelated to attempts to save estate duty that was set up for legitimate reasons. It was however concluded that the one-year *usufruct* scheme remains a concern that needs to be addressed through a legislative amendment.¹²⁹⁴ Van Gijsen¹²⁹⁵ is of the view that there is no need for changes to the law due to the increased CGT that will be raised through the scheme and make up for the loss in estate duty. However, although the CGT may raise additional revenue it would be due to the application of the relevant provisions under the *Income Tax Act*, but it still does not justify the possible avoidance under the *Estate Duty Act* that may need to be addressed.

Muller¹²⁹⁶ is of the view that the proposed amendment only provided an artificial solution that did not deal with the true underlying issue of a recipient-based approach to *usufructuary* interest in a transferor-based estate duty regime. It is agreed that the approach by National Treasury to merely scrap the shorter period valuation rule does not really solve the problem. If the recipient-based approach is

¹²⁹¹ Clause 6(1)(a) and (2) of the *Draft Taxation Laws Amendment Bill*, 2009.

¹²⁹² Meyerowitz 2009 *The Taxpayer* 150. See also Davis, Beneke and Jooste *Estate Planning* 12.3.

¹²⁹³ Standing Committee of Finance *Report-Back Hearings on the Taxation Laws Amendment Bills 2009: Final Response Document* 2.6.2. See also Van Gijsen 2014 *The Taxpayer* 66; Davis, Beneke and Jooste *Estate Planning* 12.3 and Muller *Wealth Transfer Taxation* 251.

¹²⁹⁴ Standing Committee of Finance *Report-Back Hearings on the Taxation Laws Amendment Bills 2009: Final Response Document* 2.6.2. See also Davis, Beneke and Jooste *Estate Planning* 12.3.

¹²⁹⁵ Van Gijsen 2014 *The Taxpayer* 66. Van Gijsen further questions the viability of the *usufruct* scheme as an efficient estate planning tool especially where the *bare dominium* holder dies before the first *usufructuary* as well as the instance where the successive *usufructuary* dies prior to the lapsing of the *usufruct*.

¹²⁹⁶ Muller *Wealth Transfer Taxation* 251.

to remain, a *de minimus* rule could be considered, for example where a limited right is granted for a period less than five years, the life expectancy of the beneficiary must be used, however, the point raised by Meyerowitz will also bring such a change to little effect. Alternatively, a discretion could be provided for, similar to the 12% yield rules under section 5(2) of the *Estate Duty Act* where the executor is of the view that the life expectancy of the beneficiary is not the correct valuation and a period of less than five years can be justified, the Commissioner should be given a discretion to allow for such a deviation. This way the shorter fixed period for the enjoyment of the *usufruct* is not automatically disregarded but estate duty avoidance in the estates that are crafted in a way to "misuse" the limited right provisions can be prevented.

However, if the underlying issue of a recipient-based approach in a transferor-based estate duty regime is addressed, a better solution may be found in valuing the ceasing *usufruct* over the life expectancy of the deceased immediately prior to death.¹²⁹⁷ If the results are compared with the example of the one-year *usufruct* scheme above, they are as follows:

- Valued over the one-year period in respect of the child (C): R214 296.¹²⁹⁸
- Valued over the period of 50 years relevant to the trust¹²⁹⁹ (as the ultimate beneficiary), if no successive *usufruct* was provided: R1 993 080.¹³⁰⁰
- Valued over the life expectancy of the deceased, person B (age next birthday 75): R1 293 343.¹³⁰¹

If the ceasing *usufruct* is calculated over the life expectancy of the deceased person, the deceased estate is liable for the estate duty on the value of R1 293 343,

¹²⁹⁷ Muller *Wealth Transfer Taxation* 251-252.

¹²⁹⁸ R2 000 000 x 12% x 0.8929.

¹²⁹⁹ Third proviso of s 5(1)(b) of the *Estate Duty Act*.

¹³⁰⁰ R2000 000 x 12% x 8.3045.

¹³⁰¹ R2000 000 x 12% x 5.38893.

irrespective of whether the *usufruct* accrues to the *bare dominium* owner (the ultimate beneficiary) or the beneficiary (for a one-year period).¹³⁰²

4.2.6.5 Conclusion to valuation rules

Various challenges have been addressed above regarding the valuation provisions under the *Estate Duty Act*. The application of section 5(1)(a) of the *Estate Duty Act* was analysed regarding realised property and specifically the exclusion of unlisted shares under section 5(1)(f)*bis*. The problem identified is that post-death taxes incurred on the sale of such shares do not relate to the market value as of the date of death that was included for estate duty purposes. This results in no deduction being available under the *Estate Duty Act* in respect of such taxes in the case of unlisted shares. The problem was analysed, and proposals were considered in an attempt to rectify the problem or bring clarity regarding the deductibility of post-death taxes for estate duty purposes.¹³⁰³

Challenges regarding the applications of the provisos to section 5(1)(b) of the *Estate Duty Act* are created through the recipient-based approach where the estate duty liability is payable by the beneficiary for limited interests that cease upon the death of the *usufructuary*. The issues and the impact on the estate duty liability were discussed and illustrated by way of examples. The hardship on the beneficiary of a ceasing *usufruct* was analysed, as well as the limited effect of the two provisos to section 5(1)(b), and it was found that the solution may be in following a transferor-based approach where the ceasing interest is calculated over the life expectancy of the deceased immediately prior to death and the deceased estate is liable for the estate duty payable which is aligned with the approach followed in the case of donations tax, CGT and transfer duty.¹³⁰⁴

The current valuation rules regarding limited interest have given rise to estate planning opportunities, including the one-year *usufruct* scheme that was analysed

¹³⁰² See para 6.2.6.2.2 below for the final recommendation regarding the valuation of terminating limited interests.

¹³⁰³ See para 4.2.6.2 above.

¹³⁰⁴ See para 4.2.6.3 above.

to illustrate its impact and the estate duty avoidance that accompanies such a scheme.¹³⁰⁵ It was stated that the estate duty avoidance scheme needs to be addressed and a possible solution may be in determining the value of the limited interest over the life expectancy of the deceased and not the subsequent beneficiary or the fixed shorter period.¹³⁰⁶

The following section considers the double taxation that may occur regarding estate duty as well as the relief mechanisms that are in place. The effectiveness and relevance of the relief mechanisms will be analysed to determine the need for new provisions.

4.2.7 Double taxation relief

4.2.7.1 Introduction

A deceased person who is "ordinarily resident" and owns property outside South Africa may be subject to estate duty in South Africa as well as an estate or inheritance tax in the foreign country.¹³⁰⁷ This situation is also referred to as international juridical double taxation where different countries impose an identical or similar tax on the same taxpayer regarding the same taxing event or object at the same time.¹³⁰⁸

In order to prevent double taxation, relief is provided through unilateral relief embodied in a country's domestic legislation on foreign death duties that were

¹³⁰⁵ See para 4.2.6.4 above.

¹³⁰⁶ Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 82. An attempt was made by National Treasury in the *Draft Taxation Laws Amendment Bill, 2009*, however, the proposed amendment regarding s 5(1)(b) of the *Estate Duty Act* was withdrawn as it would have had unintended consequences for limited interests that were not created to avoid estate duty. See van Gijsen 2014 *The Taxpayer* 65.

¹³⁰⁷ Davis, Beneke and Jooste *Estate Planning* 12.3 and Meyerowitz *Administration of Estates* 31.1.

¹³⁰⁸ OECD *Model Tax Convention on Income and on Capital 2017* 9; Ostaszweska and Obuoforibo *Roy Rohatgi on International Taxation* 21 and Beckmann *Estate Duty on Deceased Estates* 9.

paid¹³⁰⁹ or through the provisions of a double taxation agreement (hereafter referred to as an estate tax treaty).¹³¹⁰

Section 16(c) of the *Estate Duty Act*¹³¹¹ is the existing unilateral provision that provides that, where the deceased was ordinarily resident in South Africa at the date of death and foreign death duties were paid for property situated in that foreign country, a credit will be provided against the estate duty payable in South Africa.¹³¹² The deduction is limited to the amount of estate duty payable in South Africa on the specific property.¹³¹³ Relief cannot be sought under both the unilateral and bilateral provisions as only one mechanism can be claimed.¹³¹⁴ If an estate tax treaty exists, the relief under the estate tax treaty applies and section 16(c) is not applicable.¹³¹⁵

¹³⁰⁹ Section 16(c) of the *Estate Duty Act*.

¹³¹⁰ The OECD encourages unilateral relief to alleviate double taxation due to the limited network of estate tax treaties (see OECD *Inheritance Taxation in OECD Countries* 128). See also Beckmann *Estate Duty on Deceased Estates* 22.

¹³¹¹ Section 16(c) of the *Estate Duty Act* states that a deduction against estate duty is allowed "without in any way modifying or adding to the rights of any person under an agreement entered into by the Government of the Republic with the Government of any other country or territory relating to the prevention of or relief from double taxation in respect of estate duty, any amount of any death duties proved to the satisfaction of the Commissioner to have been paid to any other State in respect of any property situate outside the Republic and included in the estate of any person who at the date of his death was ordinarily resident in the Republic: Provided that the deduction under this paragraph shall not exceed the duty imposed on such property by this Act."

¹³¹² Section 16(a) of the *Estate Duty Act* provides for a deduction regarding transfer duty paid regarding the acquisition of property from the deceased person or their estate of any property included in the estate by a person who is liable for the estate duty attributable to the property. The provision is aimed at eliminating the double tax effect of transfer duty and estate duty payable on the same property. However, no transfer duty is payable on property inherited by testamentary or intestate succession (s 9(1)(e) of the *Transfer Duty Act*). Furthermore, due to the removal of a donation by the deceased to no longer be deemed as property for estate duty purposes, the previous circumstances under which transfer duty would have been payable where the property was included in the estate no longer exists (see s 9(1)(a) of the *Taxation Laws Amendment Act* 87 of 1988, deleted s 3(3)(c) of the *Estate Duty Act*). Section 16(a) of the *Estate Duty Act* is therefore considered to be redundant. See also Meyerowitz *Administration of Estates* 30.8; Davis, Beneke and Jooste *Estate Planning* 2.8H.

¹³¹³ Proviso to s 16(c) of the *Estate Duty Act*. See also Meyerowitz *Administration of Estates* 30.8; Stiglingh *et al Silke: South African Income Tax* 1050; Haupt *Notes on South African Income Tax* 882; Beckmann *Estate Duty on Deceased Estates* 111 and *De Ferm v Von Lieres und Wilkau* (WCHC) (unreported) case number 10805/2023 of 11 October 2023 para 26.

¹³¹⁴ Borman *The Impact of Estate Duty and Capital Gains Tax on Offshore Assets* 64; Whitfield *Taxation Implications Arising from South African Residents* 119; Wilson *Potential Cross-Border Double Taxation on Death* 29; Meyerowitz *Administration of Estates* 30.8, 31.1; Davis, Beneke and Jooste *Estate Planning* 2.8H and Stiglingh *et al Silke: South African Income Tax* 1017-1018.

¹³¹⁵ Section 16(c) read with s 26 of the *Estate Duty Act*; Meyerowitz *Administration of Estates* 30.8, 31.1; Cilliers *Administration of Estates* 601 and Davis, Beneke and Jooste *Estate Planning* 2.8H;

For example, person A (ordinarily resident in South Africa) who owns UK-sourced immovable property dies. The dutiable amount of person A's estate is less than R30 million and the estate duty rate applicable in South Africa is 20% (as the country of residence). The UK imposes an inheritance tax of 40% (as the country of source). According to the estate tax treaty between the UK and South Africa, relief from double taxation is provided by South Africa as the country of residence. The relief will be limited to the estate duty liability in South Africa which is 20%. The remaining 20% inheritance tax liability will remain payable in the UK.

South Africa has entered into an estate tax treaty with the UK, the USA, and Zimbabwe, as well as one combined treaty with Botswana, Lesotho and eSwatini¹³¹⁶ (previously known as Swaziland).¹³¹⁷ The general principle followed in terms of an estate tax treaty is similar to the guidance set out in the *Estate Tax Model* where shared taxing rights are enjoyed by both countries but the country of residence (based on the residence or *domicile* of the deceased person) should provide relief from double taxation either in the form of an exemption or a credit.¹³¹⁸ The exemption method entails the country of residence exempting certain property from its domestic taxation if the property was taxed in the foreign country.¹³¹⁹ The credit

Stiglingh *et al Silke: South African Income Tax* 1050-151 and Beckmann *Estate Duty on Deceased Estates* 112. This conclusion is based on the wording of s 16(c) of the *Estate Duty Act* that grants a credit without any modification or addition to the rights of any person under an estate tax treaty. This implies that where an estate tax treaty exists, the relief of the foreign death duty is limited to the application of the estate tax treaty and the unilateral relief under s 16(c) is unavailable.

¹³¹⁶ Swaziland's name changed to eSwatini with effect from 19 April 2018. This change resulted from the official declaration by King Mswati III that the Kingdom of Swaziland is now the Kingdom of eSwatini to honour the country's independence (see Legal Notice 80 of 2018 "The Declaration of Change of Swaziland Name Notice, 2018" published in the *Gazette* of 11 May 2018 but deemed to have come into effect on 19 April 2018). See also Adams & Adams 2018 <https://www.lexology.com/library/detail.aspx?g=278eafa1-d6c5-4be5-9524-10f1900fbe0c>.

¹³¹⁷ The estate tax treaties with Botswana, Lesotho and eSwatini, Zimbabwe and the USA were concluded under the provisions of the *Death Duties Act*, but are still in force as the treaties continue to apply regarding any similar taxes subsequently enacted by the contracting states. The treaty with the UK was entered into under s 26 of the *Estate Duty Act* and is also the only estate tax treaty that South Africa entered into that can be compared with the *Estate Tax Model* (see Beckmann *Estate Duty on Deceased Estates* 23 and SARS date unknown <https://www.sars.gov.za/legal-counsel/international-treaties-agreements/estate-duty-agreements/>).

¹³¹⁸ OECD *Estate Tax Model* 16. See also Rudnick and Gordon "Taxation of Wealth" 325.

¹³¹⁹ Article 9A of the *Estate Tax Model* (see OECD *Estate Tax Model* 88-96). See also Beckmann *Estate Duty on Deceased Estates* 23.

method entails the country of residence granting credit against the tax liability under its domestic legislation. The credit is generally equal to the foreign death duties paid for the relevant property.¹³²⁰ The relief for double taxation regarding estate duty through estate tax treaties is very limited.¹³²¹

The OECD¹³²² states that, based on the limited number of estate tax treaties, reforms should be considered where domestic rules for inheritance or estate tax relief should be improved and harmonised where possible. From a South African point of view, it may be difficult to harmonise relief provisions due to the different international bodies¹³²³ that various countries belong to and each country following its own estate or inheritance tax system. It is submitted that the focus should be on improving the unilateral provisions under section 16(c) of the *Estate Duty Act*. Rudnick and Gordon¹³²⁴ also support the enhancement of unilateral provisions and emphasise the importance of clarifying the meaning of a "qualifying tax" and the scope of "foreign property"¹³²⁵ for purposes of the relief.¹³²⁶ Clear legislative guidance should also be considered for an appropriate limitation rule regarding the relief sought.¹³²⁷

¹³²⁰ Article 9A of the *Estate Tax Model* (see OECD *Estate Tax Model* 97-108). See also Beckmann *Estate Duty on Deceased Estates* 23.

¹³²¹ Rudnick and Gordon "Taxation of Wealth" 324; Wilson *Potential Cross-Border Double Taxation on Death* 22-25; Ger 2012 *De Rebus* 59 and Ostler *The Impact of Estate Planning* 53-54. The OECD also concur that due to the limited number of estate tax treaties, focus must be placed on domestic rules for estate and inheritance tax relief (See OECD *Inheritance Taxation in OECD Countries* 74).

¹³²² OECD *Inheritance Taxation in OECD Countries* 74.

¹³²³ For example, the OECD, the European Commission, the Inter-American Centre of Tax Administrations, etc.

¹³²⁴ Rudnick and Gordon "Taxation of Wealth" 325.

¹³²⁵ Section 16(c) does not currently provide for a detailed list of qualifying foreign property and would therefore include the meaning of "property" under s 3 of the *Estate Duty Act*. The OECD states that unilateral relief is usually provided for immovable property situated abroad, but it is often incomplete as the relief may be limited to certain types of property or mismatches between inheritance and estate tax rules between the different countries may exist (OECD *Inheritance Taxation in OECD Countries* 74). See also Michaelides *The International Tax Consequences Arising on Death* 51; Wilson *Potential Cross-Border Double Taxation on Death* 33; Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 39 and Roeleveld 2015 *SAJAR* 159.

¹³²⁶ This view is aligned with the issue identified by Whitfield and Roeleveld that the *Estate Duty Act* needs to clarify which foreign taxes will qualify for the credit under s 16(c).

¹³²⁷ The *Estate Duty Act* does not contain any limitation rule but in practice the same approach is followed as when the estate duty liability must be apportioned for purposes of the rapid succession rebate under the First Schedule to the *Estate Duty Act*. See also Meyerowitz *Administration of Estates* 30.8; Cilliers *Administration of Estates* 601 and Meyerowitz 1987 *The Taxpayer* 117.

The following section will analyse the various issues for unilateral relief from double taxation under section 16(c) of the *Estate Duty Act*.

4.2.7.2 Unilateral relief under section 16(c) of the *Estate Duty Act*

4.2.7.2.1 Qualifying foreign taxes

Whitfield¹³²⁸ states that the unilateral relief under section 16(c) of the *Estate Duty Act* is limited as it is not clear what type of "foreign tax" paid upon death will qualify for the relief. He further states that the scope of "death duties" under section 16(c) should be defined to provide clarity as to which taxes and duties would fall within the ambit thereof.¹³²⁹ Michaelides¹³³⁰ also states that clarity is required regarding the meaning of "death duties" for purposes of section 16(c).

Roeleveld¹³³¹ argues that section 16(c) is limited in that it is not clear whether it will apply where a foreign tax is paid upon death on the same property but by a different taxpayer, for example, in the case of an inheritance tax regime where the inheritance tax was paid offshore by a beneficiary whereas in South Africa the estate duty is payable by the executor. The uncertainty lies in whether a credit regarding the inheritance tax can be claimed under section 16(c) against the estate duty payable in South Africa. This issue expands on the one raised by Whitfield where the first issue deals with the "type" of qualifying foreign tax¹³³² and the second issue deals with the person paying the tax. It was pointed out above¹³³³ that double international juridical taxation arises where the same or a similar tax is imposed by different countries on the *same* taxpayer on the same property at the same time. In the case of inheritance tax payable by the beneficiary, the requirement of a tax imposed on the *same* taxpayer is not met. However, it is accepted that it is still a

¹³²⁸ Whitfield *Taxation Implications Arising from South African Residents* 161, 182.

¹³²⁹ Whitfield *Taxation Implications Arising from South African Residents* 182.

¹³³⁰ Michaelides *The International Tax Consequences Arising on Death* 65.

¹³³¹ Roeleveld 2015 *SAJAR* 159.

¹³³² See discussion under para 4.2.7.2.1 below.

¹³³³ See para 4.2.7.1 below.

similar tax imposed on the same asset by different countries at the same time (death).¹³³⁴

Roeleveld¹³³⁵ is of the view that it is essential in such a situation that, even though the tax is paid by a different taxpayer, it should fall within section 16(c) to allow a credit against the estate duty paid in South Africa on the basis that it relates to the same assets of the deceased estate levied upon death. Roeleveld¹³³⁶ also points out that the current wording of the provision is not clear in this regard. Michaelides,¹³³⁷ agrees that clarity is required but also argues that based on the wide wording of section 16(c), a credit is still available even if the foreign death duty was paid by a beneficiary and not the estate as section 16(c) is not prescriptive in who has to pay the liability in order for the relief to be available. Beckmann¹³³⁸ states that, in considering whether a foreign death duty is deductible under section 16(c), it should be a comparable tax levied directly in connection with and upon death, irrespective of what it is called and the form in which it is levied. She concludes that an inheritance tax would qualify as a deduction for purposes of section 16(c). The OECD¹³³⁹ also supports the review of unilateral relief provisions to provide clarity and to prevent the risk of double taxation or non-taxation.¹³⁴⁰

In considering the type of foreign tax that would qualify for the relief under section 16(c), it is important to determine what would constitute "death duties" that were paid in a foreign country for property situated outside South Africa and included in the deceased estate for South African estate duty purposes.

¹³³⁴ Roeleveld 2015 *SAJAR* 159; Michaelides *The International Tax Consequences Arising on Death* 66 and Beckmann *Estate Duty on Deceased Estates* 225.

¹³³⁵ Roeleveld 2015 *SAJAR* 159.

¹³³⁶ Roeleveld 2015 *SAJAR* 159.

¹³³⁷ Michaelides *The International Tax Consequences Arising on Death* 66.

¹³³⁸ Beckmann *Estate Duty on Deceased Estates* 200, 225.

¹³³⁹ OECD *Inheritance Taxation in OECD Countries* 128. Unilateral relief provisions mostly provide for movable and immovable property and relief regarding a wider scope of property is required.

¹³⁴⁰ The *Estate Tax Model* provides for guidance where bilateral estate tax treaties are entered into or updated to provide for more specific measures in combatting the instance of double taxation. A discussion on the improvement of estate tax treaties fall outside the scope of this study and the focus is placed on enhancing domestic legislation to address double taxation. Rudnick and Gordon also agree with the view to enhance unilateral provisions (see Rudnick and Gordon "Taxation of Wealth" 324-325).

The wording of section 16(c) of the *Estate Duty Act* was inserted into the Act in 1960¹³⁴¹ and has not changed. The provision does not stipulate by whom the death duties should be paid but merely that a deduction should be allowed against the estate duty payable regarding any property situated outside South Africa that was also included in South Africa for estate duty purposes.¹³⁴² It is therefore accepted that the policy intention at the time was not focused on the "person" who paid the double taxation, but rather on the same property being subject to double taxation, irrespective of who paid the tax. Therefore, if the meaning of "death duties" is considered, it is worth noting that the *Estate Duty Act* does not define "death duties" and its ordinary meaning must be considered. Generally, "death duties" is defined as "taxes levied on a person's estate at the time of death".¹³⁴³ Words often related to death duties include, estate tax, inheritance tax, and death tax.¹³⁴⁴ Nevil¹³⁴⁵ refers to "death taxes" as taxes imposed on a person's estate upon their death that are levied either on the beneficiary who receives the property or on the estate and are commonly referred to as death duties, estate taxes, or inheritance taxes. The OECD¹³⁴⁶ also defines death duties as "taxes imposed on the transfer of property on account of a person's death".

Based on the above, it is clear that the words "death duties" are interchangeably used with "estate tax" and "inheritance tax" as a tax levied upon death in respect of a deceased person's estate and specifically the property of an estate and not the income of the estate. In the context of estate duty, a transferor-based estate tax payable by the foreign estate is clearly fitting within the words "estate duty". According to the OECD,¹³⁴⁷ similar types of wealth transfer taxes from an

¹³⁴¹ Section 16(c) of the *Estate Duty Act* was added by s 5(c) of the *Estate Duty Amendment Act* 65 of 1960.

¹³⁴² Michaelides *The International Tax Consequences Arising on Death* 66.

¹³⁴³ Oxford Reference 2023 <https://www.oxfordreference.com/view/10.1093/oi/authority.20110803095704769>. The Merriam-Webster dictionary defines it as a death tax, see <https://www.merriam-webster.com/dictionary/death%20duty>.

¹³⁴⁴ Dictionary.com 2023 <https://www.dictionary.com/browse/death-duty>. See also Nevil 2023 <https://www.investopedia.com/terms/d/death-taxes.asp>.

¹³⁴⁵ Nevil 2023 <https://www.investopedia.com/terms/d/death-taxes.asp>.

¹³⁴⁶ OECD date unknown <https://www.oecd.org/ctp/glossaryoftaxterms.htm>.

¹³⁴⁷ OECD *Estate Tax Model* 102 and OECD *Inheritance Taxation in OECD Countries* 63-64.

international perspective that is payable upon death include estate tax, inheritance tax,¹³⁴⁸ and gift taxes paid in the foreign country on the same property.¹³⁴⁹ The emphasis is not placed on the person who paid the taxes but on whether a similar tax was paid upon death on the same property. Furthermore, although a gift tax is considered a similar tax for purposes of the credit that is payable on the transfer of wealth at death,¹³⁵⁰ Roeleveld¹³⁵¹ and Wilson¹³⁵² concur that CGT is not considered to be a similar type of tax to estate duty as it is not a tax on the transfer of wealth but a tax on the appreciation thereof.¹³⁵³ According to the DTC,¹³⁵⁴ CGT is considered an income tax on capital income and not a wealth tax. The same position is supported by the OECD.¹³⁵⁵

It is therefore concluded that, to eliminate the double taxation of the same property upon death, a qualifying foreign tax for purposes of section 16(c) includes an inheritance tax, a gift tax or an estate tax levied upon death but excludes any foreign income taxes (including CGT).¹³⁵⁶

¹³⁴⁸ See also OECD *Inheritance Taxation in OECD Countries* 64, specifically for Portugal where stamp duty on inheritances is levied upon death on the transfer of property that is levied at a flat rate of 10 % on the net value of the estate. The stamp duty replaced the previous progressive inheritance tax system to cater for a simpler form of tax. See also Michaelides *The International Tax Consequences Arising on Death* 26-27 and Report of Expert Group *Ways to Tackle Inheritance Cross-Border Tax Obstacles* 8.

¹³⁴⁹ In some instance, stamp duty is also levied upon death that may be considered as a tax on the property of the deceased person. See OECD *Inheritance Taxation in OECD Countries* 64.

¹³⁵⁰ OECD *Estate Tax Model* 90.

¹³⁵¹ Roeleveld 2015 *SAJAR* 159.

¹³⁵² Wilson *Potential Cross-Border Double Taxation on Death* 23.

¹³⁵³ Wilson *Potential Cross-Border Double Taxation on Death* 23 and Roeleveld 2015 *SAJAR* 159. This view is aligned with the OECD's view (see OECD *Estate Tax Model* 2). See also OECD *Inheritance Taxation in OECD Countries* 63-64 where a list is provided of the worldwide death duties that are levied upon the estate at the death of a taxpayer.

¹³⁵⁴ DTC *Final Estate Duty Report* 20.

¹³⁵⁵ OECD *Inheritance Taxation in OECD Countries* 63-64, 111.

¹³⁵⁶ Most foreign countries do not levy CGT upon death and therefore, the instance where CGT is payable in a foreign country and estate duty payable in South Africa at the same time is minimal. For relief of double taxation in respect of CGT, s 6quat of the *Income Tax Act* should be relied upon. See Roeleveld 2015 *SAJAR* 152; Wilson *Potential Cross-Border Double Taxation on Death* 32; Ostler *The Impact of Estate Planning* 52; Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 81 and OECD *Inheritance Taxation in OECD Countries* 63-64. See also Michaelides *The International Tax Consequences Arising on Death* 66 where it is submitted that based on the ordinary meaning of "death duties", it includes all foreign estate related taxes, excluding income related taxes.

To define the "death duties" that will qualify for the relief under section 16(c), the following new definition is proposed:

"death duties" for purposes of section 16(c), include an estate tax, an inheritance tax, a stamp duty on an inheritance as well as a gift tax levied upon the death of the deceased but excluding any foreign income taxes (including capital gains tax).¹³⁵⁷

The following section will consider the scope of foreign property that may qualify for unilateral relief under section 16(c) of the *Estate Duty Act*.

4.2.7.2.2 Qualifying property

Section 16(c) does not currently provide for a detailed list of qualifying foreign property and would therefore include the meaning of "property"¹³⁵⁸ under section 3(1),¹³⁵⁹ (2)(a) and (b) of the *Estate Duty Act*.¹³⁶⁰ For an ordinary resident, "property" includes any right in or to property, movable or immovable, corporeal or incorporeal situated inside and outside South Africa.¹³⁶¹ Section 3(2)(a) and (b) for purposes of ordinarily resident also specifically includes any fiduciary, *usufructuary* or other like interest (on South African or foreign property), as well as a right to an annuity charged upon South African or foreign property that was held by the deceased immediately prior to death.¹³⁶² A further inclusion is any right to a South African or foreign annuity (other than a right to an annuity held upon South African or foreign property) that was enjoyed by the deceased immediately prior to death that accrued to another person upon the death of the deceased.¹³⁶³

¹³⁵⁷ Underlining indicates recommended wording.

¹³⁵⁸ Section 3(2) of the *Estate Duty Act*.

¹³⁵⁹ Section 3(1) of the *Estate Duty Act* states "For the purposes of this Act the estate of any person shall consist of all property of that person as at the 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."

¹³⁶⁰ See also Meyerowitz *Administration of Estates* 27.2; Cilliers *Administration of Estates* 502 and Davis, Beneke and Jooste *Estate Planning* 2.3.2.

¹³⁶¹ Section 3(2) of the *Estate Duty Act*.

¹³⁶² Section 3(2)(a) of the *Estate Duty Act*. See also Beckmann *Estate Duty on Deceased Estates* 68-69; Davis, Beneke and Jooste *Estate Planning* 2.3.2; Meyerowitz *Administration of Estates* 27.2 and Cilliers *Administration of Estates* 502.

¹³⁶³ Section 3(2)(b) of the *Estate Duty Act*. Beckmann *Estate Duty on Deceased Estates* 68-69; Davis, Beneke and Jooste *Estate Planning* 2.3.2; Meyerowitz *Administration of Estates* 27.2 and Cilliers *Administration of Estates* 502.

The *Estate Duty Act* does not provide a detailed definition of what would constitute "foreign property" in the estate of a person who is ordinarily resident in South Africa. No such list is found in any leading work in relation to estate duty and international deceased estates. However, even though the *Estate Duty Act* does not specifically state what would constitute "foreign property", it is generally understood and explained that the worldwide property of an ordinary resident is included in the estate for estate duty purposes.¹³⁶⁴ Foreign property is therefore widely and comprehensively interpreted to include the foreign counterpart of any property listed in section 3(1), (2)(a) and (b) of the *Estate Duty Act*.

Beckmann¹³⁶⁵ states that a problem that may arise is when such foreign rights, for example, limited rights, are included in terms of South African law,¹³⁶⁶ however, the foreign rights do not follow the South African rules and are not expressly covered under the *Estate Duty Act*. Such foreign property and rights thereto are rooted in foreign legal systems that often differ from the South African system that may result in conflicting outcomes when applying South African rules to foreign property, without having expressed provisions under the *Estate Duty Act*. Beckmann¹³⁶⁷ analysed the problem and concluded that, without having specific provisions regarding foreign property, the *Estate Duty Act* cannot always be applied directly and the foreign rules governing a specific type of property should be compared to the "property" provisions under the *Estate Duty Act*. If the foreign rules are comparable to the South African provisions, sections 3(1), (2)(a) and (b) will apply to the foreign property for estate duty purposes.¹³⁶⁸

It is submitted that it will not be feasible to provide a detailed list of foreign property in the *Estate Duty Act* as each foreign country involved may have its own rules regarding the different types of property. However, the generally-accepted

¹³⁶⁴ Haupt *Notes on South African Income Tax* 864; Stiglingh *et al Silke: South African Income Tax* 1033; Meyerowitz *Administration of Estates* 27.2; Cilliers *Administration of Estates* 502 and Davis, Beneke and Jooste *Estate Planning* 2.2.

¹³⁶⁵ Beckmann *Estate Duty on Deceased Estates* 73.

¹³⁶⁶ Law of Property and Law of Succession.

¹³⁶⁷ Beckmann *Estate Duty on Deceased Estates* 77.

¹³⁶⁸ Beckmann *Estate Duty on Deceased Estates* 77.

approach of including worldwide assets seems to be aligned internationally, and to the extent that a conflict in rules occurs, the approach discussed by Beckmann¹³⁶⁹ is supported that it will only be included where it is similar to South African rules. A possible clarification that can be considered for purposes of section 16(c) is to refer to foreign property that is similarly defined or treated as in South Africa.

The next section discusses various elements regarding a limitation rule for the purpose of the application of section 16(c) of the *Estate Duty Act*.

4.2.7.2.3 Limitation rule

4.2.7.2.3.1 General

The deduction regarding foreign death duties is limited to the amount of estate duty payable for the property in South Africa. This implies that the allowable deduction is the lesser of the estate duty and foreign death duty payable on the property.¹³⁷⁰ Apart from the general rule implied under section 16(c), no specific rules or guidance are provided in calculating a limitation for the unilateral relief sought. The following sections will consider various aspects for the purposes of designing specific provisions in this regard.

4.2.7.2.3.2 Conversion of a foreign death duty liability

For purposes of calculating the unilateral relief under the *Estate Duty Act*, it is important that the value of the foreign death duty be converted to South African currency to determine the allowable credit. The *Estate Duty Act* makes no provision for the exchange rate that must be used for purposes of section 16(c).¹³⁷¹ Michaelides¹³⁷² submits that due to the fact that it is payable at a single point in time and not for a period, the spot rate must be used. The question, however, is whether

¹³⁶⁹ Beckmann *Estate Duty on Deceased Estates* 73-77.

¹³⁷⁰ Meyerowitz *Administration of Estates* 30.8; Cilliers *Administration of Estates* 602 and Meyerowitz 1987 *The Taxpayer* 117.

¹³⁷¹ Michaelides *The International Tax Consequences Arising on Death* 67 and Meyerowitz 1987 *The Taxpayer* 117.

¹³⁷² Michaelides *The International Tax Consequences Arising on Death* 67.

it is the spot rate¹³⁷³ on the date of payment, the date of death, or the date of assessment.

The equivalent provision to section 16(c) of the *Estate Duty Act*, for income tax purposes is section 6quat of the *Income Tax Act*, which similarly allows for a credit against the South African income tax liability for any foreign income tax payable on foreign income that is also included in the South African taxable income.¹³⁷⁴ Section 6quat(4) specifically makes provision for a rule regarding the conversion of the value of the foreign income taxes payable to South African Rands.¹³⁷⁵ Section 6quat(4) states that the conversion must be done using the average exchange rate¹³⁷⁶ for the South African year of assessment in which the income to which it relates is included in taxable income.¹³⁷⁷ The principle behind section 6quat(4) is that, even though the foreign tax liability arose on a fixed date, the average exchange rate for the year of assessment should be used to convert the foreign taxes payable and not the spot rate.¹³⁷⁸

If the provision of section 6quat(1) is compared to section 16(c) of the *Estate Duty Act*, it is noted that for the credit to apply, the foreign death duty must be *paid*, whereas for section 6quat purposes the foreign taxes must be proved to be payable and not paid. Estate duty is a one-off tax in comparison to income tax that is levied on an annual basis.

In the context of section 16(c), an average rate over a period may minimise the effect of exchange rate differences over the different liability dates and payment dates as those differences are evened out. However, by applying the spot rate, a

¹³⁷³ Defined in s 1 of the *Income Tax Act* as "[T]he appropriate quoted exchange rate at a specific time by any authorised dealer in foreign exchange for the delivery of the currency".

¹³⁷⁴ Section 6quat(1) of the *Income Tax Act*.

¹³⁷⁵ See also SARS *Interpretation Note No 18 (Issue 5): Rebate and Deduction for Foreign Taxes on Income (Interpretation Note No 18)* 85.

¹³⁷⁶ Defined in s 1 of the *Income Tax Act* as "[T]he average determined by using the closing spot rates at the end of daily or monthly intervals during that year of assessment which must be consistently applied within that year of assessment".

¹³⁷⁷ See Haupt *Notes on South African Income Tax* 574; Stiglingh *et al Silke: South African Income Tax* 510; Michaelides *The International Tax Consequences Arising on Death* 57 and SARS *Interpretation Note No 18* 85.

¹³⁷⁸ Michaelides *The International Tax Consequences Arising on Death* 57-58.

more accurate amount is obtained based on the actual payment made on a specific date that will further provide certainty as to the amount that can be claimed as a credit. Goodwin¹³⁷⁹ states that, although a fixed exchange rate will most likely remove the risk involved, the difficulty lies in what the right time is to set the rate. He further states that the volatility of the currency markets is a challenge as it may result in short-term spikes or sudden drops in rates. Such changes can therefore either apply in favour or against a person when applying an exchange rate on a specific date.

Michaelides¹³⁸⁰ is of the view that the spot rate on the date of payment should be applied on the basis that section 16(c) refers to the foreign tax being *paid* and not merely payable. Beckmann¹³⁸¹ supports the spot rate, but provides an alternative by referring to the rate on the date the foreign death duty liability comes into existence. This may again differ from one country to another, for example, the date of death may give rise to the liability, or the date the assessment is issued, or specific rules that may apply as in South Africa¹³⁸² where the estate duty must be paid within 12 months from the date of death or within 30 days from the payment date on the assessment if the assessment was issued within the 12 months after death. It is accepted that the date of liability may provide various challenges to be determined in each case based on different rules that may apply in foreign countries. Considering the wording of section 16(c) is conditional upon the foreign death duty being paid, it is submitted that the date of payment will provide certainty for a person to determine a tax liability and claim the necessary credits. This approach will therefore bring adherence to the canon of certainty.

The *Income Tax Act* also contains other exchange rate provisions applicable in different contexts. For example, section 24I covers exchange rate differences that

¹³⁷⁹ Goodwin 2019 <https://www.lawskills.co.uk/articles/2019/10/the-impact-of-exchange-rates-when-administering-estates/>.

¹³⁸⁰ Michaelides *The International Tax Consequences Arising on Death* 67.

¹³⁸¹ Beckmann *Estate Duty on Deceased Estates* 202. Beckmann refers to the same issue under the German inheritance tax law where no legislative guidance is provided regarding the exchange rate to be used, but practically the date the liability comes into existence is used.

¹³⁸² Section 9C read with s 10(1) of the *Estate Duty Act*.

occur regarding foreign exchange gains and losses and section 25D gives guidance on the exchange rate that must be used for foreign currency transactions.¹³⁸³ Although the income tax provisions do not apply to estate duty, some aspects could be referred to, to draw guidance from. For example, if a spot rate is considered, guidance can be sought from section 24I(1)(b) which defines a "transaction date" as "the date on which such debt was actually incurred".¹³⁸⁴ To promote consistency, a possible "transaction date" for purposes of converting a foreign death duty debt could be clarified as the date the foreign death duty is paid.

Furthermore, section 25D(1) provides a general rule on the conversion of foreign income and expenses to South African Rands where an individual has the option to elect either the spot rate on the date the foreign income accrued or was received or the expense or loss was incurred, or the average exchange rate for the relevant year of assessment.¹³⁸⁵ The election option may provide more leniency in converting the foreign death duty to South African Rands, in that the most beneficial outcome can be chosen when claiming the section 16(c) credit as well as the impact of the volatility of the markets can be minimised.

Another question is the period over which the average should be applied. Estate duty is not determined regarding a year of assessment, but as a one-off tax on the value of the deceased as of the date of death. In the context of an inheritance tax, the liability is calculated on the value of the inheritance due to the beneficiary.

A possible period over which the rate should be determined can be the period from the date of death to the date of payment. As stated above, the average rate approach may provide greater flexibility in determining the converted value and mitigate the impact of the volatility of the markets. However, as death duty-related

¹³⁸³ Section 24I(1)(b) of the *Income Tax Act*. See also Haupt *Notes on South African Income Tax* 575; Stiglingh *et al Silke: South African Income Tax* 536; SARS *Interpretation Note No 18 86*; SARS *Interpretation Note No 63 (Issue 2): Rules for the Translation of Amounts Measured in Foreign Currencies (Interpretation Note No 63)* 9-10 and SARS *Interpretation Note No 101 (Issue 2): Gains or Losses on Foreign Exchange Transactions (Interpretation Note No 101)* 6-7.

¹³⁸⁴ See also SARS *Interpretation Note No 101* 13.

¹³⁸⁵ Section 24I(1)(b) of the *Income Tax Act*. See also Haupt *Notes on South African Income Tax* 575; Stiglingh *et al Silke: South African Income Tax* 536 and SARS *Interpretation Note No 63* 9-10.

taxes are not intended to be a continuous liability, it is submitted that a spot rate approach may be more appropriate. There is, however, no research in the South African estate duty context available to draw from in finding a suitable solution for estate duty purposes and the recommendation will be completely new.¹³⁸⁶

It is submitted that to provide certainty in calculating the correct amount to be claimed as a credit, specific provisions should be inserted into section 16(c) in support of the canon of certainty. It is recommended, based on the discussion above, that the spot rate on the date of payment of the foreign death duties should be considered. The credit to be allowed will be for the actual foreign taxes paid and the date to be used will be clear and easily determinable without confusion. An alternative is to follow a more flexible approach as in the case of section 25D of the *Income Tax Act* to include an election option between a spot rate and average rate over a qualified period.¹³⁸⁷

4.2.7.2.3.3 Method to calculate the attribution of the foreign death duty liability

The *Estate Duty Act* does not provide for a method on how the foreign death duty or the estate duty attributable to the foreign property should be calculated, however, in practice the following method is used:¹³⁸⁸

¹³⁸⁶ Seade "Tax Revenue Implications of Exchange Rate Adjustment" 54. Seade comments that the impact of exchange rates and its relevance and application in tax legislation has hardly been addressed at all.

¹³⁸⁷ See para 6.2.7.2 below for the recommendations to s 16 of the *Estate Duty Act*.

¹³⁸⁸ Meyerowitz *Administration of Estates* 30.8; Cilliers *Administration of Estates* 602 and Meyerowitz 1987 *The Taxpayer* 117. See also OECD *Estate Tax Model* 180 where the same method is recommended in determining the foreign duties attributable for purpose of calculating a credit.

x = **a/b** multiplied by **c**,

where

x = estate duty attributable to the foreign property

a = value of the foreign property included in the net value of the estate

b = net value of the estate in South Africa¹³⁸⁹

c = estate duty payable on the dutiable amount.

The value of "x" is then reduced by the foreign death duty payable that cannot exceed the value of the estate duty payable in South Africa.¹³⁹⁰

Meyerowitz¹³⁹¹ stated that, if a specific amount of foreign death duties is attributable to a specific asset, that amount will be used for purposes of section 16(c). To support the canon of clarity, the method can be stipulated in the *Estate Duty Act* together with an additional limitation rule that the deduction regarding the foreign death duties is limited to the extent that the duty is attributable to the property situated in that country as calculated per the formula.¹³⁹²

4.2.7.2.3.4 Time rule

The *Estate Duty Act* does not provide any limitation on the period a credit may be claimed under section 16(c). This effectively means that it is open-ended which is contradictory to administering an estate in an efficient and speedy manner. Similarly, prescription rules apply to ensure that tax is administered in an effective manner to prevent claims from being submitted years after the tax affairs have been concluded. In the context of an estate, a time rule will minimise unnecessary delays

¹³⁸⁹ The net value according to s 4 of the *Estate Duty Act* is calculated based on the total property and deemed property, less all available deductions, before taking into account the s 4A rebate of R3.5 million.

¹³⁹⁰ Section 16(c) of the *Estate Duty Act*.

¹³⁹¹ Meyerowitz *Administration of Estates* 30.8; Cilliers *Administration of Estates* 602; Beckmann *Estate Duty on Deceased Estates* 111 and *De Ferm v Von Lieres und Wilkau* (WCHC) (unreported) case number 10805 / 2023 of 11 October 2023 para 30 where it was stated that a foreign inheritance tax is often calculated on the receipt by the legatee in comparison to the value of the property stipulated in a will.

¹³⁹² See para 6.2.7.2 below for the recommendation regarding the method under s 16(c) of the *Estate Duty Act*.

and encourage effective administration. The European Commission¹³⁹³ states in its recommendation to countries to address their unilateral provisions regarding relief of double inheritance taxation that the tax relief should only be allowed for a reasonable period, for example, for a period of 10 years from the date of liability. The European Commission Expert Group¹³⁹⁴ further suggests that discretion for possible extensions should be provided within the "time rule" for complex cases to acknowledge the complexities often involved in cross-border estates.

Furthermore, on the basis that the timing for applying inheritance tax credits may differ among the different countries due to different tax years and estate administration processes as well as delays in resolving cross-border estates; claims should be allowed for a reasonable period.¹³⁹⁵

Estate duty is a SARS-assessed tax,¹³⁹⁶ meaning the prescription period is three years.¹³⁹⁷ However, certain exceptions apply¹³⁹⁸ where it becomes a self-assessed tax¹³⁹⁹ and the prescription period is five years.¹⁴⁰⁰ Furthermore, considering that in some international instances the payment of an estate tax liability could be deferred up to 10 years,¹⁴⁰¹ a too-strict period may not be reasonable. To stay aligned with the tax administration rules applicable under the South African rules, a time rule of three or five years may be reasonable, depending on the circumstances.¹⁴⁰²

¹³⁹³ European Commission 2011 *Official Journal of the European Union* 84.

¹³⁹⁴ Report of Expert Group *Ways to Tackle Inheritance Cross-Border Tax Obstacles* 22.

¹³⁹⁵ European Commission 2011 *Official Journal of the European Union* 82.

¹³⁹⁶ See definition of assessment in s 1 of the *Tax Administration Act*, which means "the determination of the amount of a tax liability or refund, by way of self-assessment by the taxpayer or assessment by SARS".

¹³⁹⁷ Section 99(1)(a) of the *Tax Administration Act*.

¹³⁹⁸ Section 9(4)(a) and (b) read with s 9(5) of the *Estate Duty Act*. These exceptions include the scenario where no SARS assessment was issued regarding an estate falling within s 18(3) of the *Administration of Estates Act* (where the estate has a gross value of less than R250 000) and where additional assets are found within five years after the estate was distributed.

¹³⁹⁹ Section 1 of the *Tax Administration Act* defines a "self-assessment" as the "determination of the amount of tax payable under a tax Act by a taxpayer and— (a) submitting a return which incorporates the determination of the tax; or (b) if no return is required, making a payment of the tax;".

¹⁴⁰⁰ Sections 99(1)(b) and (c) of the *Tax Administration Act*.

¹⁴⁰¹ See para 5.3.8.2 below. The US allows for an estate tax liability to be paid over a period of 10 years provided certain requirements are met.

¹⁴⁰² See para 6.2.7.2 below for the recommendation regarding the time rule under s 16(c) of the *Estate Duty Act*.

4.2.7.3 Conclusion to double taxation relief

The OECD Model has not been updated since 1982 and the European Commission has provided useful recommendations for purposes of updating unilateral relief provisions regarding double estate taxation. The OECD, in its latest report on inheritance tax, aligns its recommendations with those made by the European Commission as a sound basis on which unilateral relief provisions can be reviewed.¹⁴⁰³

The lack of clear guidance to claim unilateral relief in South Africa regarding double estate taxation was discussed and it was concluded that, to enhance clarity under section 16(c) of the *Estate Duty Act*, various recommendations are required.¹⁴⁰⁴

Such recommendations include clear conditions on when the relief can apply, for example:

- (a) The relief is not automatically allowed, but only if applied for.
- (b) The relief can only be claimed for death duties paid for the same asset that is also subject to estate duty in South Africa.
- (c) Where a tax treaty exists, the relief under section 16(c) is not available.¹⁴⁰⁵

A definition for "death duties" should be provided in section 1 of the *Estate Duty Act*.¹⁴⁰⁶ It is further recommended that the existing limitation rule where the relief is limited to the value of the estate duty payable in South Africa regarding the foreign asset be expanded to provide guidance on the method where an appropriation of foreign duties to an asset is required.¹⁴⁰⁷

Clarity is recommended regarding the exchange rate that should be used to convert the foreign death duties to South African Rands, as well as the date or period over

¹⁴⁰³ See para 4.2.7.2 above.

¹⁴⁰⁴ See para 4.2.7.3 above.

¹⁴⁰⁵ See paras 4.2.7.2.1 and 4.2.7.2.2 above.

¹⁴⁰⁶ See para 4.2.7.2.1 above.

¹⁴⁰⁷ See para 4.2.7.2.3.2 above.

which it should be applied. If the "spot rate" is chosen, a definition thereof must be provided in section 1 of the *Estate Duty Act* and if the averaging approach is chosen, a definition of the "average exchange rate" should be given.¹⁴⁰⁸ An additional limitation that is recommended is a time rule during which the relief can be applied for. It is further suggested that a standard rule of for example five years from the date the liability arises should apply and the Commissioner should be provided with the discretion to extend the period up to a maximum of 10 years, provided sufficient proof can be provided why the extension is needed.¹⁴⁰⁹

The above suggestions promote the canon of certainty by providing clear guidance on how and when relief from double taxation can be claimed. The following section will analyse the existing lack and the possible need for anti-avoidance rules under the *Estate Duty Act*.

4.2.8 Anti-avoidance rules

4.2.8.1 Introduction

The *Estate Duty Act* does not contain any general anti-avoidance rules.¹⁴¹⁰ The *Income Tax Act*, however, contains general anti-avoidance rules (GAAR) under sections 80A-80L. The taxes administered under the *Income Tax Act*, namely income tax, donations tax and CGT fall within the scope of sections 80A-80L.¹⁴¹¹ The question arises whether estate duty falls within these provisions.

Section 80A of the *Income Tax Act* provides that –

[a]n avoidance arrangement is an impermissible avoidance arrangement if the sole or main purpose was to obtain a tax benefit and...

A "tax benefit" is defined in section 80L to include "any avoidance, postponement or reduction of any liability for tax" and the word "tax" means "any tax, levy or duty

¹⁴⁰⁸ See para 4.2.7.2.3.2 above.

¹⁴⁰⁹ See para 4.2.7.2.3.4 above.

¹⁴¹⁰ Davis and Emslie 2010 *The Taxpayer* 21. Generally known as GAAR.

¹⁴¹¹ Stiglingh *et al Silke: South African Income Tax* 1189 and Haupt *Notes on South African Income Tax* 642.

imposed by the Act, or *any other Act administered by the Commissioner*". (Emphasis added)¹⁴¹²

If one's interpretation is limited to the above, it seems clear that estate duty would fall within the scope of section 80A, however, the introductory wording of section 80B(1) states that "[T]he Commissioner may determine the tax consequences under this Act...". This means that where an impermissible avoidance arrangement exists, the Commissioner can only determine the tax consequences under the *Income Tax Act* and no other tax Act, which includes the *Estate Duty Act*.¹⁴¹³ Davis and Emslie¹⁴¹⁴ concur with this view and state that such an outcome is aligned with the intention behind the repealed section 103(1) of the *Income Tax Act* which was replaced with sections 80A-80L. Although the DTC¹⁴¹⁵ motioned that the GAAR under the *Income Tax Act* applies to estate duty, the DTC stated that the GAAR is neither a suitable nor an effective deterrent against estate duty avoidance scheme due to the wide range of estate duty savings mechanisms that exist.¹⁴¹⁶

The *Draft Revenue Laws Amendment Bill, 2008* proposed a new section 25B under the *Estate Duty Act*¹⁴¹⁷ like the rule under section 20B of the *Transfer Duty Act*. The purpose was to bring alignment across the *Income Tax Act*, the *Estate Duty Act* and the *Transfer Duty Act* regarding the GAAR.¹⁴¹⁸

The public commentary received called for a reconsideration of the proposal on the basis that it was not customised for estate duty purposes and did not consider that the *bona fide* business purpose test is less relevant to estate duty. Estate-related decisions are often motivated by family matters and not necessarily by considerations that are seen as "arm's-length" principles in a business context.¹⁴¹⁹ Furthermore, the subjective tests under the GAAR where proof must be provided of

¹⁴¹² Section 80L of the *Income Tax Act*. See also Davis and Emslie 2010 *The Taxpayer* 21.

¹⁴¹³ Davis and Emslie 2010 *The Taxpayer* 21 and Muller *Wealth Transfer Taxation* 228-229.

¹⁴¹⁴ Davis and Emslie 2010 *The Taxpayer* 21.

¹⁴¹⁵ DTC *First Estate Duty Report* 35.

¹⁴¹⁶ See paras 3.5.2.8, 3.6.2.8 and Katz Commission *Fourth Report* 9.4.

¹⁴¹⁷ Section 4(1) of the *Draft Revenue Laws Amendment Bill, 2008*.

¹⁴¹⁸ National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008* 79. See also Muller *Wealth Transfer Taxation* 218-219.

¹⁴¹⁹ Muller *Wealth Transfer Taxation* 219.

a taxpayer's intention to mainly obtain a tax benefit¹⁴²⁰ is difficult to establish in the case of a deceased person. Specific rules may therefore be more relevant for estate duty purposes.

The Law Society of South Africa Estate Committee¹⁴²¹ suggests that the alternative approach under the GAAR for income tax purposes¹⁴²² for cases other than a business context could provide useful guidance in designing similar rules for estate duty. In the latter context, the arrangement must have been entered into or carried out in a manner which would not normally be employed for a *bona fide* purpose (other than obtaining a tax benefit).¹⁴²³ Such a rule, if considered as a benchmark for estate duty purposes, the arrangement should result in an estate duty saving and it must have been solely entered into to obtain the tax benefit, for example, schemes where a bequest is temporarily made to a charity to obtain the section 4(h) deduction before it is ultimately distributed to the children as the ultimate beneficiaries. It is assumed that such an arrangement would not normally be entered into apart from the tax benefit obtained. Under normal circumstances, the bequest should be made directly to the children where no estate duty saving occur. The anti-avoidance rule will allow the Commissioner to treat the arrangement as if it had not been entered into or carried out, or in such a manner as they deem appropriate.¹⁴²⁴

The above provides a starting point for a possible GAAR for estate duty purposes, however, bearing in mind that to date the GAAR has not been the desired approach. The GAAR entails an extensive procedure to uncover the scheme to determine the tax consequences and require extensive involvement from the tax administration. However, specific anti-avoidance rules entail a specific scenario resulting in a specific outcome with no space for interpretation and little involvement from the tax

¹⁴²⁰ Inter-American Centre of Tax Administration (IACT) *Toolkit for the Anti-Avoidance Rules* 82.

¹⁴²¹ Law Society of South Africa Estate Committee 2008 *De Rebus* 18.

¹⁴²² Section 80A(b) and (c) of the *Income Tax Act*.

¹⁴²³ Section 80A(b) of the *Income Tax Act*.

¹⁴²⁴ Application based on s 80B of the *Income Tax Act* that can serve as a benchmark rule to design a similar rule for estate duty purposes.

administration.¹⁴²⁵ The following section will look at the recommendations made over the years regarding specific anti-avoidance rules for estate duty.

4.2.8.2 Commissions of Enquiry

The absence of GAAR for estate duty was noted by the Margo Commission but was not elaborated on, except that specific anti-avoidance measures must be introduced to counter avoidance schemes.¹⁴²⁶ The OECD¹⁴²⁷ also supports specific rules to address anti-avoidance schemes, but the specific design thereof should be based on a country's legislative framework. The IACT¹⁴²⁸ states that, although GAAR may have a deterrent effect and serve a purpose in the absence of specific rules, it results in administrative costs, too much discretion is allowed to a tax administration, and it potentially reduces certainty in comparison to specific anti-avoidance rules.

The Katz Commission¹⁴²⁹ also emphasised the need for specific anti-avoidance rules in the absence of general anti-avoidance rules. The Commission did not favour GAAR for estate duty on the basis that when a transaction is challenged the deceased person has already died, which makes the provision of evidence an issue as well as the evaluation thereof,¹⁴³⁰ it results in uncertainty and confusion that undermines the purpose of proper planning by the deceased,¹⁴³¹ and leads to an unproductive increase of litigation.¹⁴³² The Katz Commission recommended the introduction of specific anti-avoidance rules over a period of time.¹⁴³³

The DTC¹⁴³⁴ also referred to the reasons provided by the Katz Commission as to why GAAR for estate duty would not be an effective measure to combat estate duty avoidance. An alternative recommendation by the Katz Commission was to seek

¹⁴²⁵ IACT *Toolkit for the Anti-Avoidance Rules* 82. An inherent risk is that creative taxpayers can circumvent the specific fact pattern regarding a specific anti-avoidance rule that may defeat the object and purpose of the provision.

¹⁴²⁶ Margo Commission *Margo Report* 20.57. See also para 3.4.2.8 above.

¹⁴²⁷ OECD *Inheritance Taxation in OECD Countries* 126.

¹⁴²⁸ IACT *Toolkit for the Anti-Avoidance Rules* 18.

¹⁴²⁹ Katz Commission *Fourth Report* 9.4. See also para 3.5.2.8 above.

¹⁴³⁰ Katz Commission *Fourth Report* 9.4(a). See also para 3.5.2.8 above.

¹⁴³¹ Katz Commission *Fourth Report* 9.4(b).

¹⁴³² Katz Commission *Fourth Report* 9.4(c).

¹⁴³³ Similar rules are seen in s 3(5) and s 5(1)(f)*bis* of the *Estate Duty Act*.

¹⁴³⁴ DTC *First Estate Duty Report* 35-36.

guidance from the specific provisions under the *Inheritance Tax Act* in the United Kingdom.¹⁴³⁵ Such provisions may include rules to counter artificial arrangements to manipulate the value of assets, for example, schemes where an asset is sold but is only delivered or the purchase price is paid more than a year later.¹⁴³⁶ Section 262 of the *Inheritance Tax Act* provides that the liability is triggered at the time of payment or when the asset is transferred at the current value to prevent the transfer of value in advance of an asset that is likely to increase in value.¹⁴³⁷ The United Kingdom has since the time of the Katz Commission's review and in addition to the provisions stipulated under the *Inheritance Tax Act* introduced specific rules to combat the avoidance of inheritance tax that is discussed in Chapter 5.¹⁴³⁸

The DTC¹⁴³⁹ also highlights the need for specific rules but suggests that the existing provisions of section 3(3)(d) of the *Estate Duty Act*, which serves as the existing anti-avoidance provision for estate duty purposes, be extended.

Section 3(3)(d) provides that if the deceased is immediately prior to their death competent to dispose of property¹⁴⁴⁰ for their own benefit or for the benefit of their estate,¹⁴⁴¹ then such property is deemed to be property of the deceased for estate duty purposes.¹⁴⁴² The deeming rule applies only to property that was not included in the estate under another provision of the *Estate Duty Act* or the full value of which is not otherwise required to be taken into account in determining the dutiable

¹⁴³⁵ See Katz Commission *Fourth Report* 9.5 and para 3.5.2.8 above. See also para 5.2.9 where the UK inheritance tax avoidance rules are discussed in detail. South Africa has a close legal connection with the UK and the Supreme Court of Appeal has followed the position laid down in *Duke of Westminster v IRC* 1936 AC 1 in favour of a taxpayer's rights when considering the application of general anti-avoidance rules (see IACT *Toolkit for the Anti-Avoidance Rules* 54).

¹⁴³⁶ Section 262(1) of the *Inheritance Tax Act*. See also para 3.6.2.8 for more details.

¹⁴³⁷ See Katz Commission *Fourth Report* 9.5(d). See also para 3.5.2.8 above.

¹⁴³⁸ See para 5.2.9 below.

¹⁴³⁹ DTC *Final Estate Duty Report* 32.

¹⁴⁴⁰ For purposes of s 3(3)(d) of the *Estate Duty Act*, the term "property" includes the profits of any property (see s 3(5)(a) of the *Estate Duty Act*).

¹⁴⁴¹ Specifically excluded from the category of property of which the deceased was competent to dispose of for purposes of s 3(3)(d), is the share of the deceased's spouse in any property held in community of property between the surviving spouse and the deceased immediately prior to death (s 3(5)(d) of the *Estate Duty Act*).

¹⁴⁴² Section 3(3)(d) of the *Estate Duty Act*. Specifically excluded from the category of property of which the deceased was competent to dispose of for purposes of s 3(3)(d), is the share of the deceased's spouse in any property held in community of property between the surviving spouse and the deceased immediately prior to death (s 3(5)(d) of the *Estate Duty Act*).

amount of the estate. The provision therefore applies as a catch-all provision in the absence of another provision finding application.¹⁴⁴³

The deceased is deemed "to be competent to dispose of property" if the deceased had such power that would enable them, if they were *sui iuris*,¹⁴⁴⁴ to appropriate or dispose of the property as they saw fit. This applies irrespective of whether such power was exercisable by will, power of appointment or in any other manner.¹⁴⁴⁵ Secondly, the deceased is also competent to dispose of property, if under any deed of donation, settlement, trust or other disposition made by the deceased, they retained the power to revoke or vary the provisions thereof relating to that property.¹⁴⁴⁶ The power to revoke, appropriate or dispose is deemed to exist if the deceased could have obtained such a power directly or indirectly by the exercise of any power exercisable by the deceased or with their consent. This will apply whether such exercise of power could be achieved with or without notice.¹⁴⁴⁷

The "competent requirement" is qualified in that the competence to dispose must have been exercisable for the benefit of the deceased person or their deceased estate.¹⁴⁴⁸ The *Estate Duty Act* does not provide any meaning for the phrase "for his own benefit or for the benefit of his estate" and guidance must be sought from the courts.¹⁴⁴⁹ A deceased may have the competence to dispose of property, however, the person who enjoyed the relevant competency must have been able to exercise

¹⁴⁴³ Meyerowitz *Administration of Estates* 27.49.

¹⁴⁴⁴ *Sui iuris* refers to having full legal capacity.

¹⁴⁴⁵ Section 3(5)(b)(i) of the *Estate Duty Act*.

¹⁴⁴⁶ Section 3(5)(b)(ii) of the *Estate Duty Act*.

¹⁴⁴⁷ Section 3(5)(b)(i) and (ii) read with s 3(5)(c) of the *Estate Duty Act*.

¹⁴⁴⁸ De Souza *Deemed Property of the Estate* 5-6.

¹⁴⁴⁹ See *Creighton Trust v CIR* 1955 3 SA 498 (T) and *Crookes v Watson* 1956 1 SA 277 (A) (although these cases were decided on the interpretation of s 3(3)(a) under the *Death Duties Act*, the provision is similar to s 3(3)(d) of the *Estate Duty Act* and therefore still instructive). In *Creighton Trust v CIR* 1955 3 SA 498 (T), the founder (the deceased) of the trust could appoint and remove trustees at his will and add new beneficiaries to the trust and remove existing beneficiaries. The deceased was the only income beneficiary of the trust, all investments by the trustees required his written consent. The extensive powers of the founder together with the fact that he could benefit himself without the co-operation of another lead to the application of section 3(3)(a) of the *Death Duties Act* to his estate. In *Crookes v Watson* 1956 1 SA 277 (A) para 293A the judge held that where a trustee has the right to appoint or remove another trustee, such right in and of itself not automatically result in the trustee having the ownership over the assets of the trust. See also Van Dyk and Calitz 2016 *The Journal of Applied Business Research* 1381-1382.

their right for their own benefit or for the benefit of their estate for section 3(3)(d) to apply.¹⁴⁵⁰

The DTC¹⁴⁵¹ recommended that section 3(3)(d) be extended to include trust assets if the deceased has a large, low or interest-free loan owed to them by the trust and can demand repayment within a specified period which would constitute the deceased to be effectively in control of the trust and section 3(3)(d) will apply resulting in no estate duty saving. The motive behind the recommendation was focused on trust arrangements and no other types of estate duty avoidance schemes. National Treasury went against the recommendation and instead introduced section 7C of the *Income Tax Act* to address the avoidance concern. Commentary at the time was divided between no need for specific rules that may result in unnecessary complexity, and the need for specific rules.¹⁴⁵² In spite of the recommendations by all the Commissions for specific anti-avoidance rules for estate duty, no amendments were made to the *Estate Duty Act*. Section 3(3)(d) of the *Estate Duty Act* has not yet been challenged in court and it is uncertain under what circumstances it will find application. Taken into account that most assets will be included under the existing provisions, it is submitted that it serves as a catch-all that may find application, especially in a trust deed with reservation clauses that provide the deceased, as a trustee, with unlimited powers to not only have control over trust assets but to also benefit therefrom. Instead of changing section 3(3)(d), it is submitted that other specific anti-avoidance provisions should be considered as per the OECD's recommendations below.

4.2.8.3 OECD's recommendations on tax avoidance

The OECD¹⁴⁵³ supports the design of specific estate tax avoidance measures to prevent schemes or structures that allows for exemptions or preferential treatment

¹⁴⁵⁰ Van Dyk and Calitz 2016 *The Journal of Applied Business Research* 1381-1382.

¹⁴⁵¹ DTC *Final Estate Duty Report* 30.

¹⁴⁵² See para 3.6.2.8 above.

¹⁴⁵³ OECD *Inheritance Taxation in OECD Countries* 111-112. For example, in some instances the preferential treatment regarding spousal bequests can be used to avoid estate duty to a greater extent than what was intended, however, due to the purpose behind the exemption to provide

of property solely based on the form it is transferred in. The IACT¹⁴⁵⁴ also supports the use of specific anti-avoidance rules instead of GAAR on the basis they provide certainty and are more straightforward to apply for tax administration and taxpayers.

The measures against a tax avoidance scheme should be weighed against the justification behind the tax benefit achieved. Some avoidance schemes may be tolerated provided there is a strong justification for the tax relief. The OECD highlights the following specific and frequently used avoidance schemes and their accompanying measures to combat tax avoidance that can be considered by countries in their jurisdictions. Schemes relevant to estate duty in South Africa are evaluated below.

4.2.8.3.1 Spousal bequests

Estate tax may be avoided by making bequests to beneficiaries that will be treated as exempt bequests, for example, bequests to spouses or charities. Bequests to spouses receive the most favourable estate tax treatment, however, in many countries, they are limited to legal marriages or civil unions, or the deduction is subject to a limitation. Although limiting the qualifying unions may encourage couples to enter such unions, the issue of discrimination may arise and should be considered in terms of each country's legislation.¹⁴⁵⁵

The deduction under section 4(q) of the *Estate Duty Act* regarding spousal bequests is aligned with international trends across estate and inheritance tax systems.¹⁴⁵⁶ The tax benefit in that no estate duty is payable regarding a spousal bequest should be reviewed against its justification of providing financial support to the surviving household. It was debated at length under paragraph 4.2.3 above and it was concluded that the benefit is justified. However, it is accepted that the issue

for the surviving family, the preferential treatment seems justified. The OECD recommends a limited exemption to prevent potential abuse in this regard.

¹⁴⁵⁴ IACT *Toolkit for the Anti-Avoidance Rules* 20.

¹⁴⁵⁵ OECD *Inheritance Taxation in OECD Countries* 112.

¹⁴⁵⁶ OECD *Inheritance Taxation in OECD Countries* 75.

becomes less of an avoidance scheme issue but more of an issue of whether the provision is achieving its purposes, especially in light of single parent families or hybrid family structures.¹⁴⁵⁷ From a South African perspective, section 4(q) is less considered as an avoidance scheme as estate duty is not avoided but delayed to the second dying spouse's estate. As previously discussed, a limitation to the deduction can be considered to prevent possible abuse of the provision.¹⁴⁵⁸

4.2.8.3.2 Charitable bequests

Charitable structures are often used to obtain large estate tax benefits, especially for wealthy individuals. The often blanket exemption or deduction¹⁴⁵⁹ results in huge reductions for estate tax purposes. A specific scheme that exists is where a bequest is made to a charity for a specific period after which it is transferred to the ultimate beneficiaries (for example, the children) receiving the assets at a reduced value.¹⁴⁶⁰ Such bequests are made not necessarily with the intention to benefit a charity but to exploit the available estate duty avoidance provisions. The bequest will be free from estate duty, however, if the bequest was initially made directly to the ultimate beneficiary (the child) it would have been subject to estate duty.¹⁴⁶¹ It is therefore accepted that the tax benefit of escaping estate tax on a charitable bequest regarding such a scheme is not justified in that if the true intention of the testator was followed, the scheme should not be entered into and the bequest should be made to the ultimate beneficiary directly.

The OECD's recommendation regarding the specific scheme is to restrict donors from using such a structure by not allowing a deduction for a bequest made to a charity if the bequest is to be transferred to an ultimate beneficiary.¹⁴⁶² However, such a recommendation may have to be considered from an after-the-fact

¹⁴⁵⁷ See para 3.6.2.1 above.

¹⁴⁵⁸ See para 4.2.3 above.

¹⁴⁵⁹ In the South African context, s 4(h) of the *Estate Duty Act* has no limitation to the deduction. If the bequest is made to a qualifying PBO, the full value of the bequest qualifies as a deduction for estate duty purposes.

¹⁴⁶⁰ OECD *Inheritance Taxation in OECD Countries* 114. See also the discussion in para 4.2.6.4 above.

¹⁴⁶¹ OECD *Inheritance Taxation in OECD Countries* 114.

¹⁴⁶² OECD *Inheritance Taxation in OECD Countries* 114.

perspective, as it is only at that point that a proper and factual determination can be made as to whether or not the ultimate beneficiary was in fact the charity. This may include a tail provision where for example the deduction is allowed, but a clawback is provided where the abuse becomes apparent. Such provision may combat or minimise the abuse but may administratively be burdensome.¹⁴⁶³

Besides specific schemes, the OECD recommends an alternative to the existing deduction or exemption for a bequest to a charity, as a tax credit that will ensure that the same tax benefit is available for all taxpayers making the same level of bequest to charities.¹⁴⁶⁴ It is considered that such an approach will minimise the potential abuse of a blanket deduction and enhance the canon of equity by ensuring that the same tax benefit is available to all taxpayers making the same level of a bequest to a charity.¹⁴⁶⁵

In the South African estate duty context, the deduction under section 4(h) of the *Estate Duty Act* is the available deduction without any limitation which may result in possible estate duty avoidance in that bequests are made to a charity instead of another beneficiary. The estate duty avoidance can be justified on the basis that funds are provided to public benefit organisations that conduct activities for the benefit of the public. Such justification must be measured against the potential estate duty avoidance that was noted during the Commissions' reviews, however, no changes were made.¹⁴⁶⁶

Considering the recommendations by the OECD, it is submitted that, instead of a credit approach, a limited approach regarding the existing deduction approach may be more suitable for South Africa. The reason being, depending on the size of the credit to be introduced, that a similar outcome may occur under the existing

¹⁴⁶³ See paras 6.2.6.2 and 6.2.8.2 below for recommendations to charitable bequests.

¹⁴⁶⁴ OECD *Inheritance Taxation in OECD Countries* 127. See also para 3.4.2.5 above. The Katz Commission also recommended a credit type of system regarding charitable bequests by allowing the estate duty attributable to a donation made as a deemed payment of estate duty and instead of allowing a deduction for the donation made, reduce the final estate duty liability with the deemed payment of estate duty.

¹⁴⁶⁵ See para 6.2.8.2 below.

¹⁴⁶⁶ OECD *Inheritance Taxation in OECD Countries* 111-112; see also paras 3.4.2.8, 3.5.2.7, 3.5.2.8 and 3.6.2.8 above.

approach, which may not necessarily justify the necessary administration, system changes and costs to introduce such a change. A too drastic change with negative consequences may discourage charitable bequests which are not in the best interest of the public, especially in light of South Africa's developing economy. However, to address the concern of abuse, a limitation of 50% on the bequeathed property could be considered. Additionally, to address the concern of fictitious arrangements, including the "one-year *usufruct* schemes",¹⁴⁶⁷ it is recommended that an exclusion from the deduction regarding such schemes are considered instead of a credit-based approach subject to claw-back provisions which may result in a greater administrative burden.

4.2.8.3.3 Cessation of tax residence

It is often found that the cessation of a person's tax residence occurs with the intention to avoid estate-related tax consequences where little or no estate tax arises. To address the possible estate tax avoidance, the OECD¹⁴⁶⁸ recommends that tail provisions be considered that taxpayers who cease their tax residence remain subject to estate tax in their home country for a number of years after leaving the country. For example, a tail provision states that a taxpayer will continue to be treated as a tax resident for a period of three years from the date of cessation. This means that where a deceased person ceased their tax residence a year before death, such person will continue to be treated as a tax residence for estate tax purposes. It is accepted that instances may arise where the cessation of tax residence is not related to estate tax avoidance but due to a change in a taxpayer's circumstances. A carved-out rule or proviso to the tail provision may be required to exclude a taxpayer who truly ceased their tax residence with the home country, ceased all ties and is subject to estate tax elsewhere. The carve-out rule will also assist that no double taxation arises due to the taxpayer being subject to tax in their new country while remaining subject to estate tax in their home country.¹⁴⁶⁹

¹⁴⁶⁷ See para 4.2.6.4 above.

¹⁴⁶⁸ OECD *Inheritance Taxation in OECD Countries* 112.

¹⁴⁶⁹ See also the discussion under para 4.2.1.2.1.3 above regarding the cessation of tax residence and how it can be addressed.

No tail provisions exist under the *Estate Duty Act*. The introduction of tail provisions in respect of estate duty when an individual ceases to be a resident for estate duty purposes and dies within a specific period thereafter is beneficial to address possible estate duty avoidance. Such a tail provision will be considered as part of the design for a revised definition of a "resident" for tax purposes.¹⁴⁷⁰

Although the above recommendations by the OECD provide valuable guidance in the design of estate duty avoidance rules, an alternative approach is found in the UK by way of a disclosure programme to address specific schemes.¹⁴⁷¹ This entails SARS being informed about the scheme to provide a clearance from tax avoidance as it may not be feasible to address each type of scheme through a legislative provision. The UK provisions are discussed in more detail in Chapter 5.¹⁴⁷²

4.2.8.4 OECD's recommendations on tax evasion

In addition to the above tax avoidance schemes and measures, the OECD shares several tax evasion schemes where taxpayers end up paying less than what they are legally obligated to pay due to misrepresenting income or information to tax authorities.¹⁴⁷³ The most-known estate tax evasion schemes and the respective measures to combat such schemes relevant to South Africa are addressed below.

4.2.8.4.1 Non-disclosure or misrepresentation

Abuse may occur where certain assets are excluded from the inventory of the estate or in the non-disclosure of a transfer of wealth. This abuse is more likely to occur regarding assets that are difficult to trace like jewellery, furniture, and other household goods. Assets that are registered with public institutions like motor vehicles and immovable property are not at risk.¹⁴⁷⁴

¹⁴⁷⁰ See para 6.2.1.2 below for a recommendation regarding the definition of a "resident" for estate duty purposes.

¹⁴⁷¹ See para 5.2.9.4 below for more information on the DOTAS of the UK.

¹⁴⁷² See para 5.2.9 below. See also para 6.2.8.2 below for a recommendation on the tax avoidance rules for estate duty.

¹⁴⁷³ OECD *Inheritance Taxation in OECD Countries* 111-117.

¹⁴⁷⁴ OECD *Inheritance Taxation in OECD Countries* 116.

The OECD¹⁴⁷⁵ recommends that, to reduce the administrative burden in valuing such "smaller" assets and preventing estate tax evasion, household goods should be included in the estate as a percentage of the estate's housing assets. It is submitted that such movable assets form part of the movable property of the estate for estate duty purposes and form part of the L & D account at the Master.

Roeleveld¹⁴⁷⁶ makes a similar recommendation in the form of a capped value, for example, R50 000. However, the percentage-based approach recommended by the OECD may be more equitable because the bigger an estate, the more likely a greater percentage of household goods may be in existence, therefore a percentage-type inclusion, for example, 5% of the gross value of the estate,¹⁴⁷⁷ may promote the canons of equity and convenience in administering an estate. An exception to the general rule should also be provided for in the case where an executor is able to provide a specific value, different from the percentage provided, to allow the Commissioner to approve a different value if so proven by the executor.¹⁴⁷⁸

4.2.8.4.2 Funeral expenses

Excessive deductions may occur regarding expenses, specifically funeral expenses, by either inflating their value or including ineligible expenses or debts. The OECD¹⁴⁷⁹ recommends that, to limit the potential abuse, the deduction must be subject to a condition. Such a recommendation becomes relevant in the context of section 4(a) of the *Estate Duty Act*, which provides for a deduction for the funeral, tombstone, and death-bed expenses of the deceased person.¹⁴⁸⁰ Uncertainty exists as to the

¹⁴⁷⁵ OECD *Inheritance Taxation in OECD Countries* 116. Such inclusion can be deviated from if proof of the actual value is provided for purposes of inclusion in the estate.

¹⁴⁷⁶ Roeleveld 2015 *SAJAR* 156.

¹⁴⁷⁷ The situation where the deceased person did not own a property but merely rented may arise in which case it will be difficult to determine a percentage based on the value of the housing assets. The percentage should be based on a factor that is common in most type of estates, for example the gross value of the estate (limited to the immovable and movable property).

¹⁴⁷⁸ See para 6.2.8.2 below for a recommendation in this regard.

¹⁴⁷⁹ OECD *Inheritance Taxation in OECD Countries* 116.

¹⁴⁸⁰ In the case where the deceased person was married in community of property, the surviving spouse's share of the joint estate is determined without deducting the funeral expenses related to the deceased person as such expenses are charged only against the deceased person's share of the joint estate. In practice the reasonable costs of a hearse, a coffin, a burial plot and transfer costs when a death occurred outside South Africa have been allowed. See Davis, Jooste

type of expenses that would fall within the scope of section 4(a). Meyerowitz¹⁴⁸¹ has stated that clarity is required as to which expenses will be regarded as "deathbed expenses". Clarification by way of a list of the qualifying funeral-related expenses that will be considered in calculating the value of the deduction will assist to ensure the correct deductions are claimed and capping the deductions will mitigate any potential abuse.

Determining the list of allowable expenses should be based on expenses incurred that are essential in conducting the funeral and without which it would not have been possible.¹⁴⁸² These would include, for example, the actual cost of the hearse, the coffin, the burial plot, the transfer cost of the body to its burial place, medical expenses directly related to the deceased's last illness that includes medical bills, medicines, and nursing, providing such costs are reasonable and fair.¹⁴⁸³ The costs of marble slabs, the cost of cremation, the venue hire of the funeral service, wreaths, or mourning cards are some of the costs that have been questioned as to whether it is essential to conduct the funeral service. The value of the capped amount allowed as a deduction is limited by the actual expenses incurred and it is submitted that funeral expenses may vary from one funeral to the other. A limitation based on a percentage can also be considered, for example, 5% of the gross value of the estate.¹⁴⁸⁴

4.2.8.5 Conclusion to anti-avoidance rules

The absence of general anti-avoidance rules has been raised as a concern over the years, however, the need for specific anti-avoidance measures has been favoured by each of the Commissions of Enquiry. An attempt was made in 2008 to introduce general anti-avoidance measures for estate duty but has not succeeded as it was not drafted within the specific context of estate duty. The OECD has made specific

and Beneke *Estate Planning* 2.5.2; Cilliers *Administration of Estates* 557 and Meyerowitz *Administration of Estates* 28.27.

¹⁴⁸¹ Meyerowitz *Administration of Estates* 28.2 and Cilliers *Administration of Estates* 557.

¹⁴⁸² Meyerowitz *Administration of Estates* 28.2 and Cilliers *Administration of Estates* 536.

¹⁴⁸³ Meyerowitz *Administration of Estates* 28.2 and Cilliers *Administration of Estates* 557.

¹⁴⁸⁴ See para 6.2.8.2 below for a recommendation on the deduction in relation to funeral expenses.

recommendations that have been discussed to mitigate the possible estate duty savings regarding bequests to a surviving spouse or a charity. The introduction of a tail provision was also considered to avoid taxpayers minimising their estate duty liability based on the cessation of their residence.¹⁴⁸⁵

Tax evasion measures were also addressed where capped amounts should be considered for small items such as household goods, furniture and jewellery, as well as considerations to limit the abuse where excessive deductions are claimed for funeral expenses incurred and how the abuse thereof can be reduced.

The following section discusses the administrative provisions relevant to an estate and the challenges that are experienced in relation to administering the *Estate Duty Act*.

4.2.9 Administrative provisions

4.2.9.1 Administration of a deceased estate

To explain the issues under the *Estate Duty Act*, a short description of the administration of an estate's process is provided. Deceased estates are reported to the Master that operates under the jurisdiction of the Department of Justice.¹⁴⁸⁶ Should the deceased have nominated an executor; the Master's office will make an appointment. If no nomination was made by the testator, the beneficiaries or close relatives can make a nomination for the Master to make an appointment.¹⁴⁸⁷ The executor must, subsequent to the appointment, advertise the estate in a local newspaper in circulation in the district where the deceased normally resided as well as in the *Government Gazette*.¹⁴⁸⁸ The advertisement is placed to inform debtors and creditors of the deceased to lodge their claims with the executor. The lodging of claims should usually take place within one to three months from the advertisement; however, the general period is 30 days (one month). The executor

¹⁴⁸⁵ See para 4.2.8.3.1 to 4.2.8.3.3 above.

¹⁴⁸⁶ Section 7 of the *Administration of Estates Act*.

¹⁴⁸⁷ Sections 13-15 of the *Administration of Estates Act*.

¹⁴⁸⁸ Section 29(1) of the *Administration of Estates Act*.

must file the L & D account with the Master's office within six months after the appointment as executor unless an extension is requested and approved.¹⁴⁸⁹ An estate duty addendum forms part of the L & D account in which the estate duty liability is set out. The L & D account must also be advertised in a local newspaper and in the *Government Gazette* and lie open for inspection for a minimum period of 21 days.¹⁴⁹⁰ Once the period for inspection has passed with no objections, the L & D account is approved as final by the Master, who will then provide the necessary authority to the executor to pay creditors and distribute the assets to the legatees and heirs of the estate.¹⁴⁹¹ Once all responsibilities have been complied with, the executor will apply to the Master for release from their duty as executor and the estate will be considered to be wound-up.¹⁴⁹²

The link between the L & D account and estate duty as part of the administration process discussed above is found in the estate duty addendum of the L & D account that must correspond with the estate duty calculation set out in the estate duty return. The submission of the estate duty return is accompanied by various issues that are discussed in the following section.

4.2.9.2 Returns

4.2.9.2.1 Timeline for submission

Every executor is required to submit an estate duty return¹⁴⁹³ (also known as the REV 267)¹⁴⁹⁴ in terms of which the dutiable amount of the estate must be provided, together with details regarding the property¹⁴⁹⁵ and deemed property¹⁴⁹⁶ of the estate

¹⁴⁸⁹ Section 35(1) of the *Administration of Estates Act*.

¹⁴⁹⁰ Section 35(4) of the *Administration of Estates Act*.

¹⁴⁹¹ Section 35(12) of the *Administration of Estates Act*.

¹⁴⁹² Section 56 of the *Administration of Estates Act*.

¹⁴⁹³ Section 7(1) of the *Estate Duty Act*.

¹⁴⁹⁴ SARS 2021 <https://www.sars.gov.za/types-of-tax/estate-duty/> and <https://www.sars.gov.za/find-a-form/>.

¹⁴⁹⁵ Section 7(1)(a) of the *Estate Duty Act*.

¹⁴⁹⁶ Section 7(1)(b) of the *Estate Duty Act*.

and any deduction¹⁴⁹⁷ claimed under section 4 of the *Estate Duty Act*.¹⁴⁹⁸ The Commissioner may also call upon any other person who has control of or any interest in property included in the estate to submit such return.¹⁴⁹⁹

Claims (which include tax liabilities¹⁵⁰⁰) that are not submitted to the executor to account for it in the L & D account within the required timeline may result in a delay in the winding up of the estate if a creditor later objects to the L & D account. This may cause unnecessary delays in the winding up of the estate that frustrates the beneficiaries in receiving their inheritances.

SARS and its tax claims play an important role in the administration of the estate. All outstanding tax returns (including income tax, VAT, PAYE, and estate duty) of the deceased person must be submitted to ensure the necessary assessments are raised and lodged as claims against the L & D account.¹⁵⁰¹ From a timing perspective, such returns must be submitted and assessments must be raised within the first few months after the executor is appointed to ensure the correct tax liabilities are submitted as claims during the first advertisement period when the executor advertises the death of the deceased and calls upon creditors to submit their claims. This will ensure that the claims are correctly accounted for in the L & D account.

Although the timelines for the submission of the income tax returns are covered under a Public Notice¹⁵⁰² which provides for the due date of the income tax filing season for each year of assessment, there is no timeline under the *Estate Duty Act*

¹⁴⁹⁷ These deductions include the income tax liability in the hands of the deceased person up to the date of death that is allowed under s 4(b) of the *Estate Duty Act* and the CGT liability that may arise after the date of death that may be accounted for under s 4(c) of the *Estate Duty Act* under certain instances (see paras 4.2.1.1 and 4.2.2.1 above).

¹⁴⁹⁸ Section 7(1)(c) of the *Estate Duty Act*.

¹⁴⁹⁹ Section 7(1) of the *Estate Duty Act*.

¹⁵⁰⁰ This includes income tax, CGT, VAT and employees' tax.

¹⁵⁰¹ The income tax, VAT and PAYE returns must be taken into account for estate duty purposes as an asset (credit) or a liability (debit) when submitting the estate duty return.

¹⁵⁰² Issued under s 25 of the *Tax Administration Act*, read with s 66(1) of the *Income Tax Act* for submission of income tax returns for the 2023 tax year (Public Notice 3540 in GG 48788 of 14 June 2023).

for the submission of the estate duty return.¹⁵⁰³ The OECD¹⁵⁰⁴ supports clear filing dates to support the canon of certainty for an executor to have clear guidance regarding the tax obligations of the deceased. Furthermore, for the estate duty calculation to be correct, all income tax and other tax types must be assessed first to allow for the necessary asset (in the case of a refund) or deduction (in the case of a tax liability) for estate duty purposes.¹⁵⁰⁵

In practice, the estate duty return¹⁵⁰⁶ is submitted to SARS together with an L & D account. However, if SARS disagrees with the outcome of the return and the corresponding provision for the SARS liability in the L & D account, it will lead to an objection to the account for the liability to be corrected that may cause further delays. Furthermore, to adhere to the timelines under the *Administration of Estates Act*, all types of tax returns should already be submitted and assessed by SARS before the advertisement is placed for creditors to submit their claims as the different types of assessment are required for SARS to submit a claim. The current practice of making provisions for the SARS claim in the L & D account is insufficient and does not enhance certainty and may cause further delays in the process due to objections by SARS to take into account the correct tax assessment.¹⁵⁰⁷

¹⁵⁰³ Section 7 of the *Estate Duty Act*.

¹⁵⁰⁴ OECD *Inheritance Taxation in OECD Countries* 100. Rudnick and Gordon support the view of fixed filing dates within a specific period after death. It is further suggested that small estates should be exempt from filing to lessen the administrative burden on taxpayers and the tax administration by not expecting all estates to file. See Rudnick and Gordon "Taxation of Wealth" 332.

¹⁵⁰⁵ Both income tax and estate duty are assessed by SARS, which therefore requires a submission of a tax return by the taxpayer to be assessed. See s 66 of the *Income Tax Act*, s 7 of the *Estate Duty Act* and the definition of "assessment" in s 1 of the *Tax Administration Act*.

¹⁵⁰⁶ The OECD observed that the form of filing will depend on each country's system and whether an inheritance or estate tax is levied, however timelines should be clear. See OECD *Inheritance Taxation in OECD Countries* 99-100.

¹⁵⁰⁷ Estimated assessments are also issued by SARS under s 95 of the *Tax Administration Act* if returns remain outstanding and, in an attempt, to submit a claim, however, the estimated assessment does not take the place of the return and the return therefore remains outstanding, unless it is an agreed estimated assessment under s 95(3) of the *Tax Administration Act*.

The following table illustrates the current and possible future timelines that can be considered to encourage a quicker turnaround time on the filing of tax returns¹⁵⁰⁸ that aligns with the timelines stipulated under the *Administration of Estates Act*.

Table 4.5: Current and proposed timelines for tax return compliance

Time	Death 1509	Appointment 1510	Claims 1511	IT12 ¹⁵¹²	L & D account 1513	REV267 1514
Current flow of timeline	January	e.g., March/April	1-3 months after appointed (e.g., June/July)	Filing season (October/January)	6 months after appointed (e.g., September/October)	Open, no due date
Proposed flow of timeline	January	e.g., March/April	1-3 months after appointed (e.g., June/July)	6 months from date of death (e.g., July)	6 months after appointed (e.g., September/October)	9 months from date of death (e.g., September/October)

If it is assumed that the timelines under the *Administration of Estates Act* will remain the same, but the timelines for the tax returns need to be reconsidered. On the basis that the estate duty return is reliant on the income tax assessment for income tax and CGT purposes, it is important that an assessment is issued, and the correct liability is accounted for under section 4(b) in the estate duty return. Therefore, it is recommended that tighter timelines should be introduced for the submission of

¹⁵⁰⁸ It is accepted that this study does not deal with the income tax obligations but on the basis that the submission of the estate duty return is reliant on the filing requirements of the income tax returns, it is taken into account for purposes of making a recommendation for estate duty purposes.

¹⁵⁰⁹ The date of death of the deceased person.

¹⁵¹⁰ The date the executor is appointed by the Master and the letter of executorship is issued.

¹⁵¹¹ The date the creditors' claims must be submitted. The executor places an advertisement under s 29 of the *Administration of Estates Act* in the local newspaper and *Government Gazette* to advertise the death and for creditors to submit their claims. The cut-off date for the submission of the creditors' claims can be between one and three months from the date the advertisement was published (see s 29 of the *Administration of Estates Act*).

¹⁵¹² The due date of the submission of the ITR12 (income tax return) which is published annually under a public notice issued under s 25 of the *Tax Administration Act*.

¹⁵¹³ The date that the L & D account must be submitted to the Master for approval and must be within six months from the date the letter of executorship was issued or such further period as the Master may allow (see s 35(1) of the *Administration of Estates Act*).

¹⁵¹⁴ The date the estate duty return must be submitted and currently the *Estate Duty Act* does not provide a period in which it must be submitted.

the deceased person's last income tax return up to the date of death. Instead of allowing the entire filing season, it is suggested that a due date of six months from the date of death is prescribed for the submission of the deceased's last income tax return up to the date of death.

Since income tax is assessed by SARS and the SARS assessments must be taken into account when completing the estate duty return to calculate the estate duty liability (also based on a SARS assessment), a period must be allowed from the submission of the income tax return up to the due date for the estate duty return. This is also based on the fact that an objection or appeal may apply regarding the income tax assessment which allows for a period of up to 80 days.¹⁵¹⁵ It is submitted that, due to the strict timelines under the *Administration of Estates Act* that must be adhered to in the administration of an estate, there are sufficient grounds that exceptions to the general timelines under the *Tax Administration Act* need to be considered to not cause unnecessary delays in wrapping up the deceased's tax affairs and to ensure the correct tax claim is provided for in the L & D account.¹⁵¹⁶

It is further recommended that the *Estate Duty Act* should prescribe a due date for the submission of the estate duty return to enhance the efficient administration of a deceased estate. The estate duty return can only be properly completed once the income tax assessments are completed and therefore a due date after the income tax return due date is proposed. A period of nine months¹⁵¹⁷ after the date of death is recommended to ensure sufficient time is allowed for the income tax assessment before submitting the estate duty return that must be accounted for in the estate duty addendum of the L & D account. However, it is accepted that various unforeseen circumstances may influence the executor's ability to adhere to the

¹⁵¹⁵ See s 103 of the *Tax Administration Act* where the previous 30-day period has been replaced with the 80-day period.

¹⁵¹⁶ See para 4.2.9.6 below for a discussion on tax administration provisions.

¹⁵¹⁷ It is accepted that the due date for the submission of the estate duty return may run concurrently with the time the L & D account is lodged for approval, which is reasonable seeing that the estate duty assessment (based on the estate duty return) and the estate duty addendum should align. However, considering delays that often occur in the appointment of the executor, the due date may precede the submission of the L & D account. See *Field Administration Process and Procedure* 14. The concurrent timelines will be less of a concern should estate duty be treated as a self-assessed tax, see para 4.2.9.3 below.

timelines and it is therefore suggested that discretion should also be included in the provisions for an extended period the Commissioner may allow. These recommendations will enhance the canon of certainty and convenience in the compliance aspects under the *Estate Duty Act* that are currently absent, and it may further reduce the time delays experienced in the administration of an estate.

The OECD,¹⁵¹⁸ from an administration point of view, recommends making better use of third-party data and the exchange of information between governments to pre-populate estate tax returns to enhance tax compliance. A further measure that can be considered is to allow a taxpayer, while they are still alive to pre-lodge an estate tax return that can be updated by the executor upon death to strengthen compliance and to reduce the administrative burden on the executor when administering the estate.¹⁵¹⁹

The use of third-party data to pre-populate estate tax returns will add value to the estate duty system in South Africa. It is not necessarily a legislative consideration for purposes of the *Estate Duty Act*, but will add value in making compliance easier for executors, providing certainty, and handling the tax affairs of the deceased person in an efficient manner. Such enhancements in dealing with deceased estates and determining an estate duty liability will promote the certainty, convenience, and efficiency canons of taxation.

The OECD's recommendation to allow the deceased person to pre-lodge estate tax returns while they are still alive may be considered from a practical or legislative perspective. If considered from a practical point of view where such pre-lodging is optional, the enhancement's impact is limited to systems and processes, however, if the intention is to make it compulsory, legislative provisions must be introduced. Such an option will assist executors in submitting the estate duty return in a speedy manner while having most of the information at hand and in turn wrapping up the estate in an efficient and accurate manner. The incorporation of the OECD

¹⁵¹⁸ The use of such information may provide a more complete picture of the assets and income available in an estate and strengthen reporting requirements. See OECD *Inheritance Taxation in OECD Countries* 101.

¹⁵¹⁹ OECD *Inheritance Taxation in OECD Countries* 101.

recommendations will encourage voluntary compliance and reduce the extent that executors are required to collect information and the time it takes to finalise an estate.

4.2.9.2.2 Obligation to submit an estate duty return

Every executor is required to submit an estate duty return¹⁵²⁰ or the Commissioner may request any other person who has control of or any interest in property included in the estate to submit such return.¹⁵²¹ It could be argued that an executor is only required to submit if there is a dutiable amount regarding estate duty. However, to enhance vertical equity, to ensure the correct target group is included and to minimise the unnecessary administrative burden on the executor as well as SARS, it is recommended that the obligation to submit an estate duty return should be reconsidered. In instances where there are no or minimal assets, the requirement to submit should be removed as it results in delays regarding administrative burdens and related costs incurred that do not produce any revenue to the *fiscus*. Such an approach is supported by Rudnick and Gordon¹⁵²² to exempt small estates from filing to alleviate the administrative burden on the executor and the tax administrator. To address the concern and to adhere to the canon of certainty, a filing threshold was recommended to clarify when an estate duty return is required and when not.¹⁵²³

4.2.9.3 Assessment

In addition to prescribing timelines for the submission of an estate duty return and narrowing the group of taxpayers who are obliged to submit a return, the type of assessment that arise in the case of estate duty may have further implications in wrapping up the tax affairs in a more efficient manner.

Estate duty is generally assessed by SARS in respect of every estate. SARS issues a notice of assessment to the executor or, in the absence of an executor, to any

¹⁵²⁰ Section 7(1) of the *Estate Duty Act*. See also SARS 2021 <https://www.sars.gov.za/types-of-tax/estate-duty/> and <https://www.sars.gov.za/find-a-form/>.

¹⁵²¹ Section 7(1) of the *Estate Duty Act*.

¹⁵²² Rudnick and Gordon "Taxation of Wealth" 332.

¹⁵²³ See para 6.2.9.2.1 below for a recommendation in this regard.

person liable for the duty.¹⁵²⁴ There are exceptions where it is deemed to be done by way of a self-assessment.¹⁵²⁵ Furthermore, where the Commissioner is dissatisfied with the value of a property disclosed in the estate duty return or of the view that the dutiable amount disclosed in the return is not correct, the Commissioner may prior to the issuing of an assessment adjust such value or dutiable amount and issue an assessment accordingly.¹⁵²⁶

A notice of assessment is issued for each return submitted regarding a dutiable estate. When issuing a notice of assessment, the Commissioner must have due regard in the calculation of the duty to any duty chargeable on any previous returns submitted for the same estate.¹⁵²⁷ If no returns were submitted, the Commissioner may issue an estimated assessment based on the available information.¹⁵²⁸ Where a notice of assessment has not been issued, it is deemed to have been issued in the following instances by way of a self-assessment:¹⁵²⁹

- (a) in the case of a section 18(3) estate under the *Administration of Estates Act* where the gross value of the estate is less than R250 000 on the date the death notice is given to the Master,¹⁵³⁰ or
- (b) in any other case, on the date the estate becomes distributable in terms of section 35(12) of the *Administration of Estates Act*.¹⁵³¹

The above deeming rule was introduced as a deemed self-assessment from 1 January 2009 regarding persons who die on or after that date, where the

¹⁵²⁴ Section 9(1) of the *Estate Duty Act*.

¹⁵²⁵ Section 9(4) and (5) of the *Estate Duty Act*. Section 1(1) of the *Tax Administration Act* defines a "self-assessment" in the context of estate duty where a return is required to mean a determination of a tax liability payable under a tax Act by a taxpayer when submitting a return which incorporates the determination of the tax liability. If no return was required, a self-assessment would constitute any payment of the tax liability.

¹⁵²⁶ Section 9(1A) of the *Estate Duty Act*. The wording of s 9(1A) was previously contained in s 8(1) of the *Estate Duty Act*, which was replaced with the insertion of s 9(1A) in 2011 with the introduction of the *Tax Administration Act*.

¹⁵²⁷ Section 9(3) of the *Estate Duty Act*.

¹⁵²⁸ Section 95 of the *Tax Administration Act*. Previously, estimated assessments were issued under s 7(2) of the *Estate Duty Act*.

¹⁵²⁹ Section 9(4)(a) read with s 9(5) of the *Estate Duty Act*.

¹⁵³⁰ Section 9(4)(a)(i) of the *Estate Duty Act*.

¹⁵³¹ Section 9(4)(a)(ii) of the *Estate Duty Act*.

Commissioner did not issue an estate duty assessment. The rationale was to reduce the administrative burden on SARS to issue an estate duty assessment regarding every estate, especially old cases.¹⁵³² Furthermore, although the amendment was explained as a conversion of the estate duty system to a self-assessment system, in practice it has still been treated as a SARS assessment.¹⁵³³ With the implementation of the *Tax Administration Act* in 2012, section 9(5) was added to the *Estate Duty Act* to clarify that the deemed assessments should be treated as self-assessments to lift the administrative burden on SARS and to reduce unnecessary delays in the finalisation of an estate.¹⁵³⁴ These amendments indicate the relevance of a self-assessment that was noted by the National Treasury to minimise unnecessary delays in finalising an estate and lift the administrative burden on SARS.

If any additional property is found within five years and a supplementary L & D account is required, the above deeming rule does not apply and the notice of assessment is deemed to have been issued by way of a self-assessment¹⁵³⁵ on the date the supplementary L & D account becomes distributable in terms of section 35(12) of the *Administration of Estates Act*.¹⁵³⁶ If any additional property is found more than five years after the date of the assessment or the deemed date and an L & D account is required, the additional property is subject to estate duty as if it was the sole property of the estate and the date of death is further deemed to have taken place on the date the property is reflected in the L & D account.¹⁵³⁷

The fact that estate duty is generally assessed by SARS, may cause a delay in the finalisation of an estate if there is a backlog or delay by SARS in issuing such an

¹⁵³² National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008* 80.

¹⁵³³ National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008* 80. An assessment issued by SARS is where the determination of the tax liability or refund is done by way of an assessment by SARS (see definition of "assessment" under s 1(1) of the *Tax Administration Act*).

¹⁵³⁴ Section 9(5) of the *Estate Duty Act*.

¹⁵³⁵ Section 9(4)(b) read with s 9(5) of the *Estate Duty Act*.

¹⁵³⁶ Section 9(4)(b) of the *Estate Duty Act*.

¹⁵³⁷ Section 9(4)(c) of the *Estate Duty Act*.

assessment. Visser¹⁵³⁸ states that executors often find themselves at the mercy of SARS and the Master where delays are experienced. The Tax Ombud¹⁵³⁹ has raised concerns regarding the delays that are experienced at SARS to code a taxpayer as deceased and to update the executor's details to enable the executor to deal with the deceased person's tax affairs. Visser¹⁵⁴⁰ also states that delays at SARS may cause hindrances in finalising a deceased estate. Such hindrance includes the delay in the issuing of an estate duty assessment as the executor cannot finalise an estate until the estate duty assessment is received and any outstanding liability is paid.

Although the delay in the issuing of an estate duty assessment results in a delay in finalising an estate, it does not prevent the executor from making payment in respect of the estate duty liability. The estate duty liability must be paid within 12 months from the date of death or within 30 days from the date of payment if the assessment is issued within 12 months after death to avoid interest being payable.¹⁵⁴¹ However, certainty in settling the full amount will be reliant on the final assessment being issued by SARS to ensure no further liability remains unpaid.

As a follow-on step from the changes made in 2009 and 2011, it is suggested that estate duty should be converted to a self-assessment¹⁵⁴² system in all respects. This will mean that the estate duty return should be regarded as a self-assessment when submitted by the executor, in terms of which the estate duty liability is calculated. A self-assessment approach will circumvent many issues, including delays by SARS in issuing estate duty assessments, and delays in paying the estate duty liability as the executor will be required to settle the estate duty liability based on the estate duty return without waiting for an assessment to be issued. The conversion of estate

¹⁵³⁸ See also Visser 2022 <https://www.moneyweb.co.za/in-depth/fisa/stumbling-blocks-to-winding-up-deceased-estates/> and Aliwal Road Group 2018 <https://www.aliwalroad.co.za/2018/08/02/why-does-it-take-at-least-six-months-and-sometimes-more-than-twelve-months-to-wind-up-an-estate/>.

¹⁵³⁹ Tax Ombud 2022 <https://www.taxombud.gov.za/systemic-issues-2/>.

¹⁵⁴⁰ Visser 2021 <https://www.moneyweb.co.za/in-depth/fisa/managing-delays-in-the-winding-up-of-a-deceased-estate/>.

¹⁵⁴¹ Section 10(1) of the *Estate Duty Act*.

¹⁵⁴² A "self-assessment" is defined in s 1(1) of the *Tax Administration Act* to mean "the determination of the amount of tax payable under a tax Act by a taxpayer and (a) submitting a return which incorporates the determination of the tax; or (b) if no return is required, making a payment of the tax;"

duty to a self-assessment system will result in various consequential amendments that must be considered in respect of:

- (a) section 7 of the *Estate Duty Act* that deals with the submission of the estate duty return to ensure it is regarded as the calculation of the estate duty liability as well as clarity as to when it should be submitted;
- (b) the payment rule under section 9C, which should include a timeframe in which the estate duty liability should be paid while considering the challenges that may be experienced taking into account the administration of an estate;¹⁵⁴³
- (c) the interest rules under section 10(1) of the *Estate Duty Act*, which should clarify when interest will become payable, for example, if the estate duty is not paid within the period stipulated in section 9C, interest shall be payable; and
- (d) the provisions under section 10(2) of the *Estate Duty Act*, that covers interest-free extensions for the payment of estate duty that will also be impacted by any self-assessment rules that may be considered.¹⁵⁴⁴

It is submitted that the conversion to a self-assessment system for estate duty will lead to minimal administration by SARS in assessing an estate. The return submitted by the executor will serve as the assessment which must be submitted within a specific timeline, followed by the estate duty payment. This may address many delays that may be experienced in the administration of an estate (including waiting for an assessment to be issued by SARS) and provide an efficient, convenient, and certain manner of dealing with estate duty. Therefore, a self-assessment is also more cost-effective in the collection of revenue as the cost to collect tax will be less due to most of the functions regarding the assessment and payment are not due to SARS resources but required by the executor, which will address the DTC's concern

¹⁵⁴³ See para 4.2.9.4 below for more recommendation on payment provisions.

¹⁵⁴⁴ See para 4.2.9.4 below for more recommendation on payment provisions.

that estate duty is seen as manifestly inefficient as the cost involved in collecting estate duty is disproportionately high in comparison to the revenue yield.¹⁵⁴⁵

4.2.9.4 Payment

An estate duty liability must be paid within 12 months after the date of death or 30 days from the date of assessment¹⁵⁴⁶ if an assessment is issued within 12 months after the date of death.¹⁵⁴⁷ The requirement to pay within 12 months from the date of death if no assessment is issued is not stipulated under the payment provisions of section 9C of the *Estate Duty Act* and only appears in the interest provision under section 10(1).¹⁵⁴⁸ This creates confusion and uncertainty that may result in no payment by an executor until the assessment is issued, which leads to interest being levied. Transparency and clarity in terms of legislative provisions are important for easy and voluntary compliance by taxpayers and therefore the requirements for payment should not be disguised under the interest provisions.

Across OECD countries, the timelines for the payment of an estate tax liability vary. Although specified timelines are provided, it varies from being payable within a period of time after death (for example, 6 to 48 months) or after receiving an assessment (within one to two months).¹⁵⁴⁹

The OECD encourages flexible payment options to improve overall estate tax compliance and efficiency. Such options may include payments in instalments and extensions of payment deadlines, including making use of self-assessment filing¹⁵⁵⁰

¹⁵⁴⁵ DTC *First Estate Duty Report* 32.

¹⁵⁴⁶ The date of payment prescribed in the notice of assessment is usually 30 days from the date of assessment. See SARS 2021 <https://www.sars.gov.za/types-of-tax/estate-duty/>.

¹⁵⁴⁷ Section 9C read with s 10(1) of the *Estate Duty Act*. See also Davis, Jooste and Beneke *Estate Planning* 2.8B.

¹⁵⁴⁸ Section 10(1) of the *Estate Duty Act* states that interest is payable on any unpaid duty after a period of 12 months after the date of death, unless an assessment was issued within that period, the interest is calculated from the end of the thirty-day period from the payment date notified in the estate duty assessment.

¹⁵⁴⁹ The UK requires the payment of inheritance tax with the submission of the return and a beneficiary is not allowed to receive an inheritance before the inheritance tax liability in relation to the asset is settled. This may promote compliance as payments are being made on time, but difficulty may arise if immediate liquidity is not available. See OECD *Inheritance Taxation in OECD Countries* 100.

¹⁵⁵⁰ See para 4.2.9.3 above.

where minimal administration is required by the revenue authority in assessing the estate.¹⁵⁵¹ To address liquidity issues, especially where the majority of the assets are found in immovable property, the OECD recommends that different payment methods should be considered, for example, short-term payment extensions (free of interest)¹⁵⁵² or deferred payment arrangements.¹⁵⁵³

Deferred payment arrangements should be provided subject to specific conditions and only upon application by the liable party. Funds are often stuck in assets that are not immediately accessible that may warrant a deferred arrangement, but caution should be taken that such provisions are not abused to unnecessarily delay the payment of estate tax liability. The arrangement should only be allowed after it has been approved by the revenue authority and an application itself does not mean an approval.¹⁵⁵⁴ Deferred payment arrangements can be capped to a certain period of time, for example, five or 10 years, and limited to certain assets and circumstances.¹⁵⁵⁵ Such an arrangement may entail the payment of instalments after an initial deferred period, and a condition can be stipulated that a deposit must be paid by the original due date to qualify for such deferred arrangement.¹⁵⁵⁶ The OECD concludes that each country must consider alternative payment options to improve the efficiency of its system within its existing legislative framework.

Rudnick and Gordon¹⁵⁵⁷ recommend a stricter approach by promoting the payment of an estate tax liability upon the due date of the return. An extension for the

¹⁵⁵¹ OECD *Inheritance Taxation in OECD Countries* 101.

¹⁵⁵² Such provision must be subject to certain conditions being met and its aim is to provide flexibility. Similar to s 10(2) of the *Estate Duty Act*. Rudnick and Gordon, however, recommends that an extension of payment should be subject to interest (see for example s 6166 of the *Internal Revenue Code* in the US and para 5.3.8.2 below).

¹⁵⁵³ OECD *Inheritance Taxation in OECD Countries* 126. Deferred payment arrangements can be limited to certain property and provided sufficient justification is provided that the full payment of the tax liability will cause hardship. Sections 167-168 of the *Tax Administration Act* allows for deferred payment arrangement provided the requirements set out therein are met.

¹⁵⁵⁴ OECD *Inheritance Taxation in OECD Countries* 100.

¹⁵⁵⁵ See paras 5.2.8.2 and 5.3.8.2 below for the available arrangements and circumstances they apply in the UK and US respectively. The US specifically provides for a 10-year deferral plan provided strict requirements are met. See s 6161 of the *Internal Revenue Code*.

¹⁵⁵⁶ OECD *Inheritance Taxation in OECD Countries* 126. See also s 6161 of the US *Internal Revenue Code* for an example where a maximum period of 10 years is allowed to defer a payment or not later than 12 months after the due date for the last instalment.

¹⁵⁵⁷ Rudnick and Gordon "Taxation of Wealth" 332.

payment can be granted under specific circumstances (for example, when an estate primarily consists of illiquid assets), provided it is subject to an interest charge. The legislative provisions providing for the extension should not be drafted to provide for the delay in payment until assets are sold as that can result in a lock-in problem, unless interest is charged. The eligibility for an extension should rather be based on the composition of the estate, for example, an estate that mainly consists of immovable property or a farm.

When the above is considered in the context of the *Estate Duty Act*, estate duty is payable within 12 months from the date of death, unless an assessment was issued, then it is payable within 30 days from the date of the assessment to avoid interest being levied.¹⁵⁵⁸

Section 10(2) of the *Estate Duty Act* currently provides that an interest-free extension on the payment of estate duty can be requested if an application is made in writing within the prescribed time periods of 12 months from the date of death or 30 days from the date of assessment and provided a reasonable deposit is made. Due to no clear guidelines in the legislation, the issues that arise include, what circumstances would be falling within section 10(2) and what would be considered a "reasonable" deposit. The uncertainty can be clarified by providing guidelines as to when section 10(2) can be applied by providing either a specific list of circumstances or broader principles that must be considered when making an application. Instead of referring to a "reasonable" deposit which is subject to interpretation and is different to determine for each estate, a deposit could be considered regarding a percentage of the final anticipated liability.

An alternative or additional provision may be to allow for an automatic interest-free extension if a certain percentage of the calculated estate duty liability is paid within a shorter period. However, such liability will be reliant on a return serving as a self-assessment by the executor or an assessment issued by SARS. Such specific extension provision going beyond an interest-free extension is currently lacking

¹⁵⁵⁸ Section 10(1) of the *Estate Duty Act*.

under the *Estate Duty Act*. A recommendation that could be considered is that if 25% of the estate duty liability is paid within six months after the date of death, an automatic interest-free extension of six months is granted from the date of payment.

Regarding deferred payment arrangements, the *Tax Administration Act* already provides for such arrangements for all tax types (excluding customs and excise duties).¹⁵⁵⁹ Prior to the introduction of the *Tax Administration Act*, section 9(2) of the *Estate Duty Act* allowed for the estate duty liability to be paid in one sum or in instalments as approved by the Commissioner, having regard to the circumstances of the case. Section 9(2) did not stipulate any qualifying criteria. Section 9(2) was repealed, and the existing requirements under section 168 of the *Tax Administration Act* that must be met before a deferred arrangement may be entered into, include that:

- (a) a taxpayer must suffer from a deficiency in assets or liquidity which will be changed in the near future;
- (b) income or receipts are expected to settle the tax debt;
- (c) the immediate recovery of the tax debt is uneconomical, but it is likely to improve in the future;
- (d) the collection of the tax debt is harsh, and the deferral of the tax debt will not place the collection thereof in jeopardy; and
- (e) SARS may request the taxpayer to provide security.

The above criteria under the *Tax Administration Act* provide a generic framework in which a deferred arrangement can be considered. However, it may be more effective to look at specific provisions in the context of estate duty due to the strict timelines an estate needs to be dealt with under the supervision of the Master as well as the short period for the submission of claims. For example, specific

¹⁵⁵⁹ See ss 167-168 of the *Tax Administration Act*.

arrangements in relation to estate duty within its own timelines could be considered, provided certain qualifying requirements are met.

Specific qualifying criteria for a deferred arrangement for estate duty could include the following:

- (a) A minimum deposit payment of 10% is required (subject to the discretion of the Commissioner if the minimum percentage is not considered reasonable).
- (b) The deposit must be paid by the original due date.
- (c) The maximum period the deferral can be granted for, is five years.
- (d) A clear justification stipulating the hardship that the estate duty liability creates in the estate, is required.
- (e) The deferral is only allowed regarding the estate duty liability in relation to immovable property.
- (f) The deferral is granted interest-free for the first six months whereafter interest is payable for the remainder of the deferred period until the full liability is settled.

Based on the above, the canon of certainty will be enhanced if more clear payment guidance is given through the *Estate Duty Act*. Due to the challenges that may accompany the administration of an estate as well as the unique timelines that must be adhered to, flexible payment options should be provided. For example, the existing interest-free extension provisions under section 10(2) can be clarified, an additional automatic extension provision as well as estate duty-specific deferred payment criteria in the search for a revised *Estate Duty Act* can be considered.¹⁵⁶⁰

¹⁵⁶⁰ See para 6.2.9.2.2 below for a recommendation regarding the payment provisions under the *Estate Duty Act*.

4.2.9.5 Penalties

Penalties are often imposed to encourage voluntary compliance (through honest and accurate declarations)¹⁵⁶¹ and to deter unwanted behaviour by penalising errant taxpayers. The *Estate Duty Act* does not contain any penalty provisions in respect of administrative non-compliance under the Act. Previously, section 28(1)(b) of the *Estate Duty Act* provided for a fixed penalty regarding the late or non-submission of an estate duty return. However, with the introduction of the *Tax Administration Act*, section 28 of the *Estate Duty Act* was repealed, as penalty provisions are now dealt with under Chapters 15 and 16 of the *Tax Administration Act*. They deal with administrative non-compliance and understatement penalties respectively.

Administrative non-compliance penalties relate to failures to comply with administrative requirements under a tax Act and provide for a general as well as a specific non-compliance penalty.¹⁵⁶²

The general non-compliance penalty is a fixed-amount penalty, listed in a public notice under section 210 of the *Tax Administration Act*¹⁵⁶³ and is charged when an administrative obligation is not complied with, as provided for under a tax Act. The fixed-amount penalty is limited to those instances listed in the public notice. Administrative non-compliance regarding a tax obligation under the *Estate Duty Act* is not listed in the public notice and therefore, the fixed-amount penalty under section 210 of the *Tax Administration Act* does not apply to estate duty.

Percentage-based penalties are dealt with under section 213 of the *Tax Administration Act*. If an amount of tax was not paid as and when required under a tax Act, SARS may impose a penalty equal to the percentage prescribed in the relevant tax Act of the amount of unpaid tax. The procedures for the imposition and remittance of a percentage-based penalty are regulated by the *Tax Administration*

¹⁵⁶¹ *CIR v McNeil* 1951 1 SA 481 (A), 22 SATC 374 para 382; *Israelsohn v CIR* 1952 3 SA 529 (A), 18 SATC 247 paras 257-258; *Income Tax Case 1331* 1980 43 SATC 76 para 84; *Income Tax Case 1334* 1981 43 SATC 98 para 106; *Income Tax Case 1430* 1987 50 SATC 51 para 54 and *KBI v Mabotsa* 1993 55 SATC 98 para 103.

¹⁵⁶² Chapter 15 of the *Tax Administration Act*.

¹⁵⁶³ Public Notice 1531 in GG 45540 of 1 January 2022.

Act, but the circumstances that trigger the imposition of the penalty remain in the applicable tax Acts. The *Estate Duty Act* does not make provision for the imposition of a percentage-based penalty and therefore does not apply to estate duty.

Non-compliance that results in an understatement of "tax"¹⁵⁶⁴ due is addressed by the understatement penalty regime under Chapter 16 of the *Tax Administration Act*. Since estate duty is a "tax" under the *Tax Administration Act*, any understatement in respect thereof may be subject to an "understatement penalty".¹⁵⁶⁵ For an understatement penalty to be levied there must be an action (the understatement) by the taxpayer upon whom the penalty is imposed. If the purpose of a penalty is considered; it is to punish the wrongdoer and to deter future non-compliance, it could be argued that the imposition of a penalty on the deceased estate for a wrongdoing by an executor is not achieving its purpose, especially in the context of estate duty. The person who performs the non-compliance is the executor who represents the deceased person, however, on the basis that the executor will settle the liability out of the deceased estate, it may be argued inequitable as the executor is not suffering any consequences for their actions.¹⁵⁶⁶ The consequential effect is that the residue of the estate reduces by way of the penalty that is settled therefrom and the amount distributable to the beneficiaries of the estate becomes less.¹⁵⁶⁷

To ensure the correct person is bearing the consequences and to combat continuous non-compliance, it is suggested that the person against whom the penalty must be imposed is not the deceased estate but the executor in their personal capacity. This is because the executor makes an understatement in the estate duty return which

¹⁵⁶⁴ Defined in s 1 of the *Tax Administration Act* as a "tax, duty, levy, royalty, fee, contribution, penalty, interest and any other money imposed under a tax Act."

¹⁵⁶⁵ Section 222 of the *Tax Administration Act*.

¹⁵⁶⁶ See *Income Tax Case 1461 1989 51 SATC 165 (T)* where a decision, in the context of income tax was made, where the executor and beneficiaries cannot be held liable for the wrongdoing by the deceased prior to his death that resulted in no penalty being imposed on the deceased estate. Although it was decided in a different context, the same principle applies that the one party (beneficiaries) should not bear the consequences of the wrongdoing by the executor. In the latter instance, the penalty should be imposed on the executor in his personal capacity.

¹⁵⁶⁷ The beneficiaries still have a right of recourse against the executor, however, the time and effort and hardship placed on the beneficiaries are unjustified.

is the trigger for the imposition of the understatement penalty.¹⁵⁶⁸ Therefore, the executor should be fully personally liable for any prejudice caused by the understatement penalty. The imposition of penalties in respect of non-compliance on the executor in their personal capacity is aligned with international standards.¹⁵⁶⁹

The OECD¹⁵⁷⁰ further states that most OECD countries apply a penalty for the late and non-payment of estate tax liabilities. The *Estate Duty Act* has never imposed a penalty on the late or non-payment of the estate duty liability, even though it has previously imposed a penalty for the non-submission of an estate duty return. In the absence of a penalty, interest remains payable under section 10(1) of the *Estate Duty Act* as soon as the liability is not settled in full within the prescribed periods.

To make it harder not to comply and encourage compliance for the efficient administration of an estate, it is recommended that a penalty is introduced regarding the non-submission of the estate duty return. The administrative non-compliance regarding a tax obligation under the *Estate Duty Act* in the form of the non-submission of the estate duty return could be listed in the public notice in terms of section 210 of the *Tax Administration Act*.

It is however submitted that, as with the interest payable regarding the late or non-payment of the estate duty liability, the imposition of the penalty will reduce the ultimate amount that becomes distributable to the beneficiaries of the estate. The recurring penalty as per the public notice could be considered too harsh in the context of a deceased estate in which case a one-off penalty may be considered instead of a monthly recurring penalty. It is once again relevant that if the non-compliance is due to the fault of the executor, provided it is not done in good faith or due to circumstances beyond their control, the executor should be personally held liable, instead of the estate. Specific personal liability rules are currently lacking under the *Estate Duty Act*, and the provisions under the *Tax Administration Act*¹⁵⁷¹

¹⁵⁶⁸ Section 221 of the *Tax Administration Act*. See also SARS *Guide to Understatement Penalties (Issue 2)* 8.

¹⁵⁶⁹ See para 5.2.8.3 below. See also OECD *Inheritance Taxation in OECD Countries* 99-100.

¹⁵⁷⁰ OECD *Inheritance Taxation in OECD Countries* 100.

¹⁵⁷¹ Section 155 of the *Tax Administration Act*.

are generally applicable and limited to the abuse of funds or assets of the estate but do not extend to the non-adherence of compliance obligations.¹⁵⁷²

4.2.9.6 Tax administration provisions

The administrative provisions regarding estate duty were previously set out in the *Estate Duty Act*, however, the implementation of the *Tax Administration Act* resulted in the repeal of most of the administrative provisions in the *Estate Duty Act*.¹⁵⁷³ These provisions include, amongst others, provisions dealing with search and seizure procedures,¹⁵⁷⁴ reduced and estimated assessments,¹⁵⁷⁵ prescription,¹⁵⁷⁶ onus of proof,¹⁵⁷⁷ returns by insurers,¹⁵⁷⁸ refunds¹⁵⁷⁹ and penalty provisions.¹⁵⁸⁰ The specific provisions that remained in the *Estate Duty Act*,¹⁵⁸¹ must be read in conjunction with the *Tax Administration Act*.

Section 6(3) of the *Estate Duty Act*¹⁵⁸² further provides that, to the extent that the administrative requirements and procedures for purposes of the performance of any duty, power, obligation, or exercise of any right under the *Estate Duty Act*, are not

¹⁵⁷² See para 6.2.9.2.3 below for recommendations regarding penalty provisions for estate duty purposes.

¹⁵⁷³ Davis, Jooste and Beneke *Estate Planning* 2.8A. The purpose of the *Tax Administration Act* was to incorporate all generic tax administrative provisions into one piece of legislation instead of duplication the same under various tax Acts and to simplify the provisions. Administrative provisions that are unique to a certain type of tax remained in the specific Act (see SARS *Short Guide to the Tax Administration Act* 4).

¹⁵⁷⁴ Repealed ss 8A, 8B, 8C, 8D and 8E of the *Estate Duty Act*.

¹⁵⁷⁵ Repealed ss 7(2) and 9B of the *Estate Duty Act*. See ss 95 and 93 of the *Tax Administration Act*.

¹⁵⁷⁶ Repealed s 9A of the *Estate Duty Act*. See s 99 of the *Tax Administration Act*.

¹⁵⁷⁷ Repealed s 23bis of the *Estate Duty Act*. See s 102 of the *Tax Administration Act*.

¹⁵⁷⁸ Repealed s 23 of the *Estate Duty Act*. See the Public Notice 241 in GG 41512 of 1 March 2018 issued in terms of s 26 of the *Tax Administration Act*.

¹⁵⁷⁹ Repealed s 25A of the *Estate Duty Act*. See Chapter 13 of the *Tax Administration Act*.

¹⁵⁸⁰ Repealed ss 28(1), (2) and 28A of the *Estate Duty Act*. The only penalty provision that remained in the *Estate Duty Act* was that where a person fails to comply with any reasonable provision of the Commissioner or the Master, or obstructs them in carrying out the provisions of the *Estate Duty Act*, such person shall be guilty of an offence and be liable for conviction of a fine or to imprisonment for not more than two year (see s 28(2)(c) and (d) of the *Estate Duty Act*). See Chapters 15 and 16 of the *Tax Administration Act*.

¹⁵⁸¹ For example, the provisions regarding returns, assessments and interest contained in ss 7, 9 and 10 of the *Estate Duty Act*.

¹⁵⁸² Section 6(3) of the *Estate Duty Act* states: "Administrative requirements and procedures for purposes of the performance of any duty, power or obligation or the exercise of any right in terms of this Act are, to the extent not regulated in this Act, regulated by the Tax Administration Act."

regulated under the *Estate Duty Act*, such requirement or procedure will be regulated by the *Tax Administration Act*.¹⁵⁸³ From an estate duty perspective, this means that the related provisions are not specifically written with estate duty in mind but regarding the administration of tax in general.

The timelines and processes under the *Tax Administration Act* are drafted based on the generic approach across all tax types and do not take cognisance of the tighter processes and timelines specifically in relation to estate duty and the wider process under the *Administration of Estates Act*. For example, no clear timelines are provided for estate duty returns or assessments and any dispute provisions under Chapter 9 of the *Tax Administration Act* apply to tax in general without considering the estate context. As explained above,¹⁵⁸⁴ tax returns should be submitted and assessments must be issued as soon as possible after death to ensure the claims are submitted within the period provided for under the *Administration of Estates Act*.¹⁵⁸⁵ However, legally the executor has the entire filing season to submit an income tax return having no bearing to the tighter deadlines under the *Administration of Estates Act*.¹⁵⁸⁶ The follow-on effect of delays with income tax is that further delays occur in finalising the estate duty process.

When considering write-off provisions, specifically temporary write-offs, the reinstatement of such a debt should not take place subsequent to the finalisation of an estate, however, no such limitations are found in terms of the current wording of the *Tax Administration Act*.¹⁵⁸⁷ Such misalignment creates uncertainty and delays in adhering to the deceased's tax affairs, keeping in mind the overarching process under the *Administration of Estates Act* that must be adhered to. If a temporary write-off from estate duty is reinstated, it may result in an additional assessment being raised by SARS if the circumstances allow it¹⁵⁸⁸ and prescription has not taken

¹⁵⁸³ SARS *Short Guide to the Tax Administration Act* 4.

¹⁵⁸⁴ See paras 4.2.9.2 and 4.2.9.3 above.

¹⁵⁸⁵ Section 29 of the *Administration of Estates Act*.

¹⁵⁸⁶ Section 25 of the *Tax Administration Act*, read with s 66 of the *Income Tax Act*.

¹⁵⁸⁷ See ss 196-198 of the *Tax Administration Act*.

¹⁵⁸⁸ For example, the L & D account has not been approved by the Master.

place.¹⁵⁸⁹ It will cause further delays in the finalisation of the estate if objections are lodged against the L & D account provided the Master has not yet approved the L & D account. Due to the nature of a deceased estate that is wound up for purposes of distributing the assets to the beneficiaries, temporary write-offs should have limited application and provision should be made for permanent write-offs under qualifying circumstances.¹⁵⁹⁰ The provisions for deferred payments have been discussed above,¹⁵⁹¹ which also justify specific rules for estate duty purposes in the context of deceased estates.

The *Tax Administration Act* seeks to enforce the established principle that simplified law enhances clarity.¹⁵⁹² The underlying principle is that it is easier for a taxpayer to fully comply with the law that they understand, in comparison to the law that is either too general or too technical and difficult to understand and comply with.¹⁵⁹³ This approach also supports the canons of clarity and certainty, however, it is submitted that the recommendations above regarding instances where estate-specific provisions should be considered will further support the canon of certainty due to the specific process involved. The generic provisions are currently regarded as too vague and not fully compatible with the specific process and timelines that must be adhered to in the administration of a deceased estate.

4.3 Conclusion

This chapter covered a detailed selection of problem areas that exist under the *Estate Duty Act*. In answering the question as to what problem areas exist under the *Estate Duty Act*, the following were identified:

- (a) The challenges regarding the jurisdictional basis of estate duty was discussed and in particular the misaligned tax consequences under the

¹⁵⁸⁹ See s 99 of the *Tax Administration Act*.

¹⁵⁹⁰ Qualifying circumstances may include estates where the Master already released the executor from their duties and allowed for the executor to distribute the estate. Unexceptional delays in the issuing of tax assessments, despite the executor taking the necessary steps to comply with all tax obligations.

¹⁵⁹¹ See para 4.2.9.4 above.

¹⁵⁹² SARS *Short Guide to the Tax Administration Act* 4.

¹⁵⁹³ SARS *Short Guide to the Tax Administration Act* 4.

Income Tax Act and the *Estate Duty Act* due to a person being a "resident" for income tax, donations tax and CGT purposes but not "ordinarily resident" for estate duty purposes.¹⁵⁹⁴ The justification for a legislative definition of a "resident" for estate duty purposes was considered and found justified on the basis to bring certainty and equality.¹⁵⁹⁵

- (b) The misalignment in the scope of property of a non-resident for estate duty and CGT purposes were discussed. Recommendations were considered to bring alignment in this regard.¹⁵⁹⁶
- (c) The rationale and treatment of life policies for estate duty purposes were analysed and a need for change was identified to justify the taxation of life insurance policies. To enhance certainty and clarity it was found that there is a need for refined requirements for a life policy to be included as deemed property under the *Estate Duty Act*.¹⁵⁹⁷
- (d) The validity of retaining the section 4(q) deduction for spousal bequests and the constitutionality thereof were analysed and sufficient justification was found for its retention.¹⁵⁹⁸ The application of preferential treatment to a non-resident spouse was questioned and found to be in need of further consideration and possible limitation.¹⁵⁹⁹
- (e) The need for a legislative rule or meaning for "accrual" under the *Estate Duty Act* was considered and found needed in order to provide greater certainty in determining the available deductions in calculating the estate duty liability.¹⁶⁰⁰

¹⁵⁹⁴ See para 4.2.1.1 above.

¹⁵⁹⁵ See para 4.2.1.2 above.

¹⁵⁹⁶ See para 4.2.2.1 above.

¹⁵⁹⁷ See para 4.2.2.2 above.

¹⁵⁹⁸ See para 4.2.3.3 above.

¹⁵⁹⁹ See para 4.2.3.6 above.

¹⁶⁰⁰ See para 4.2.4 above.

- (f) The basis of the primary abatement value was questioned and found that the impact of inflation is lacking.¹⁶⁰¹ The portable abatement between spouses was also discussed and found unjustified, especially in the event that a more equitable primary abatement is introduced.¹⁶⁰²
- (g) Different valuation rules and related challenges regarding the termination of limited interest were discussed and it was concluded that amendments are required to bring alignment and clarity across estate duty and the donations tax approach to enhance the canon of certainty and to limit potential estate duty avoidance schemes.¹⁶⁰³
- (h) The limited application of available unilateral relief under the *Estate Duty Act* was analysed and found to lack sufficient measures to provide certainty regarding the necessary relief in respect of double taxation. Recommendations for enhancement were discussed to provide more clarity when seeking unilateral relief from double estate taxation.¹⁶⁰⁴
- (i) The lack of specific anti-avoidance rules for estate duty purposes was identified and various measures were discussed to provide clarity and to limit further abuse to avoid estate duty.¹⁶⁰⁵
- (j) The misalignment of the administrative provisions under the *Administration of Estates Act* and the *Estate Duty Act* was discussed,¹⁶⁰⁶ specifically regarding the timelines for the submission of claims, as well as the compliance measures under the *Estate Duty Act* for returns, assessment payment and penalty provisions.¹⁶⁰⁷ It was found that specific rules are required to provide certainty and clarity to enhance voluntary compliance

¹⁶⁰¹ See para 4.2.5.2 above.

¹⁶⁰² See para 4.2.5.3 above.

¹⁶⁰³ See paras 4.2.6.1 to 4.2.6.5 above.

¹⁶⁰⁴ See paras 4.2.7.1 to 4.2.7.3 above.

¹⁶⁰⁵ See para 4.2.8.1 to 4.2.8.5 above.

¹⁶⁰⁶ See para 4.9.2.1 above.

¹⁶⁰⁷ See paras 4.2.9.2 and 4.2.9.6 above.

for estate duty purposes and the consequences in the event of non-compliance.¹⁶⁰⁸

Preliminary recommendations to address the problems identified were discussed but will be formulated into final recommendations in the search for a revised *Estate Duty Act* in Chapter 6. The adherence of the *Estate Duty Act* to the canons of taxation (equality, certainty, convenience and cost efficiency) was discussed throughout the chapter as part of the analysis of the identified problem areas. Overall, it was found that the *Estate Duty Act* in its current form falls short to comply with the canon of equality as well as that it does not provide the necessary certainty and convenience to taxpayers in complying with their tax obligations.¹⁶⁰⁹

In light of the aim of this study to provide recommendations in the search for a revised *Estate Duty Act*, it is significant to compare the identified problem areas with similar problem areas and possible solutions offered by the transferor-based inheritance tax and estate tax regimes of the UK and the US, respectively. This is done to establish where more appropriate solutions can be offered to make the current estate duty regime more aligned to the four canons of taxation, being equitable and clear in its application, efficient and simplified.

The following chapter will provide a comparative study of the inheritance tax system of the UK and the estate tax system of the US. First, these systems will be explored for ways and measures to improve the existing measures under the *Estate Duty Act* regarding the problem areas identified. Secondly, these systems will be evaluated against the background of the problem areas identified under the current South African estate duty system to determine if there are more workable solutions. Lastly, the previous reforms undergone by the UK and US will be reviewed to identify any recommendations that can be utilised and customised in respect of the South African estate duty system to address the existing problem areas.

¹⁶⁰⁸ See para 4.3 above.

¹⁶⁰⁹ See paras 4.2.2 to 4.2.9 above.

CHAPTER 5 WEALTH TRANSFER TAX SYSTEMS IN THE UNITED KINGDOM AND THE UNITED STATES

Abstract

This chapter provides a comparative study of wealth transfer tax systems in the United Kingdom (UK) and the United States (US). These countries are selected based on similarity to the South African transferor-based estate duty system. The specific provisions under both countries that speak to the problem areas identified in Chapter 4 are analysed to seek guidance for purposes of making recommendations on the *Estate Duty Act*. Specific considerations from the UK include the design of its statutory definition of a resident and the anti-avoidance rules. Guidance from the US includes its overall distinction in the treatment between residents and non-residents as well as the indexing of its estate tax exemption for inflation. Both countries provide insight into the treatment of life policies and when they should be taxable, detailed provisions when claiming unilateral tax relief and administrative provisions to enhance voluntary compliance. The evaluation is necessary as the lessons learnt by other countries are valuable in searching for a revised *Estate Duty Act*.

5.1 Introduction

Based on the problem areas discussed in Chapter 4, the reference to other countries that are administering a similar wealth transfer tax is seen as a useful benchmark exercise to address those problem areas working towards a revised *Estate Duty Act*. This chapter will therefore address the question of what direction can be taken from foreign jurisdictions to influence the recommendations for a revised *Estate Duty Act*.

In motivating recommendations for the existing *Estate Duty Act*, countries with similar transferor-based wealth transfer tax systems, such as the inheritance tax system of the UK and the estate tax system of the US are discussed. Both countries have specifically-designed rules that will be evaluated against the problem areas in

the *Estate Duty Act* identified in Chapter 4 to recommend ways that will result in greater adherence to the canons of taxation. For example, the statutory definition of a "resident", specific provisions for double taxation relief and anti-avoidance rules will be amongst the areas discussed under the UK, whereas the different treatment for residents and non-residents, as well as the administrative and penalty provisions will be discussed under the US, and analysed for further guidance.

This chapter does not give a detailed analysis of the UK or US inheritance tax or estate tax law. It is intended to follow a functional approach as a comparative method by referring to these countries in respect of their inheritance tax and estate tax law, and to seek direction regarding the specific problem areas identified under the *Estate Duty Act*.

5.2 Inheritance taxation in the United Kingdom

5.2.1 Historical development

The earliest death duty, called a probate duty, dates to 1694 and consisted of a tax levied under the *Stamp Act*, 1694.¹⁶¹⁰ Between 1767 and 1782, the way the probate duty was levied changed from a fixed rate to a graduated rate. During the same period, a legacy duty was introduced on the beneficiary regarding the inheritance received.¹⁶¹¹ In 1881, a succession duty was introduced to apply to any tax-free wealth under the probate or legacy duties.¹⁶¹²

In 1894 the probate duty was repealed and an estate duty was introduced in an attempt to streamline the existing duties.¹⁶¹³ The estate duty was levied at a progressive rate on the assets in the deceased estate as well as on gifts or donations

¹⁶¹⁰ Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>. Probate duty was levied at a fixed rate of five Shillings on every estate exceeding £20. It was further also applicable to any personal estate that consisted of probate of wills or where letters of administration were issued.

¹⁶¹¹ Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>.

¹⁶¹² Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>.

¹⁶¹³ Butler 2016 [https://www.theguardian.com/money/2016/apr/10/inheritance-tax-a-brief-history-of-death-duties#:~:text=Modern%20inheritance%20tax%20dates%20back,fund%20the%20war%20a%20gainst%20Napoleon](https://www.theguardian.com/money/2016/apr/10/inheritance-tax-a-brief-history-of-death-duties#:~:text=Modern%20inheritance%20tax%20dates%20back,fund%20the%20war%20a%20gainst%20Napoleon.). See also Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>.

that were made within a certain period before death.¹⁶¹⁴ The change to an estate duty did not come without flaws as smaller estates could still end up with a heavy burden of death duties because the legacy and succession duties were still in place, whereas in larger estates the passing of wealth through legacies and bequests were free from any death duties.¹⁶¹⁵ To rectify the unfairness, the legacy and succession duties were abolished in 1949, and the three-year period before death for taxable donations was extended to a five-year period.¹⁶¹⁶ The period for taxable donations was extended to seven years in 1969 and still applies today.¹⁶¹⁷

In 1975, estate duty was abolished and replaced with a transferor-based capital transfer tax to fully capture donations made during a person's lifetime and included specific provisions in respect of properties that vested in discretionary trusts.¹⁶¹⁸ The capital transfer tax harmed economic growth in that it discouraged any transfers of wealth to younger generations.¹⁶¹⁹ This led to the introduction of the *Inheritance Tax Act*.¹⁶²⁰ It reintroduced the approach to only tax donations made within a certain period before the death of the deceased person as per the previously-repealed estate duty system, and was renamed to "inheritance tax".¹⁶²¹ The inheritance tax is primarily based on the earlier estate duty system; the legal structure is

¹⁶¹⁴ The period changed from time to time. It was initially set at one year before it was changed to three years. See also Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 50 and Muller *Wealth Transfer Taxation* 267. Corresponding changes were made to the South African estate duty regime during the same time where the succession duty was replaced with an estate duty and donations made shortly before death were included as deemed property in the estate. See para 3.2 above.

¹⁶¹⁵ Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>.

¹⁶¹⁶ The *Finance Act*, 1949 and Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>.

¹⁶¹⁷ The *Finance Act*, 1969 and Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>.

¹⁶¹⁸ Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>; Sandford 1987 *Fiscal Studies* 18; Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 50 and Muller *Wealth Transfer Taxation* 267.

¹⁶¹⁹ Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>; Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 50; Muller *Wealth Transfer Taxation* 267 and Butler 2016 <https://www.theguardian.com/money/2016/apr/10/inheritance-tax-a-brief-history-of-death-duties#:~:text=Modern%20inheritance%20tax%20dates%20back,fund%20the%20war%20a%20gainst%20Napoleon>. See also Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>.

¹⁶²⁰ The *Inheritance Tax Act* is annually amended by the relevant *Finance Act* of that particular year.

¹⁶²¹ The *Finance Act*, 1986; Sandford 1987 *Fiscal Studies* 15; Final Duties 2021 <https://finalduties.co.uk/the-history-of-inheritance-tax/>; Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 50 and Muller *Wealth Transfer Taxation* 267-268.

modernised and the specific provisions for discretionary trusts under the capital transfer tax regime are retained.¹⁶²² The inheritance tax system has been criticised for being unfair and complex,¹⁶²³ which resulted in various tax reform proposals over time of which the latest by the Office of Tax Simplification (OTS) and All-Party Parliamentary Group (APPG) will be referred to where applicable.

5.2.2 Overview of inheritance tax

The UK levies a unified estate and gift tax that is referred to as an inheritance tax.¹⁶²⁴ Inheritance tax is levied on the value of the assets in the deceased estate¹⁶²⁵ at the time of death,¹⁶²⁶ as well as on the value of certain chargeable transfers made within seven years before the date of death.¹⁶²⁷ The basis behind the levying of an inheritance tax is the loss of value to the transferor's estate as a result of the transfer.¹⁶²⁸

The *Inheritance Tax Act* distinguishes between transfers made during a person's lifetime¹⁶²⁹ and transfers on death.¹⁶³⁰ A transfer (whether during the deceased's lifetime or upon death) can be an exempt transfer,¹⁶³¹ a potentially exempt transfer

¹⁶²² Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 50 and Muller *Wealth Transfer Taxation* 268.

¹⁶²³ Boadway, Chamberlain and Emmerson "Taxation of Wealth and Wealth Transfers" 741-742.

¹⁶²⁴ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 454.

¹⁶²⁵ The estate of the deceased consists of all the property the deceased was beneficially entitled to, subject to certain exceptions (s 5(1) of the *Inheritance Tax Act*). See also His Majesty's Revenue & Customs (HMRC) 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04029>.

¹⁶²⁶ Inheritance tax is levied on the basis that the deceased person is deemed to transfer their estate immediately before death. It is therefore levied on the loss to the transferor's estate that resulted due to the transfer. See Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 454 and Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 51.

¹⁶²⁷ HMRC 2023 <https://www.hmrc.gov.uk/inheritancetax/intro/basics.htm> and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 454.

¹⁶²⁸ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 454. See also Boadway, Chamberlain and Emmerson "Taxation of Wealth and Wealth Transfers" 743 and Jestle *Inheritance Tax Regimes: A Comparison* 2.

¹⁶²⁹ Section 2(1) of the *Inheritance Tax Act*.

¹⁶³⁰ Section 4 of the *Inheritance Tax Act*. See HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04029>.

¹⁶³¹ Section 2(2) of the *Inheritance Tax Act* read with ss 18-35A of the *Inheritance Tax Act*. The *Inheritance Tax Act* makes provisions for a wide range of exemptions where no inheritance tax is payable, for example, gifts to a spouse or civil partner, or a charity. The *Inheritance Tax Act* also provides for an annual exemption of up to £3000 for a gift to any person, a small gift

(PET)¹⁶³² or a chargeable transfer.¹⁶³³

A chargeable lifetime transfer is calculated on the difference in the value of the transferor's estate before and after the transfer.¹⁶³⁴ Inheritance tax is immediately payable if the value of the transfer, together with the value of any other transfers made during the seven years preceding the transfer, exceeds the nil rate band¹⁶³⁵ of £325 000. The value exceeding the nil-rate band is subject to inheritance tax at a rate of 20%.¹⁶³⁶ If the nil rate band is not exceeded, no inheritance tax is payable.¹⁶³⁷

For example, five years before his death, person A made a chargeable transfer of £400 000 and made no other transfers during his lifetime. At the time of the transfer, £75 000¹⁶³⁸ is subject to inheritance tax of £15 000.¹⁶³⁹

The deemed transfer at death is calculated based on the total value of the deceased's property they have been beneficially entitled to,¹⁶⁴⁰ all chargeable lifetime transfers and PETs made within the seven years before death. To the extent that the transfers on death exceed the nil rate band and other available exclusions and

exemption of up to £250 and an exemption in respect of wedding and civil partnership gifts up to a maximum value of £5 000. See also HMRC 2023 <https://www.gov.uk/inheritance-tax/gifts>.
¹⁶³² Section 3A of the *Inheritance Tax Act*. A PET is a gift that was made more than seven years before the deceased's death on which no inheritance tax is payable. However, if the transferor dies between three and seven years after making the gift, the inheritance due is calculated on a sliding scale (see s 7(4) of the *Inheritance Tax Act*).

¹⁶³³ Section 2 of the *Inheritance Tax Act*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 454. Chargeable transfers are immediately subject to inheritance tax, whether made during the deceased lifetime or upon death and first make use of the available abatements and exemptions and the excess being subject to inheritance tax.

¹⁶³⁴ Muller *Wealth Transfer Taxation* 268.

¹⁶³⁵ The "nil rate band" is like the s 4A primary abatement under the *Estate Duty Act* and serve as an inheritance tax-free threshold. See para 5.2.6.1 below for a further discussion in the nil rate band.

¹⁶³⁶ Section 7(2) of the *Inheritance Tax Act* read with Schedule 1 to the Act. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 454.

¹⁶³⁷ Section 7 of the *Inheritance Tax Act* read with Schedule 1 to the Act. See also Boadway, Chamberlain and Emmerson "Taxation of Wealth and Wealth Transfers" 743-744; Jestle *Inheritance Tax Regimes: A Comparison* 3-4 and Muller *Wealth Transfer Taxation* 269.

¹⁶³⁸ £400 000 (gross donation) - £325 000 (nil rate band).

¹⁶³⁹ £75 000 x 20%.

¹⁶⁴⁰ The meaning ascribed to "beneficially entitled" includes only property the deceased was entitled to or property the deceased has an interest in. See HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04031>.

exemptions,¹⁶⁴¹ it will be subject to inheritance tax at a rate of 40%.¹⁶⁴² A credit of 20% will be allowed for any tax paid regarding the chargeable lifetime transfer that was also included in the total value of the taxable estate at death.¹⁶⁴³

Using the same example above, let's say person A dies five years after the chargeable transfer was made. His taxable estate (including the previous chargeable transfer) is £1.5 million. The inheritance tax that was paid on the chargeable transfer during person A's lifetime was £15 000. The inheritance tax liability is calculated as follows: £1.5 million¹⁶⁴⁴ (taxable estate) x 40% (inheritance tax rate at death) = £600 000 less £15 000 (credit for inheritance tax previously paid) = £585 000 payable at death by the estate.

The UK also provides for a rebate like the rapid succession rebate under the South African *Estate Duty Act*. Where the deceased estate includes property that was received within five years before their death and inheritance tax was previously paid in respect of that transfer, the inheritance tax payable on the second transfer will be reduced by a percentage of the inheritance tax paid on the first transfer.¹⁶⁴⁵ This is also referred to as successive transfer relief.¹⁶⁴⁶

The inheritance tax is levied on the deceased estate and is payable by the executor of the estate, instead of the beneficiaries.¹⁶⁴⁷

¹⁶⁴¹ These include the residence nil rate band in respect of the deceased's main residence, specific exemptions in respect of a spouse, civil partner or spouse and general annual exemptions as well as those in respect of small gifts and wedding gifts. See Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 454.

¹⁶⁴² Section 7 of the *Inheritance Tax Act* read with Schedule 1 to the Act.

¹⁶⁴³ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 454.

¹⁶⁴⁴ The nil rate band of £325 000 was already utilised during A's lifetime in respect of the chargeable lifetime transfer that nothing is available to reduce the taxable estate at death.

¹⁶⁴⁵ Section 7(4) of the *Inheritance Tax Act* read with Schedule 1 to the Act.

¹⁶⁴⁶ The UK relief is calculated over five years and the percentage reduction varies from 100% to 20%. This is like the rapid succession rebate in respect of deaths within 10 years under the First Schedule to the *Estate Duty Act*. See also Muller *Wealth Transfer Taxation* 269; Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 462 and HMRC 2023 <https://www.gov.uk/inheritance-tax/gifts>.

¹⁶⁴⁷ Section 200(1)(a) of the *Inheritance Tax Act*. Certain exceptions to the general rule exist in the case of a failed PET where the donee is primarily liable for the inheritance tax liability or a liability in respect of trust assets is the liability of the trustees. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 461-462.

5.2.3 Tax base

5.2.3.1 Taxing event

A chargeable transfer gives rise to an inheritance tax liability¹⁶⁴⁸ and can be made during the deceased's lifetime (within the seven years before their death)¹⁶⁴⁹ or upon death. The charging provisions under the *Inheritance Tax Act* consist of three core provisions that impose inheritance tax on a lifetime transfer,¹⁶⁵⁰ namely:

- (a) A value must be transferred by way of a chargeable transfer.¹⁶⁵¹
- (b) A chargeable transfer made by an individual is a transfer of value that is not exempt.¹⁶⁵²
- (c) A transfer of value is a disposition¹⁶⁵³ by a person that leads to a decrease in the value of the estate because of the disposal.¹⁶⁵⁴

A deemed chargeable transfer of value takes place upon death¹⁶⁵⁵ and on settled

¹⁶⁴⁸ Section 2(1) of the *Inheritance Tax Act*.

¹⁶⁴⁹ Section 3A of the *Inheritance Tax Act*.

¹⁶⁵⁰ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04021>.

¹⁶⁵¹ Section 1 of the *Inheritance Tax Act*.

¹⁶⁵² Section 2(1) of the *Inheritance Tax Act*.

¹⁶⁵³ A "disposition" is defined to include all types of disposals and transfers of cash and property as well as the creation and release or write-off of a debt or other right enforceable against a person or their estate. See HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04023>, as well as s 272 of the *Inheritance Tax Act* that includes dispositions by associated operations; s 3(3) of the *Inheritance Tax Act* that includes the omission to exercise a right resulting in the decrease of a person's estate and increase in another person's estate; s 262 of the *Inheritance Tax Act* that includes future payments made after 12 months after a transfer as a partial consideration and s 98 of the *Inheritance Tax Act* that includes the alteration of a close company's share or loan capital.

¹⁶⁵⁴ Section 3(1) of the *Inheritance Tax Act*. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04024>.

¹⁶⁵⁵ Section 4(1) of the *Inheritance Tax Act*.

property¹⁶⁵⁶ in which the deceased held an interest.¹⁶⁵⁷ The difference between a lifetime transfer and a chargeable transfer upon death is that in the case of a lifetime transfer it must start with a disposition, whereas upon death, a deemed transfer of value takes place.¹⁶⁵⁸

To determine whether a disposition is a chargeable transfer it must first be ascertained if it consists of excluded property.¹⁶⁵⁹ If not, it must be established if it is a transfer of value.¹⁶⁶⁰ Certain exclusions from the transfer of value exist under sections 10-17 of the *Inheritance Tax Act*,¹⁶⁶¹ but if none is applicable the disposition is considered a transfer of value.¹⁶⁶² The next step is to determine if the value transferred is reduced by any relief¹⁶⁶³ or if any exemption¹⁶⁶⁴ is applicable that will be deducted from the value transferred. If the value transferred is not entirely reduced by the available reliefs or is not exempt, the remaining value of the transfer will be considered a chargeable transfer.¹⁶⁶⁵

¹⁶⁵⁶ The charging provisions for settled property can be divided between a person who has an interest in possession (IIP) in the settled property (an IIP trust), that is a beneficial entitlement or where the settled property is held in a trust in which the deceased had no interest in possession (a discretionary trust). In the case of an IIP trust, the settled property forms part of a person's estate and is subject to inheritance tax on death (s 49(1) of the *Inheritance Tax Act*) or during their lifetime as if they owned the property in their name (ss 51(1) and 52(1) of the *Inheritance Tax Act*). In the case of a discretionary trust, the beneficiary merely has a right to be considered by the trustees of the trust when making a distribution. See HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm16062>.

¹⁶⁵⁷ Section 52(1) of the *Inheritance Tax Act*. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04021>. Section 59 of the *Inheritance Tax Act* defines a "qualifying interest in possession" as an interest in possession to which an individual is beneficially entitled to. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm16062>.

¹⁶⁵⁸ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04024>.

¹⁶⁵⁹ Section 6 of the *Inheritance Tax Act*. This includes property in which the deceased held no beneficial interest (including property in a trust), property outside the UK owned by a person non-UK domiciled and property transferred out of the estate before the seven years preceding death.

¹⁶⁶⁰ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04022>.

¹⁶⁶¹ These exclusions include for example, dispositions that are not intended to provide a gratuitous benefit, dispositions for the maintenance of family members, waiver of remunerations, and renunciations of a legacy.

¹⁶⁶² Section 3 of the *Inheritance Tax Act*.

¹⁶⁶³ Reliefs include business or agricultural relief under ss 104 and 106 of the *Inheritance Tax Act*.

¹⁶⁶⁴ Sections 18-29A of the *Inheritance Tax Act* include for example transfers to spouses or civil partners or charities.

¹⁶⁶⁵ Section 2(1) of the *Inheritance Tax Act*. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04022>. There may also be circumstances where

5.2.3.2 Jurisdictional basis

The liability of inheritance tax is determined depending on a person's domicile, deemed domicile, or the location of the property.¹⁶⁶⁶

5.2.3.2.1 Domicile

Inheritance tax is calculated on the worldwide property of a person who is domiciled or deemed domiciled in the UK.¹⁶⁶⁷ Domicile is a common-law concept that determines the rules that must be applied.¹⁶⁶⁸ A person is born with a domicile of origin, based on their father's domicile at that time. A person can replace their domicile by acquiring a new domicile of choice by moving to another country with the intention to stay there permanently or indefinitely. A person is therefore considered domiciled in the country where the person has a permanent home available, even if resident in another country.¹⁶⁶⁹ A person cannot have more than one domicile at the same time and the onus of proving a change in domicile rests on the person declaring the change.¹⁶⁷⁰

Additional tests apply to establish a deemed domicile for inheritance tax purposes where the concept of "domicile" is combined with the statutory residence test for income tax purposes and includes:¹⁶⁷¹

inheritance tax will still not be charged on a chargeable transfer as such property is not considered.

¹⁶⁶⁶ Section 6(1) of the *Inheritance Tax Act*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 459-460 and HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm13001>.

¹⁶⁶⁷ Sections 6(1) and 267 of the *Inheritance Tax Act*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 459-460 and HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm13001>.

¹⁶⁶⁸ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm13001>. See also Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 415.

¹⁶⁶⁹ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm13021> and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 459-460.

¹⁶⁷⁰ Muller *Wealth Transfer Taxation* 274 and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 460.

¹⁶⁷¹ The two additional tests apply to persons who have emigrated from the UK or who have been resident in the UK for tax purposes for many years (see s 267 of the *Inheritance Tax Act*). See also Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 416.

- (a) a person who is domiciled in the UK within the three years immediately before death (the three-year rule);¹⁶⁷²
- (b) a person is a resident in the UK for income tax purposes (according to the statutory residence test) in at least 15 out of the last 20 tax years (the 15-out-of-20-year rule);¹⁶⁷³ or
- (c) a person will be deemed domiciled in the UK for inheritance tax purposes for any relevant tax year in which they are a UK resident for income tax purposes if they were resident in one of the two prior tax years.¹⁶⁷⁴

A tail provision is also provided for under the deemed domicile rules in that a person who is UK domiciled or deemed domiciled and leaves the UK to permanently reside elsewhere will be deemed to be domiciled in the UK for three more calendar years thereafter.¹⁶⁷⁵ Goldberg¹⁶⁷⁶ identifies such retention of domicile as a major issue that may arise in estate and inheritance tax conflicts where a change in domicile took place but a retention rule exists. Care should therefore be taken in drafting a tail provision due to the conflict that may arise from a jurisdictional basis and double tax implications, however, the risk can be mitigated by including a proviso that, where tax residence was obtained in the foreign jurisdiction, the tail provision will not apply. This may seem to counter the purpose of the provision to avoid estate duty, but considering the proposed proviso, it will apply in cases it was truly intended for.

The UK's deemed domicile rules illustrate how an objective test (the statutory residence test) can tie in with a common-law test (domicile). Although the concept

¹⁶⁷² Section 267(1)(a) of the *Inheritance Tax Act*.

¹⁶⁷³ Section 267(1)(b) of the *Inheritance Tax Act*. Before 6 April 2017, the rule was 17 out of 20 years. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm13024>.

¹⁶⁷⁴ Section 267(1)(aa) of the *Inheritance Tax Act*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 460.

¹⁶⁷⁵ Section 267(1)(a) of the *Inheritance Tax Act*; Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 460 and Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 418. This serves as a tail provision that also serves as an anti-avoidance measure where a person may try to manipulate their tax residency for tax benefits.

¹⁶⁷⁶ Goldberg "Estate Tax Conflicts resulting from a Change in Residence" 3.

of "domicile" is not currently applicable in the South African context, the hybrid approach found in the deemed domicile rules may provide insight for purposes of making recommendations for a revised *Estate Duty Act*. Such a hybrid approach is supported by Arendse, Stark and Renaud,¹⁶⁷⁷ but is further qualified with an additional proviso that a person who was "ordinarily resident" retains such status until that person becomes "ordinarily resident" in a new place.¹⁶⁷⁸ The latter approach may seem more appropriate than the current tail provisions under the UK inheritance tax rules as the provision will only apply for as long as no other residence was obtained that places the taxpayer under another country's jurisdiction.

In a recent review of the UK inheritance tax system by the OTS and the APPG (OTS and APPG UK Inheritance tax review), the concept of "domicile" and its relevance to the inheritance tax system was questioned. It is regarded as problematic in the sense that it depends on the intention to settle permanently and indefinitely in one country rather than another. However, it is difficult to establish a person's intention after the individual is dead.¹⁶⁷⁹ The APPG recommended that the connecting factor of domicile should be replaced by the residence test where inheritance tax becomes chargeable on a worldwide basis once an individual has been a UK tax resident.¹⁶⁸⁰

The following section will provide a brief overview of the similarities between the meaning of "ordinarily resident" in the UK and South Africa before the UK converted to a statutory residence test that will be discussed below for possible insights in recommending a statutory definition for "resident" under the *Estate Duty Act*.

¹⁶⁷⁷ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 22.

¹⁶⁷⁸ See para 5.2.3.2.2 below.

¹⁶⁷⁹ Tee, Monte and Polley 2021 <https://www.mondaq.com/uk/tax-authorities/1023592/uk-inheritance-tax-reform-lessons-from-europe>. This is the same challenge that is experienced regarding the concept of "ordinarily resident" for estate duty purposes in South Africa.

¹⁶⁸⁰ The recommended test was that the deceased must have been a UK resident for more than 10 out of the last 15 years. See APPG *Reform of Inheritance Tax* 11. The OTS however made no recommendation in this regard. The APPG's recommendation was however not accepted as it will result in a radical reform and rethinking of the inheritance tax system that requires many years to implement (see Tee, Monte and Polley 2021 <https://www.mondaq.com/uk/tax-authorities/1023592/uk-inheritance-tax-reform-lessons-from-europe> and Dobinson 2021 <https://www.saffery.com/insights/news/government-accepts-some-ots-recommendations-but-rejects-others/>).

5.2.3.2.2 "Ordinarily residence" in the UK

As a starting point in considering a statutory definition for "resident" under the *Estate Duty Act*, the similarity in the principles laid down by the courts in South Africa and the UK are considered to determine whether the statutory definition introduced by the UK can serve as a benchmark. Arendse, Stark and Renaud¹⁶⁸¹ state that the UK residency rules and legislation are the foundation of the South African residency principles of an individual, which is reflected in the *Cohen*¹⁶⁸² and *Kuttel*¹⁶⁸³ cases. In both cases, when the South African courts sought to interpret "residence" and "ordinarily resident", they relied heavily on UK case law.

The principles laid down by UK case law are to a significant extent similar to South African case law principles in the following way:

- (a) In South Africa, a person is "ordinarily resident" where their real home is, being that person's usual or principal place of residence,¹⁶⁸⁴ and the UK looks at where the person has a settled or usually at home.¹⁶⁸⁵
- (b) In South Africa, although a person can have more than one residence,¹⁶⁸⁶ a person can be *ordinarily resident* in only one place.¹⁶⁸⁷ In the UK, a person can reside in more than one country, but can only be *domiciled*¹⁶⁸⁸ in one place.¹⁶⁸⁹
- (c) In South Africa, return visits after a taxpayer left do not indicate that the taxpayer becomes ordinarily resident again, but the reasons for the visits

¹⁶⁸¹ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 19.

¹⁶⁸² 1946 AD 174 13 SATC. See also para 4.2.1.2. above for a detailed discussion on the case.

¹⁶⁸³ 1992 3 SA 242 (A) 54 SATC. See also para 4.2.1.2. above for a detailed discussion on the case.

¹⁶⁸⁴ *Cohen* case para 371.

¹⁶⁸⁵ *Levene v IRC* (1928) AC 217 para 505 (the *Levene* case).

¹⁶⁸⁶ *Kuttel* case paras 304-305.

¹⁶⁸⁷ *Cohen* case para 371.

¹⁶⁸⁸ Although "ordinarily resident" and "domiciled" are different concepts, similar tests are applied in establishing the presence thereof (see *Cohen* case 371).

¹⁶⁸⁹ *Levene* case para 505.

are important.¹⁶⁹⁰ Various objective facts must be considered.¹⁶⁹¹ In the UK, a person must stay in a place with some degree of continuity or permanence, even where temporary trips abroad are taken, to be ordinarily resident.¹⁶⁹² Whether a person is ordinarily resident is determined based on a person's subjective intention and objective facts, taking into account the duration of presence, regularity of visits, personal and family ties, and the availability of a home.¹⁶⁹³

5.2.3.2.3 UK statutory residence test

Before 2013, the UK, similar to SA, relied solely on case law to define "ordinarily resident". However, from 6 April 2013, with the introduction of a statutory residence test, the concept of "ordinarily resident" was abandoned to provide certainty in determining tax residency.¹⁶⁹⁴ Schedule 45 to the *Finance Act, 2013* (the *Finance Act*) sets out the UK statutory residence test.¹⁶⁹⁵ The test considers the amount of time spent in the UK and any ties a person may have with the UK.¹⁶⁹⁶ The basic rule¹⁶⁹⁷ is that an individual is a UK resident for a year of assessment if they meet the automatic UK test or the sufficient ties test for that year. If none of these tests is met (and one of the automatic overseas tests is met¹⁶⁹⁸), they are not a UK resident.¹⁶⁹⁹

Although the UK statutory residence test is mainly applicable in the context of income tax, it is relevant for this study as it serves as a replacement for the meaning

¹⁶⁹⁰ *Kuttl* case para 306.

¹⁶⁹¹ *Income Tax Case 961* 1961 SATC 648 para 649 and SARS *Interpretation Note No 3 5* for a list of factors to be considered.

¹⁶⁹² *Levene* case para 746.

¹⁶⁹³ *IRC v Lysaght* 1928 AC 234, 13 TC 511 para 249 and *Shepherd v IRC* 2006 STC 1821.

¹⁶⁹⁴ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 19.

¹⁶⁹⁵ See also HMRC 2023 <https://www.gov.uk/government/publications/rdr3-statutory-residence-test-srt/guidance-note-for-statutory-residence-test-srt-rdr3>.

¹⁶⁹⁶ HMRC 2023 <https://www.gov.uk/government/publications/rdr3-statutory-residence-test-srt/guidance-note-for-statutory-residence-test-srt-rdr3>.

¹⁶⁹⁷ Paragraph 3 of Schedule 45 to the *Finance Act*.

¹⁶⁹⁸ Paragraphs 11-16 of Schedule 45 to the *Finance Act*.

¹⁶⁹⁹ Paragraph 4 of Schedule 45 to the *Finance Act*.

of "ordinarily residence" that also applies under the South African *Estate Duty Act*.¹⁷⁰⁰ The "deemed domicile" test applicable for UK inheritance tax purposes¹⁷⁰¹ is also linked to a person's residence status based on the statutory residency test to clarify a person's domicile¹⁷⁰² status in the UK.¹⁷⁰³

The statutory residency test consists of an automatic overseas test, the automatic UK test and the sufficient UK ties test which are briefly set out below:

5.2.3.2.3.1 The automatic overseas test

A person is not a UK resident if:

- (a) A person was a UK resident during the previous three tax years and spent less than 16 days in the UK in the current year, provided the person did not pass away (first automatic overseas test).¹⁷⁰⁴
- (b) A person was not a UK resident during the previous three tax years and spent less than 46 days in the UK in the current year (second automatic overseas test).¹⁷⁰⁵
- (c) A person works full-time outside the UK without a significant break,¹⁷⁰⁶ and spends less than 91 days in the UK during the tax year and, if working in the UK, it is less than 31 days (exceeding three hours of work a day) (third automatic overseas test).¹⁷⁰⁷

¹⁷⁰⁰ In many foreign jurisdictions, different concepts (residence versus domicile) apply to income tax and estate tax. However, in South Africa, the concept of "ordinarily resident" is applicable for income tax and estate duty purposes. It is therefore possible that a revised concept may apply to both tax types.

¹⁷⁰¹ See para 5.2.3.2.1 above.

¹⁷⁰² The concept of "domicile" and "ordinarily resident" is not the same (see Delpont *The Definition of Property for Estate Duty Purposes* 84).

¹⁷⁰³ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 459-460 and para 5.2.3.2.1 above for a discussion on the UK domicile rules for inheritance tax purposes.

¹⁷⁰⁴ Paragraph 12 of Schedule 45 to the *Finance Act*.

¹⁷⁰⁵ Paragraph 13 of Schedule 45 to the *Finance Act*.

¹⁷⁰⁶ A significant break is when more than 31 days passed where no work was done for more than three years, or if work was possible but a day of leave was submitted. See also para 29(2) of Schedule 45 to the *Finance Act*.

¹⁷⁰⁷ Paragraph 14 of Schedule 45 to the *Finance Act*.

The automatic overseas tests further contain "tail provisions" where a person who leaves the UK to live and work outside the UK, will only cease tax residency after three years.¹⁷⁰⁸

The first automatic overseas test does not apply to a deceased person, however, the second and third tests can apply to a deceased person, but depending on the date of death, the "days" requirement may need to be adjusted to not refer to the "year" but instead "the period from the start of the tax year to the day before death".¹⁷⁰⁹

Two additional automatic overseas tests apply solely to a deceased person where such person will not be a resident in the UK in the year of death:

- (a) If the deceased person spends less than 46 days in the UK in the year of death and:
 - (i) the deceased was not a resident of the UK during the two preceding tax years; or
 - (ii) the deceased was not resident in the UK in the immediately preceding tax year and the tax year before that was a split year¹⁷¹⁰ due to

¹⁷⁰⁸ This approach is aligned with the OECD recommendation to have "tail provisions" to eliminate the risk of estate tax avoidance schemes (see OECD *Inheritance Taxation in OECD Countries* 74).

¹⁷⁰⁹ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11910>. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11930>, where the HMRC provides detailed guidelines in dealing with modified conditions. In South Africa, a similar approach applies for a taxpayer who is alive with a change in status like ceasing residence or being sequestered where the period of assessment ends on the day before the status changed. However, for a deceased taxpayer the period of assessment ends on the date of death. See ss 9H(2) and 66(13)(a) of the *Income Tax Act*.

¹⁷¹⁰ A "split year" defined in para 43 of Schedule 45 to the *Finance Act*, includes a tax year where an individual is a UK resident and circumstances apply that result in the taxpayer leaving the UK.

circumstances¹⁷¹¹ that led the person to leave the UK (fourth automatic overseas test).¹⁷¹²

- (b) If the deceased person was not a resident in the UK during the two preceding tax years by meeting the third automatic overseas test for each year;¹⁷¹³ or was not a UK resident during the preceding tax year by meeting the third automatic overseas test that was preceded by a split year due to taking on full-time work outside the UK (fifth automatic overseas test).¹⁷¹⁴

Where the deceased person dies during the year of assessment, the "days" requirement under the third automatic overseas test must be met under the modified conditions calculated from the start of the tax year to the day before death.¹⁷¹⁵

5.2.3.2.3.2 The automatic UK test

A person is a UK resident if they do not meet any of the automatic overseas tests and:

- (a) Spend 183 days or more in the UK during a tax year (first automatic UK test).¹⁷¹⁶
- (b) Spend more than 91 days in the UK during a tax year and at the same time owns and lives in that home for at least 30 out of the 90 days. The individual should not own any homes abroad or if the individual owns a home abroad,

¹⁷¹¹ Such circumstances include the deceased or their spouse or partner starting to work full-time overseas; or where no home is available in the UK due to the person leaving (see paras 44-46 of Schedule 45 to the *Finance Act*).

¹⁷¹² Paragraph 15 of Schedule 45 to the *Finance Act*.

¹⁷¹³ Paragraph 16(1) of Schedule 45 to the *Finance Act*.

¹⁷¹⁴ Paragraph 16(2) of Schedule 45 to the *Finance Act*.

¹⁷¹⁵ Paragraph 16(3) of Schedule 45 to the *Finance Act*.

¹⁷¹⁶ Paragraph 7 of Schedule 45 to the *Finance Act*.

they must spend less than 30 days in that home during the year¹⁷¹⁷ (second automatic UK test).¹⁷¹⁸

- (c) Worked full-time in the UK for 365 days, without any significant break and the 365 days can be spread across two tax years (third automatic UK test).¹⁷¹⁹

Although the above three automatic UK tests can apply to a deceased person, there is a fourth automatic test that only applies to a deceased person who is regarded as a UK tax resident in a tax year if they were a UK resident for the three immediately preceding tax year through meeting one of the above-mentioned automatic UK tests and not meeting an automatic overseas test. The tax year immediately before the deceased person died must not be a split year (if it is assumed the deceased was a non-resident in the year of death), and when the deceased died, they owned a home in the UK.¹⁷²⁰ If the deceased person owned more than one home, at least one must be in the UK and the deceased must not have spent sufficient time in the overseas home during that tax year.¹⁷²¹

Example 1: Fourth automatic test for deceased persons

Person A lived in the UK their entire life, only owned a home in the UK and died on 10 April 2022 while on a two-week holiday in France. What is person A's residence status in the UK?

Since person A lived in the UK their entire life, they do not meet any of the automatic overseas tests and as a deceased person, the first three automatic UK tests do not apply. However, person A was a resident in the UK for each of the three previous years of

¹⁷¹⁷ If the individual owns more than one home outside the UK, the 30-days test should be considered for each home separately.

¹⁷¹⁸ Paragraph 8 of Schedule 45 to the *Finance Act*.

¹⁷¹⁹ Paragraph 9 of Schedule 45 to the *Finance Act*. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11300> for a detailed discussion on the third automatic UK test.

¹⁷²⁰ Paragraph 10 of Schedule 45 to the *Finance Act*.

¹⁷²¹ Sufficient time is more than 30 days in a tax year or every day in the year of death, including the day of death. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11940> and HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11950>.

assessment and no "split year" is relevant for the 2021/2022 year of assessment. On the basis that person A had a home in the UK at the time of their death and owned no overseas home, they are a resident in the UK at the time of death under the fourth automatic UK test applicable to deceased persons.

Example 2: Deceased person owning property inside and outside the UK

Person B lived and worked in the UK and has been a UK resident for seven years up to the 2021-2022 year of assessment. In June 2022 person B retires, buys a home in Spain, and relocates to live in Spain. Person B retains their home in the UK for visits to the UK, however, person B dies in June 2023. Since person B left, they only had a two-week visit in the UK during May 2023. Otherwise, person B has spent every night in their home in Spain. What is person B's residence status in the UK at death?

The automatic overseas tests as well as the first three automatic UK tests do not apply to person B. In the year of death, person B owned a home in the UK and in Spain, however, sufficient time was spent in their home in Spain (more than 30 days) which results in person B not being a resident in the UK under the fourth automatic UK test.

5.2.3.2.3.3 The sufficient ties test

Where the automatic overseas test or the automatic UK test does not apply to an individual's circumstances, the sufficient ties test must be relied on. The sufficient ties test is an evaluation of a person's ties with the UK together with the number of days they are present in the UK to determine whether such they are a UK tax resident in a tax year.¹⁷²² The test has five ties that are considered to determine whether they are a UK tax resident. The ties are:

- (a) A family tie is where a person's spouse, partner or minor child is in the UK.¹⁷²³

¹⁷²² Paragraph 17 of Schedule 45 to the *Finance Act*.

¹⁷²³ Paragraph 32 of Schedule 45 to the *Finance Act*.

- (b) An accommodation tie is when a person uses available accommodation in the UK.¹⁷²⁴
- (c) A work tie is where a person works at least 40 days in the UK.¹⁷²⁵
- (d) A 90-day tie is when a person spends more than 90 days in the UK during either of the two preceding tax years.¹⁷²⁶
- (e) A country tie is where a person spends more time in the UK than any other country during a tax year.¹⁷²⁷

The test effectively provides, based on a table, that the lesser days spent in the UK, the more UK ties are required to be a UK tax resident.¹⁷²⁸ The sufficient ties test¹⁷²⁹ consists of a quantitative objective test that can be substantiated by a person's facts and circumstances.

Based on the above, the UK statutory residence test provides an objective and clear test that makes it easy for a person to determine their tax residence based on the days in and ties with the UK. Hardie¹⁷³⁰ criticises the test on the basis that it contains various challenges in interpreting its different concepts. He further states that the test is not a mere calculation of days but includes many components.¹⁷³¹ The number of days is considered strict, however, Hardie,¹⁷³² despite the criticism, considers the statutory resident test an improvement on the common-law approach of interpreting "ordinarily residence". Arendse, Stark and Renaud¹⁷³³ support the new statutory residence test as a practical approach that recognises the modern movement of

¹⁷²⁴ Paragraph 34 of Schedule 45 to the *Finance Act*.

¹⁷²⁵ Paragraph 35 of Schedule 45 to the *Finance Act*.

¹⁷²⁶ Paragraph 37 of Schedule 45 to the *Finance Act*.

¹⁷²⁷ Paragraph 38 of Schedule 45 to the *Finance Act*.

¹⁷²⁸ Paragraphs 18 and 19 of Schedule 45 to the *Finance Act* contain the tables that provide for the criteria in respect of the days in the UK and the ties.

¹⁷²⁹ The sufficient ties test bears similarities with the existing objective factors under the "ordinarily resident" test but without the subjective intention element.

¹⁷³⁰ Hardie *Analysis of the Expression "Ordinarily Resident"* 52.

¹⁷³¹ These include the concepts like a significant break, UK ties and what each one relates to, days spent, the place of work and days spent.

¹⁷³² Hardie *Analysis of the Expression "Ordinarily Resident"* 53.

¹⁷³³ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 20.

taxpayers and provides certainty to taxpayers and the revenue authority in decision-making.

Arendse, Stark and Renaud¹⁷³⁴ criticise the test on the basis that more detailed records to prove the number of days present in the UK, and clear guidance to understand each of the components of the test, are required. However, they further state that the benefit of certainty outweighs any burden of record-keeping.¹⁷³⁵ The test is a useful comparison in the review of the "ordinarily resident" test for South African tax purposes to design defined objective requirements and eliminate the subjective intention component. Such a change removes the uncertainty that currently exists in determining "ordinarily resident".

Since the statutory residence test was designed in the context of income tax, it also ties in with the UK domicile rules concerning the inheritance tax liability upon death. The jurisdictional basis for a non-UK domiciled person is discussed below.

5.2.3.3 Location of assets

Section 6(1) of the *Inheritance Tax Act* provides that property situated outside the UK is not subject to inheritance tax if the person who owns it or is beneficially entitled to it is domiciled outside the UK.¹⁷³⁶ Section 6(3) further excludes certain specific property from the tax base of a person who is not domiciled or deemed domiciled in the UK.¹⁷³⁷ This may lead to the result where a donor who is a UK resident, but not domiciled or deemed domiciled in the UK and donates assets situated outside the UK, to not be subject to inheritance tax.¹⁷³⁸

¹⁷³⁴ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 20.

¹⁷³⁵ Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 20.

¹⁷³⁶ Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 414, 417. See also Jestle *Inheritance Tax Regimes: A Comparison* 2-3 and Boadway, Chamberlain and Emmerson "Taxation of Wealth and Wealth Transfers" 743-744.

¹⁷³⁷ The exclusions under s 6(3) of the *Inheritance Tax Act* include for example war certificates, national savings certificates, and premium savings bonds.

¹⁷³⁸ Tee, Monte and Polley 2021 <https://www.mondaq.com/uk/tax-authorities/1023592/uk-inheritance-tax-reform-lessons-from-europe> and Weber-Frisch and Duquennois-Djoua 2014 *ERA Forum* 414.

5.2.4 Scope of property

The meaning of "estate" is widely defined to include the aggregate of all the property the deceased was beneficially entitled to,¹⁷³⁹ subject to certain exclusions.¹⁷⁴⁰ "Property" is defined to include any right or interest but excluding a settlement power.¹⁷⁴¹ Any property (excluding settled property¹⁷⁴²) over which the deceased had a "general power" which allowed them to dispose of it (if they were *sui iuris*),¹⁷⁴³ is regarded as property the deceased is beneficially entitled to and included in their estate.¹⁷⁴⁴ The *Inheritance Tax Act* further provides that, if any change in the value of the estate takes place as a result of a person's death, such change in value should be taken into account as if it took place before death.¹⁷⁴⁵

A life insurance policy is a specific asset when considering the problems identified under the *Estate Duty Act*. A life insurance policy taken out on the life of the deceased that is payable to the deceased estate upon their death is included as

¹⁷³⁹ The term "beneficially entitled to" for inheritance tax purposes refers to property a person owns either legally or beneficially by enjoying the income derived from it (see HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04441>).

¹⁷⁴⁰ Section 5(1) of the *Inheritance Tax Act*. The excluded property refers to an interest in possession in settled property under s 71A or s 71D or s 5(1A) of the *Inheritance Tax Act*, which mainly refers to property the deceased is not beneficially entitled to like property held in a discretionary trust. Settled property is held in a trust administered by trustees for the benefit of the beneficiaries, however, the trustees are liable for the inheritance tax liability on settled property (see HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm16050>).

¹⁷⁴¹ Section 272 of the *Inheritance Tax Act*. A "settlement power" is defined in s 47A of the *Inheritance Tax Act* and refers to "any power over, or exercisable (whether directly or indirectly) in relation to, settled property or a settlement". This refers to the power held by a trustee to administer the property held in trust for the benefit of its beneficiaries.

¹⁷⁴² Property held in a discretionary trust in which the deceased had no interest in possession (beneficial interest or entitlement) which is not included in the deceased's estate (see HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm04081>).

¹⁷⁴³ "Sui iuris" is defined to mean "having full legal rights or capacity" (see Webster 2022 https://www.merriam-webster.com/dictionary/sui%20juris#:~:text=%3A%20having%20full%20legal%20capacity%20to,Latin%2C%20of%20one%27s%20own%20right)).

¹⁷⁴⁴ Section 5(2) of the *Inheritance Tax Act*. This provision is like s 3(3)(d) of the *Estate Duty Act* that includes as deemed property any property the deceased was competent to dispose of immediately before death for their benefit or the benefit of their estate.

¹⁷⁴⁵ Section 171 of the *Inheritance Tax Act*, however, s 171(2) of the *Inheritance Tax Act* excludes alterations in the rights attached to unquoted shares or securities and the termination on the death of an interest or the passing of any interest by survivorship. See also Muller *Wealth Transfer Taxation* 278.

property in the deceased estate and is subject to inheritance tax at death.¹⁷⁴⁶ The value of the policy payable upon death is included in the estate. If the policy is not payable to the deceased estate but to a third party, the policy falls outside the estate and will not be chargeable upon death.¹⁷⁴⁷

A common approach to ensure the life insurance policy is not included in the taxable estate, is to put the life insurance policy "in trust".¹⁷⁴⁸ This means that the pay-out of the life insurance policy will be paid to a trust established by the deceased. The trustees of the trust will look after the policy on behalf of the beneficiaries of the trust (whom the deceased intended to benefit from the life policy). The policy will therefore not form part of the legal estate of the deceased and not be subject to inheritance tax.¹⁷⁴⁹ A life insurance policy that is written into a trust will have a similar effect as in South Africa, as it will reach the beneficiary in a much quicker way without having to pass through the estate and the executor's hands. In the UK it means it bypasses probate which is the legal process that the executor is responsible for to administer the deceased's estate.¹⁷⁵⁰ The one clear distinction from South Africa is that, when a life insurance policy is paid to a third party (and not the deceased estate) it is not subject to inheritance tax, whereas in South Africa it is included as deemed property in the estate and may be subject to estate duty.

The OTS, in its review of the inheritance tax system and specifically life insurance policies, found that most policies are not written in trust, which results in them being

¹⁷⁴⁶ Section 2 of the *Inheritance Tax Act*; HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm20012> and Wait 2021 <https://www.forbes.com/uk/advisor/life-insurance/inheritance-tax/>.

¹⁷⁴⁷ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm20012>; Wait 2021 <https://www.forbes.com/uk/advisor/life-insurance/inheritance-tax/>; Muller *Wealth Transfer Taxation* 278 and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 465.

¹⁷⁴⁸ Wait 2021 <https://www.forbes.com/uk/advisor/life-insurance/inheritance-tax/> and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 465.

¹⁷⁴⁹ Wait 2021 <https://www.forbes.com/uk/advisor/life-insurance/inheritance-tax/>; HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm20012> and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 465.

¹⁷⁵⁰ Wait 2021 <https://www.forbes.com/uk/advisor/life-insurance/inheritance-tax/>; HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm20012>; Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 465 and OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 52.

included in the deceased estate and potentially subject to inheritance tax.¹⁷⁵¹ However, it states that such policies are mostly covered by the spousal exemption or nil rate band which results in the life insurance policies not being subject to inheritance tax.¹⁷⁵² The OTS¹⁷⁵³ observed in this regard that, when there was a standard route to take where life insurance policies fall outside the deceased estate and not being subject to inheritance tax, then such an approach should be the default result for tax purposes without having to jump through hoops to obtain the benefit. The OTS,¹⁷⁵⁴ therefore, recommended that all death benefit payments from life insurance policies should be exempt from inheritance tax upon the death of the life assured without the need for them to be written in trust. However, no changes have been made so far in this regard due to the radical reform it would result in.

5.2.5 Valuations

Property is valued at the "market value" under the *Inheritance Tax Act*, subject to exceptions for business property and agricultural property enjoying more favourable treatment.¹⁷⁵⁵ The general rule provides that property should be valued at the "market value" which is the price the property is reasonably expected to obtain if sold in the open market at the time the property is transferred.¹⁷⁵⁶ However, should the whole property be placed on the market at the same time, it will not reduce the price.¹⁷⁵⁷ In determining the market value for unquoted shares,¹⁷⁵⁸ it is assumed that all available information that a prudent potential buyer might reasonably require to enter into a private agreement at market value with a seller is available to the potential buyer.¹⁷⁵⁹

¹⁷⁵¹ OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 53.

¹⁷⁵² OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 53.

¹⁷⁵³ OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 53.

¹⁷⁵⁴ OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 55.

¹⁷⁵⁵ Section 160 of the *Inheritance Tax Act* read with s 104 (business property) and s 116 (agricultural property). See also Muller *Wealth Transfer Taxation* 278.

¹⁷⁵⁶ Section 160 of the *Inheritance Tax Act*.

¹⁷⁵⁷ Section 160 of the *Inheritance Tax Act*.

¹⁷⁵⁸ Unquoted shares in the UK context are like unlisted shares in the South African context.

¹⁷⁵⁹ Section 168 of the *Inheritance Tax Act*. See also Muller *Wealth Transfer Taxation* 279.

Contractual exclusions or restrictions in respect of the right to dispose of a property shall be disregarded unless consideration in money or money's worth was given for it.¹⁷⁶⁰ The market value of all property owned by the deceased immediately before their death must be obtained for transfers at death.¹⁷⁶¹

The inheritance tax treatment of limited interests in the form of a *usufruct*, as well as the property (*bare dominium*) over which the *usufruct* exists, has changed over the years. The treatments differ depending on whether the limited interest was created on or after 22 March 2006.¹⁷⁶²

For limited interests created before 22 March 2006, the transfer of the *bare dominium* in a property is excluded from the tax base,¹⁷⁶³ subject to certain exclusions to counter tax avoidance. If the limited interest is created for inadequate consideration, it consists of a chargeable transfer which is valued based on the underlying property. The valuation does not take into account the fact that the interest holder may only enjoy the interest for a specific period.¹⁷⁶⁴ The termination of the limited interest is treated as a transfer of the underlying property between the interest holder and the next interest holder or the *bare dominium* holder.¹⁷⁶⁵ The transaction does not take place between the original owner and the next interest holder or *bare dominium* holder of the property so dissolved, but between the interest holders alone. This led to the inequitable result that the payment made by the *bare dominium* holder to the original owner of the property is not considered.¹⁷⁶⁶

¹⁷⁶⁰ Section 163(1) of the *Inheritance Tax Act*. The provision was designed to counter artificial arrangements. Other specific anti-avoidance arrangements are found in s 161 concerning "related property" and s 262 which provides that where property is delivered more than one year after the disposition, the market value of the property on its actual delivery date must be used. See para 5.2.9 below for more anti-avoidance measures.

¹⁷⁶¹ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm09704>.

¹⁷⁶² Sections 48, 49E(1) and (2) of the *Inheritance Tax Act*. See also Muller *Wealth Transfer Taxation* 305.

¹⁷⁶³ Section 48 of the *Inheritance Tax Act*. The transfer of a *bare dominium* is regarded as a "reversionary interest" as defined in s 272, read with s 47, of the *Inheritance Tax Act*.

¹⁷⁶⁴ Section 49E(1) of the *Inheritance Tax Act*.

¹⁷⁶⁵ Section 49E(2) of the *Inheritance Tax Act*.

¹⁷⁶⁶ Muller *Wealth Transfer Taxation* 305.

Example 3: Bare dominium holder¹⁷⁶⁷

Person A, who is UK-domiciled, owns property worth £2 million. Person A transfers the *bare dominium* in the property to his son (C), subject to a lifelong *usufruct* to his daughter (B). C paid £600 000 to person A for the *bare dominium*. Person A will be liable for inheritance tax on £2 million, which is the full value of the property, not taking into account the consideration received for the *bare dominium*. When B dies as the limited interest holder, her deceased estate will be liable for inheritance tax on the full value of the underlying property and not limited to the usufruct she enjoyed. Upon the death of C, his deceased estate will be liable for inheritance tax on the full value of the underlying property.

The position for limited interests created after 22 March 2006 is that the creation of a limited interest results in an immediate chargeable lifetime transfer, and the underlying property would be liable for periodic and exit charges.¹⁷⁶⁸ When the limited interest is terminated, no taxable event arises.¹⁷⁶⁹

5.2.6 Relief mechanisms

5.2.6.1 Nil rate band

Inheritance tax is payable at a zero rate if the aggregate value of the chargeable lifetime transfers and transfers at death is less than £325 000, also known as the "nil rate band".¹⁷⁷⁰ The nil rate band is to remain unchanged until April 2026.¹⁷⁷¹

¹⁷⁶⁷ This example is mainly taken from the example set out in Muller *Wealth Transfer Taxation* 305.

¹⁷⁶⁸ Section 49(1) of the *Inheritance Tax Act* provides that the limited interest holder is treated as the person who is beneficially entitled to the property in which the interest is held. However, for limited interests created after 22 March 2006, s 49(1) only applies if it is an immediate post-death interest. The effect of s 49 is that the limited interest holder is treated as the absolute owner of the property. See HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm16063>.

¹⁷⁶⁹ Section 49(1) of the *Inheritance Tax Act* includes the value of the current limited interest. Any interests in the future (reversionary interests) are generally excluded from an individual's estate on death by virtue (see s 48 of the *Inheritance Tax Act*).

¹⁷⁷⁰ Section 7 of the *Inheritance Tax Act*. The "nil rate band" is like the s 4A abatement of R3.5 million under the *Estate Duty Act* of South Africa.

¹⁷⁷¹ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 461. See also Jestle *Inheritance Tax Regimes: A Comparison* 4-5.

Any unused portion of the nil rate band on the death of the first-dying spouse can be transferred to the surviving spouse or civil partner (also known as the transferable nil rate band).¹⁷⁷² The unused portion of the nil rate band that passes to the surviving spouse does not require assets to be transferred to the surviving spouse upon the death of the first-dying spouse.¹⁷⁷³

5.2.6.2 Main residence nil rate band

An additional nil rate band was introduced in respect of individuals who died on or after 6 April 2017. The residence nil rate band is set at £175 000 and remains fixed until April 2026.¹⁷⁷⁴ The residence nil rate band is applicable when a person, upon death, bequeaths their home to their children or other direct descendants.¹⁷⁷⁵ The value of the residence nil rate band is limited to the value of the property that is bequeathed to the direct descendant and is solely applicable upon death and not on any lifetime transfers. The residence nil rate band is not a relief on the home itself, but reduces the total inheritance tax charge on death.¹⁷⁷⁶ The unused portion of the residence nil rate band can also be transferred to the estate of their spouse or civil partner.¹⁷⁷⁷ If the deceased person does not bequeath their main residence to a direct descendant or moves to a less valuable home, or into a nursing or care home, the residence nil rate band is still applicable if they leave other property to their direct descendants.¹⁷⁷⁸

¹⁷⁷² Sections 8A-C of the *Inheritance Tax Act*. The transferable nil rate band is like the portable spousal abatement under s 4A(2) under the *Estate Duty Act* in South Africa.

¹⁷⁷³ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm43002>. See also, APPG *Reform of Inheritance Tax* 8 where the APPG recommended that the nil rate band of £325,000 only applies to transfers at death and not in respect of lifetime (PET) transfers. The OTS also recommended a review of the application of the nil rate band to solely apply at death and make all lifetime transfers subject to inheritance tax in the hand of the estate, instead of the beneficiary (see OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 34-35).

¹⁷⁷⁴ The residence nil rate band was introduced from 6 April 2017 and increased annually by £25 000 until 2 April 2020, where it will remain fixed until April 2026. Ernst & Young *Worldwide Estate and Inheritance Tax Guide* 2023 461.

¹⁷⁷⁵ Section 8E of the *Inheritance Tax Act*.

¹⁷⁷⁶ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm46001>.

¹⁷⁷⁷ Section 8M of the *Inheritance Tax Act*.

¹⁷⁷⁸ Sections 8F-FA of the *Inheritance Tax Act*. The APPG recommended that the residence nil rate band be abolished in conjunction with the nil rate band being increased to £500,000 per person (see APPG *Reform of Inheritance Tax* 37). The OTS made various recommendations ranging

In addition to the nil rate band, various exemptions and deductions are available in calculating the inheritance tax liability that is set out below.

5.2.6.3 Exemptions

The exemptions in respect of inheritance tax are divided between those applicable to lifetime transfers¹⁷⁷⁹ and those applicable to both lifetime transfers and transfers upon death.¹⁷⁸⁰

5.2.6.3.1 Exemptions for lifetime transfers

The following exemptions only applies to lifetime transfers:¹⁷⁸¹

- (a) Small gifts up to £250 per donee per tax year;¹⁷⁸²
- (b) an annual exemption of up to £3 000 on chargeable transfers that can be carried forward for one year;¹⁷⁸³
- (c) gifts between £1 000 and £5 000 in respect of a marriage or civil partner (depending on who the donor is);¹⁷⁸⁴
- (d) payments for maintenance for family members;¹⁷⁸⁵ and

from abolishing the residence nil rate band to extending its application to all direct descendants (see OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 65-71). No similar relief is found in South Africa for estate duty purposes. South Africa does not have a similar exclusion for estate duty purposes on the deceased's main residence.

¹⁷⁷⁹ These exemptions are like the exemptions regarding the donations tax regime in South Africa.

¹⁷⁸⁰ The exemptions on transfers at death are like those regarding the estate duty regime in South Africa.

¹⁷⁸¹ Exemptions for lifetime transfers are like exemptions for donations tax purposes and are included here for completeness' sake.

¹⁷⁸² Section 20 of the *Inheritance Tax Act*. The APPG made a recommendation for the exemption to be abolished. See APPG *Reform of Inheritance Tax* 8.

¹⁷⁸³ Section 19 of the *Inheritance Tax Act*. The APPG and OTS made recommendations for the annual exemption to be abolished due to it being outdated, alternatively, it should be increased. See APPG *Reform of Inheritance Tax* 8 and OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 7.

¹⁷⁸⁴ Section 22 of the *Inheritance Tax Act*. The APPG made a recommendation for the exemption to be abolished. See APPG *Reform of Inheritance Tax* 8.

¹⁷⁸⁵ Section 11(1) of the *Inheritance Tax Act*. These include maintenance in respect of a spouse, a minor child, or children in full-time education. Like the exemption available under s 56(2)(c) of the *Income Tax Act* in respect of the maintenance of a family member.

- (e) normal expenditure incurred out of the donor's income that does not impact their standard of living.¹⁷⁸⁶

5.2.6.3.2 Exemptions for lifetime and death transfers

Various exemptions apply regarding a transfer of a specific asset or purpose, whether made during a person's life or upon death. Each will be set out below:

- (a) *Transfers between spouses or civil partners.*¹⁷⁸⁷ An unlimited exemption applies regarding transfers by a non-UK-domiciled spouse or civil partner to a UK-domiciled spouse or civil partner,¹⁷⁸⁸ or between two non-UK-domiciled spouses or civil partners.¹⁷⁸⁹ However, the exemption is limited to the nil rate band value of £325 000 on transfers by a UK-domiciled spouse or civil partner to a non-UK-domiciled spouse or civil partner.¹⁷⁹⁰ An unlimited exemption may apply regarding the transfer to a non-UK-domiciled spouse if such spouse elects to be treated as UK domiciled for inheritance tax purposes.¹⁷⁹¹ Such an election also results in the entire estate of the non-UK-domiciled spouse being included for inheritance tax purposes.¹⁷⁹²

¹⁷⁸⁶ Section 21 of the *Inheritance Tax Act*.

¹⁷⁸⁷ Section 18(1) of the *Inheritance Tax Act*.

¹⁷⁸⁸ Since 5 December 2005, same-sex couples enjoy the same exemptions and reliefs as married couples as they can register as civil partners under the *Civil Partnership Act*, 2004 and enjoy further rights under the *Marriage (Same-Sex Couples) Act*, 2013.

¹⁷⁸⁹ Section 18(1) of the *Inheritance Tax Act*. See Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 461 and HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm11033>. Both the OTS and APPG agreed that the spousal exemption should be retained with its limitation in respect of a transfer to a non-UK domiciled spouse or a life partner. See APPG *Reform of Inheritance Tax* 11 and OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 64. It was considered by the OTS to extend the exemption to cohabitation partnerships would be far-reaching. This is like the s 4(q) deduction under the *Estate Duty Act*; however, no limitation is in place regarding a bequest to a non-resident surviving spouse.

¹⁷⁹⁰ Section 18(2) of the *Inheritance Tax Act*. See Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 460 and HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm11033>.

¹⁷⁹¹ The election by the non-UK domiciled spouse to be treated as UK domiciled is only for inheritance tax purposes and does not apply for purposes of other tax types. The election is irrevocable unless the person ceases to be a UK tax resident for four consecutive tax years in which case the election ceases to have effect. The election may be made by the taxpayer during their lifetime or by the executor upon the death of the deceased.

¹⁷⁹² Section 18 of the *Inheritance Tax Act*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 460.

- (b) *Transfers to charities and favoured institutions.*¹⁷⁹³ An unlimited exemption applies regarding gifts or bequests made to certain charities,¹⁷⁹⁴ political parties,¹⁷⁹⁵ registered housing associations,¹⁷⁹⁶ national institutions,¹⁷⁹⁷ and gifts of property into the maintenance funds for historic buildings.¹⁷⁹⁸ In addition, where provision is made in a will for a charitable legacy where at least 10% of the net value of the deceased person's estate is left to a UK-registered charity, the inheritance tax rate applicable to such an estate is reduced by 10%, which will reduce the effective rate to 36%.¹⁷⁹⁹ The reduced rate will be automatically applied if the 10% condition is met, however, certain people, for example the executor of the deceased person, the beneficiary or trustees in respect of settled property, may opt out of the provision.¹⁸⁰⁰
- (c) *Transfers to heritage property.*¹⁸⁰¹ An exemption from inheritance tax applies regarding transfers of heritage property (including books, works of art, land or buildings of national, scientific, historic or scientific interest), where an undertaking is made to preserve the property with public access.¹⁸⁰² If the new owner does not honour the undertaking or sell the property,

¹⁷⁹³ Sections 23-27 of the *Inheritance Tax Act*.

¹⁷⁹⁴ Section 23 of the *Inheritance Tax Act*. The APPG and OTS agreed the exemptions available to charities and the reduced rate should be retained (see APPG *Reform of Inheritance Tax* 11 and OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 82). The charities are not limited to local charities but include charities established in the European Union and foreign jurisdictions (see Low Incomes Tax Reform Group 2023 <https://www.litr.org.uk/tax-guides/bereavement/what-reliefs-and-exemptions-are-there-inheritance-tax>).

¹⁷⁹⁵ Section 24 of the *Inheritance Tax Act*. A transfer to a UK political party is free from inheritance tax provided the party at the last general election had either at least two members of Parliament in the House of Commons or one member of Parliament and received at least 150 000 votes (see Low Incomes Tax Reform Group 2023 <https://www.litr.org.uk/tax-guides/bereavement/what-reliefs-and-exemptions-are-there-inheritance-tax>).

¹⁷⁹⁶ Section 24A of the *Inheritance Tax Act*.

¹⁷⁹⁷ Section 25 of the *Inheritance Tax Act*.

¹⁷⁹⁸ Section 27 of the *Inheritance Tax Act*.

¹⁷⁹⁹ Schedule 1A to the *Inheritance Tax Act*.

¹⁸⁰⁰ Paragraph 7 of Schedule 1A to the *Inheritance Tax Act*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide* 2023 459-460.

¹⁸⁰¹ Sections 30-35 of the *Inheritance Tax Act*.

¹⁸⁰² HMRC 2023 <https://www.gov.uk/guidance/tax-relief-for-national-heritage-assets>. Like the deduction under s 4(o) of the *Estate Duty Act*.

inheritance tax becomes payable by withdrawing the previously-allowed exemption. The qualifying assets are determined by the HMRC.¹⁸⁰³

- (d) *Gifts of agricultural or business property.*¹⁸⁰⁴ The relief from inheritance tax on business property reduces the value of a business or its assets when determining the related inheritance tax liability. A 100% exemption is available when the business property consists of the ownership or share of a business. A 50% exemption applies to shares controlling more than 50% of the voting rights in a listed company or land, buildings or machinery owned by the deceased and used in a business.¹⁸⁰⁵ Relief from inheritance tax on agricultural property applies to land or pasture that is used to grow crops or to rear animals. A 100% exemption applies where the person who owned the land farmed it themselves or in the case where someone else used the farmland on a short-term grazing licence.¹⁸⁰⁶ A 50% exemption applies in all other cases.¹⁸⁰⁷

The above exemptions apply without affecting the nil rate band.¹⁸⁰⁸

5.2.6.4 Quick succession relief

Where a person inherits assets and died within five years from inheriting, relief is available where a portion of the tax paid on the earlier death can be set off against the tax liability in respect of the latter death according to a sliding scale.¹⁸⁰⁹

¹⁸⁰³ HMRC 2023 <https://www.gov.uk/guidance/tax-relief-for-national-heritage-assets>.

¹⁸⁰⁴ Sections 116 and 104 of the *Inheritance Tax Act*. The exemption can be either 50% or 100% depending on the nature of the property. See Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 462.

¹⁸⁰⁵ HMRC 2023 <https://www.gov.uk/business-relief-inheritance-tax/what-qualifies-for-business-relief> and Low Incomes Tax Reform Group 2023 <https://www.litrg.org.uk/tax-guides/bereavement/what-reliefs-and-exemptions-are-there-inheritance-tax>.

¹⁸⁰⁶ HMRC 2023 <https://www.gov.uk/guidance/agricultural-relief-on-inheritance-tax>.

¹⁸⁰⁷ HMRC 2023 <https://www.gov.uk/guidance/agricultural-relief-on-inheritance-tax>.

¹⁸⁰⁸ In South Africa, the primary rebate under s 4A is also available in addition to the deductions under s 4 of the *Estate Duty Act*.

¹⁸⁰⁹ Sections 141-141A of the *Inheritance Tax Act*. The UK quick succession relief is like the rapid succession relief in South Africa under the First Schedule to the *Estate Duty Act*. The only difference is in the UK it is determined over five years and in South Africa it is over 10 years.

5.2.6.5 Deductions

The *Inheritance Tax Act* allows for the deduction of all liabilities that exist at the date of death.¹⁸¹⁰ The *Inheritance Tax Act* makes provision for two exceptions regarding expenses incurred after the date of death, namely reasonable funeral expenses¹⁸¹¹ and foreign administration expenses.¹⁸¹² Section 172 of the *Inheritance Tax Act* does not provide a specific list of the expenses that will qualify as reasonable funeral expenses but the general practice is to allow a deduction for the cost of a tombstone or gravestone.¹⁸¹³ In respect of foreign expenses, the deduction is limited to the lower of the additional foreign expenses or 5% of the value of the property situated outside the UK that is being administered or realised. The deduction only applies to additional expenses, for example, the excess expenditure above the cost incurred to deal with the property in the UK.¹⁸¹⁴

General costs incurred in administering the estate in the UK cannot be deducted as they are incurred after the date of death.¹⁸¹⁵ For inheritance tax purposes, a liability must be legally enforceable and is defined to mean a debt imposed by law or a debt for which consideration was received in money or money's worth.¹⁸¹⁶

The deduction allowed is the actual value of the liability, except in the case of debts that are payable at a future date where a discounted value is taken into account¹⁸¹⁷ and contingent tax liabilities.¹⁸¹⁸ A deduction is allowed on any inheritance tax liability

¹⁸¹⁰ Section 5(3) of the *Inheritance Tax Act*.

¹⁸¹¹ Section 172 of the *Inheritance Tax Act*.

¹⁸¹² Section 173 of the *Inheritance Tax Act*. See HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm27050>.

¹⁸¹³ HMRC 1987 <https://www.gov.uk/government/publications/statement-of-practice-7-1987/statement-of-practice-7-1987>.

¹⁸¹⁴ Like the approach taken under s 4(e) of the *Estate Duty Act*.

¹⁸¹⁵ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm28381>. This position is aligned with the position in South Africa that the estate duty liability is determined as at the date of death and only debts incurred as at the date of death should be allowed as a deduction against the estate and not debts that arise after the date of death. However, the *Estate Duty Act* does allow for administrative expenses incurred in the administration of an estate (see s 4(c) of the *Estate Duty Act*).

¹⁸¹⁶ Section 5(5) of the *Inheritance Tax Act*.

¹⁸¹⁷ Section 162(2) of the *Inheritance Tax Act*.

¹⁸¹⁸ Section 174 read with s 162(2) of the *Inheritance Tax Act*.

of the deceased person at the full amount whenever due.¹⁸¹⁹ A deduction is also allowed on the income tax and capital gains tax liabilities of the deceased up to the date of death even though it is only discharged after the date of death on the condition that it is paid by the deceased's estate.¹⁸²⁰

5.2.6.6 Double taxation relief

The *Inheritance Tax Act* makes provision for double taxation relief in one of two ways, namely through double tax agreements¹⁸²¹ entered into for wealth transfer taxes, or through the granting of a tax credit unilaterally regarding the wealth transfer tax paid for property on which inheritance tax is also payable.¹⁸²² The requirements to qualify for the unilateral relief is that both inheritance tax and a similar foreign tax must be chargeable on the same event (death or a lifetime gift) and attributable to the value of the same property.¹⁸²³ Section 159 of the *Inheritance Tax Act* does not provide a specific meaning for "foreign property" and is considered wide in its application based on the wording that the relief is available to "any property" as long as it is situated outside the UK. The emphasis is placed on the location of the property instead of the type of property and the unilateral credit limited to the value of the overseas tax is allowed for property situated in the foreign jurisdiction imposing the tax.¹⁸²⁴ In the case where the property is neither situated in the foreign jurisdiction nor the UK or, if situated in both the foreign jurisdiction and the UK, the relief is calculated according to a specific formula.¹⁸²⁵

¹⁸¹⁹ Section 162(3) of the *Inheritance Tax Act*.

¹⁸²⁰ Section 175A of the *Inheritance Tax Act*.

¹⁸²¹ The UK has an existing double taxation agreement with South Africa to cover lifetime transfers as well as transfers on death. See Muller *Wealth Transfer Taxation* 276.

¹⁸²² Sections 158 and 159 of the *Inheritance Tax Act*.

¹⁸²³ Section 159(1) of the *Inheritance Tax Act*. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm27185>. This position is aligned with the recommendation under para 4.2.7.2.1 to provide more clarity under s 16(c) of the *Estate Duty Act* to clarify the types of tax that may qualify for unilateral relief.

¹⁸²⁴ Section 159(2) of the *Inheritance Tax Act*. HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm27185>.

¹⁸²⁵ Section 159(3) of the *Inheritance Tax Act*. The formula is $A/(A + B) = C$, where A is the amount of inheritance tax payable, B is the amount of tax payable in the foreign jurisdiction and C is the smaller of A and B. This position is aligned with the recommendation under para 4.2.7.2.3.3 to s 16(c) of the *Estate Duty Act* to set out the formula to attribute the tax payable on the foreign property for more clarity in claiming unilateral relief.

If a double tax agreement is in place, the relief under the agreement will be applied.¹⁸²⁶ However, if no double tax agreement exists, unilateral relief will be applied under section 159(1) of the *Inheritance Tax Act* to ensure no double taxation arises regarding the same asset. If relief is available under the double tax agreement and unilaterally, whichever method provides the greater relief, will be applied.¹⁸²⁷

5.2.7 Rates

An inheritance tax rate of 20% applies to chargeable lifetime transfers.¹⁸²⁸ Potentially exempt transfers only become subject to inheritance tax if the transferor dies within seven years of making the transfer.¹⁸²⁹ If the transferor dies between three and seven years after making the chargeable transfer, a sliding scale applies. If a higher amount of inheritance tax becomes payable at death, any inheritance tax previously paid regarding the lifetime chargeable transfer is set off against the inheritance tax liability at death.¹⁸³⁰

Transfers on death are subject to inheritance tax at a rate of 40%.¹⁸³¹ Where at least 10% of the net value of the deceased person's estate is left to a UK-registered charity, the inheritance tax rate applicable to such an estate is reduced by 10%, which will reduce the effective rate to 36%.¹⁸³² Certain trusts are subject to

¹⁸²⁶ Section 158 of the *Inheritance Tax Act*.

¹⁸²⁷ Section 159(7) of the *Inheritance Tax Act*.

¹⁸²⁸ Section 7(2) of the *Inheritance Tax Act* read with Schedule 1 to the Act. Inheritance tax is levied on a cumulative basis in respect of all gifts made within the seven years before death together with the deemed transfer of the deceased's estate at death that do not qualify for exemptions or reliefs.

¹⁸²⁹ Section 7(4) of the *Inheritance Tax Act*.

¹⁸³⁰ Section 7(5) of the *Inheritance Tax Act*.

¹⁸³¹ Section 7(1) of the *Inheritance Tax Act* read with Schedule 1 to the Act. The APPG in its review of the inheritance tax system was of the view that the 40% flat rate is excessive and the reason for estate planning strategies. The OTS observed that large estates only pay effective rates of 10% due to reliefs and exemptions utilised by them and recommended a reform regarding the relief and reforms available. The APG recommended a reduced rate of 10% for estates with a value less than £2 million and 20% for estates with a value over £2 million (see APPG *Reform of Inheritance Tax* 11 and Tee, Monte and Polley 2021 <https://www.mondaq.com/uk/tax-authorities/1023592/uk-inheritance-tax-reform-lessons-from-europe>).

¹⁸³² Schedule 1A to the *Inheritance Tax Act*.

inheritance tax on a 10-yearly basis as well as when distributions are made to beneficiaries.¹⁸³³ The maximum rate applicable is 6% of the fund value.¹⁸³⁴

The following paragraphs will consider the various administrative provisions involved in administering a deceased estate in respect of the inheritance tax.

5.2.8 Administrative functions

5.2.8.1 Returns

In addition to the payment of the inheritance tax liability, Form IHT400¹⁸³⁵ (the inheritance tax return) must be submitted to the HMRC Capital Tax Offices within 12 months from the end of the month of death to account for the deceased's taxable estate.¹⁸³⁶ The submission of the inheritance tax return is usually done at the same time when applying for a grant of probate,¹⁸³⁷ provided the inheritance tax liability was settled within six months from the date of death.¹⁸³⁸ The submission of the inheritance tax return, together with the payment of the liability without waiting for the HMRC to issue an assessment, implies a self-assessed approach.¹⁸³⁹

5.2.8.2 Payment rules

The due date for the payment of an inheritance tax liability in respect of a lifetime transfer and a transfer on death differs. For lifetime transfers made between 6 April and 30 September of a tax year, it is due on 30 April of the following year, whereas

¹⁸³³ Section 64 of the *Inheritance Tax Act*.

¹⁸³⁴ Section 66 of the *Inheritance Tax Act*.

¹⁸³⁵ The form in which accounts must be submitted is prescribed under s 257 of the *Inheritance Tax Act*.

¹⁸³⁶ Section 216 read with s 256 of the *Inheritance Tax Act*.

¹⁸³⁷ The grant of probate where a will is in place is like the appointment of the executor by the Master of the High Court to allow the executor to administer the estate. See Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 471.

¹⁸³⁸ Section 226(2) of the *Inheritance Tax Act* provides that the personal representatives must pay all the tax for which they are liable on delivery of the IHT400 and may also pay the portion of the liability due by others if so requested. If the instalment option is available, only the portion of the deceased estate's liability which has then become due must be paid when submitting the IHT 400.

¹⁸³⁹ The self-assessed approach is aligned with the recommendation under para 4.2.9.3 above regarding estate duty in South Africa to expedite the administration of an estate and to enhance clarity in calculating the estate duty liability.

the inheritance tax payable on transfers made between 1 October and 5 April is due six months after the end of the month in which the chargeable transfer was made.¹⁸⁴⁰ The inheritance tax liability regarding chargeable transfers on death is due within six months after the end of the month in which the death occurred.¹⁸⁴¹ As a general rule, interest is payable on any unpaid inheritance tax from the day after the due date.¹⁸⁴² If tax is underpaid, interest is payable on the underpaid amount.¹⁸⁴³

The person liable for the inheritance tax liability regarding a lifetime transfer is either the transferor, the beneficiary, or the trustee in receipt of settled property.¹⁸⁴⁴ For chargeable transfers on death, it is the liability of the personal representative of the deceased estate.¹⁸⁴⁵

5.2.8.3 Penalties

The *Inheritance Tax Act* imposes certain obligations on taxpayers (the person committing the non-compliance) and provides for penalties to combat non-compliance when such obligations are not met or dealt with negligently or fraudulently. Penalties are imposed for various acts or omissions that might prevent the collection of inheritance tax properly due. Penalties are imposed under the following circumstances:

¹⁸⁴⁰ Section 226(1) of the *Inheritance Tax Act*. From 6 April 2014, the inheritance tax payment and filing dates for a trust are within six months of the transfer.

¹⁸⁴¹ Section 226(1) of the *Inheritance Tax Act*. If the payment is allowed in instalments, only the first instalment is due according to the due dates under s 226 of the *Inheritance Tax Act* (see s 227(3) of the *Inheritance Tax Act*). Instalment arrangements are an exception to the general rule and are only allowed if certain conditions are met specified under ss 227-229 of the *Inheritance Tax Act*. South Africa requires the estate duty liability to be settled within 12 months after the date of death if no assessment is issued by SARS within the first 12 months after death (see para 4.2.9.4 above and s 10(1) of the *Estate Duty Act*).

¹⁸⁴² Sections 233 and 236(1) of the *Inheritance Tax Act*.

¹⁸⁴³ Sections 233 and 240 of the *Inheritance Tax Act*. Interest is similarly payable on any unpaid estate duty in South Africa (see s 10(1) of the *Estate Duty Act*).

¹⁸⁴⁴ Section 199 of the *Inheritance Tax Act*.

¹⁸⁴⁵ Section 200 of the *Inheritance Tax Act*. There are exceptions to the general rule where a trustee may be held liable in respect of settled property in a trust or the beneficiary who is beneficially entitled to an interest in possession of a property. Estate duty in South Africa is similarly a transferor-based wealth transfer tax where it is predominantly payable by the executor, subject to certain exceptions.

- (a) An account is either delivered late or not delivered;¹⁸⁴⁶
- (b) an account, information or document is incorrect;¹⁸⁴⁷
- (c) the correction required for an error is not made within a reasonable time;¹⁸⁴⁸
and
- (d) a section 219A notice for information is not complied with.¹⁸⁴⁹

All the penalties are subject to the defence of a reasonable excuse,¹⁸⁵⁰ which may result in a reduced penalty, or a penalty being completely remitted.¹⁸⁵¹ In addition to penalty provisions to combat non-compliance,¹⁸⁵² specific anti-avoidance rules regarding inheritance tax which will be discussed below, are in place.

5.2.9 Anti-avoidance rules

5.2.9.1 Introduction

The HMRC has taken an approach against tax avoidance from the perspective that it is "bending the rules of the tax system to gain a tax advantage that Parliament never intended".¹⁸⁵³ The anti-avoidance rules aim to shape the behaviour and break the tendency of taxpayers to create avoidance schemes.¹⁸⁵⁴

¹⁸⁴⁶ Section 245 of the *Inheritance Tax Act*. No similar penalty exists in South Africa for estate duty.

¹⁸⁴⁷ Section 247 of the *Inheritance Tax Act*. This is similar to an understatement penalty under Chapter 16 of the *Tax Administration Act* that may apply to estate duty in South Africa if a substantial understatement was made.

¹⁸⁴⁸ Section 248 of the *Inheritance Tax Act*.

¹⁸⁴⁹ Section 245A(3) of the *Inheritance Tax Act*.

¹⁸⁵⁰ The *Inheritance Tax Act* does not contain a definition of what is meant by "reasonable excuse". The standard of reasonableness can vary from one case to the next and must be evaluated based on each case's merits. An excuse is generally considered reasonable only if circumstances are involved beyond the taxpayer's control (see HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm36061>).

¹⁸⁵¹ See s 253 of the *Inheritance Tax Act*. See also HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm36023>.

¹⁸⁵² The *Estate Duty Act* lacks detailed and extensive penalty provisions in respect of estate duty in South Africa.

¹⁸⁵³ HMRC 2022 <https://www.gov.uk/guidance/tax-avoidance-an-introduction>. See also Peng 2021 *Singapore Comparative Law Review* 135.

¹⁸⁵⁴ Peng 2021 *Singapore Comparative Law Review* 135-136.

5.2.9.2 Specific anti-avoidance rules

The HMRC has been relying on specific anti-avoidance rules and the common law to address tax avoidance schemes regarding all taxes, including inheritance tax. The *Inheritance Tax Act*, together with the *Finance Acts*, contain specific provisions to combat avoidance schemes for each tax year.¹⁸⁵⁵ Specific measures to combat avoidance of inheritance tax include gifts with a reservation of benefit (GWRB) rules¹⁸⁵⁶ and the pre-owned assets charge.¹⁸⁵⁷ GWRB refers to the transfer of a property to another person to exclude the property from the donor's estate while the donor continues to derive a benefit from the property.¹⁸⁵⁸ For example, a donor transfers a property to another person but continues to live in the property until his date of death. This will be regarded as a GWRB as the donor continued to enjoy a benefit after the donation was made, in which case the property will be included in the deceased estate at the date of death. In the absence of the GWRB provisions, such a property that was transferred while continuing to derive a benefit from it, would not constitute an asset of the deceased estate at the date of death.¹⁸⁵⁹

The pre-owned asset charge to income tax (POA) was introduced to combat schemes that were introduced in an attempt to avoid being a GWRB, although the same outcome was achieved by transferring a property while continuing to derive a benefit from it.¹⁸⁶⁰ The POA provides for a charge to income tax on benefits derived

¹⁸⁵⁵ Peng 2021 *Singapore Comparative Law Review* 135-136; the *Finance Act*, 2004; the *Finance Act*, 2013.

¹⁸⁵⁶ Introduced by s 102 of the *Finance Act*, 1986.

¹⁸⁵⁷ Introduced by the *Finance Act*, 2004.

¹⁸⁵⁸ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm14301>.

¹⁸⁵⁹ For more details on GWR, see HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm14301>. See also OTS *Inheritance Tax Review – Second report: Simplifying the Design of Inheritance Tax* 56.

¹⁸⁶⁰ OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 56-57; para 11(5)(a) to Schedule 15 of the *Finance Act*, 2004 and HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm44001>.

by the donor of the property.¹⁸⁶¹ The POA applies to land,¹⁸⁶² household and personal goods¹⁸⁶³ and intangible property.¹⁸⁶⁴

5.2.9.3 General anti-avoidance rules (GAAR)

Before the introduction of specific measures, the judicial approach was followed to deal with tax avoidance cases. The courts, in the absence of statutory avoidance rules, formulated the Ramsey principle, which requires the court to take a purposive approach to interpret legislation.¹⁸⁶⁵ The Ramsey principle provides that, where a taxpayer entered into a scheme containing a preordained series of transactions or a single composite transaction that included a step with no commercial purpose, such step or steps should be ignored for UK tax law purposes.¹⁸⁶⁶ In *Mayes v Revenue and Customs Commissioners*,¹⁸⁶⁷ a tax avoidance scheme entailed a seven-step route to create an artificial tax loss that was set off against other tax liabilities. However, the Ramsey principle could not be relied upon to defeat the scheme.¹⁸⁶⁸ The case emphasised the need for general anti-avoidance rules (GAAR), which would enable the HMRC to strike down the avoidance arrangement without relying on specific anti-avoidance rules. This led to the introduction in 2013 of GAAR that also applies to inheritance tax, under the *Finance Act, 2013*.¹⁸⁶⁹ The GAAR aims to target abusive tax arrangements.¹⁸⁷⁰

The GAAR takes effect after discovering a tax avoidance arrangement, which has been criticised for not changing a taxpayer's behaviour. Parliament responded by

¹⁸⁶¹ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm44001>.

¹⁸⁶² HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm44003>.

¹⁸⁶³ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm44006>.

¹⁸⁶⁴ HMRC 2023 <https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm44009>. The POA rule imposes an annual income tax charge on the value of the benefit but due to its complexity, the OTS recommended it may no longer be necessary considering the inheritance tax avoidance rules in place (see OTS *Inheritance Tax Review – Second Report: Simplifying the Design of Inheritance Tax* 56-58).

¹⁸⁶⁵ McLaughlin 2000 <https://www.taxationweb.co.uk/tax-articles/general/the-ramsay-principle.html>.

¹⁸⁶⁶ *Ramsey Ltd v IRC* 1982 AC 300 (HL). See also *Furniss v Dawson* 1984 AC 474.

¹⁸⁶⁷ 2011 EWCA Civ 407, 2011 STC 1269.

¹⁸⁶⁸ Peng 2021 *Singapore Comparative Law Review* 137.

¹⁸⁶⁹ HMRC *General Anti-Abuse Rule (GAAR) Guidance* B9; Peng 2021 *Singapore Comparative Law Review* 137 and ss 206-215 of the *Finance Act, 2013*.

¹⁸⁷⁰ HMRC *General Anti-Abuse Rule (GAAR) Guidance* B9-B11.

imposing penalties¹⁸⁷¹ to deter anti-avoidance schemes and introducing disclosure programmes.

5.2.9.4 Disclosure of tax avoidance schemes

In addition to the GAAR under the *Finance Act* and the specific anti-avoidance rules under the *Inheritance Tax Act*, in 2011, inheritance tax disclosure of tax avoidance schemes (DOTAS) rules were introduced.¹⁸⁷² The DOTAS rules were introduced and now form an essential part of the UK's legal framework to address inheritance tax avoidance schemes.¹⁸⁷³ The DOTAS rules enable the HMRC to identify tax avoidance schemes at an earlier stage, to understand how widely it is being applied, and to be proactive in closing down schemes or introducing new specific anti-avoidance rules to counter such schemes.¹⁸⁷⁴ The main feature of the DOTAS rules is to impose a statutory duty on specific persons¹⁸⁷⁵ to inform the HMRC about schemes that adhere to certain hallmarks.

The rules initially required any inheritance tax planning arrangement¹⁸⁷⁶ that was entered into specifically to create a tax advantage and therefore pay less inheritance tax, to be disclosed to the HMRC.¹⁸⁷⁷ However, from 1 April 2018, tighter rules and new conditions called inheritance tax hallmarks, apply.¹⁸⁷⁸

¹⁸⁷¹ A penalty is imposed on any person who enables another person to use an abusive tax avoidance arrangement that the HMRC later defeats. See s 16 of Schedule 16 to the *Finance Act (No.2)*, 2017 and Peng 2021 *Singapore Comparative Law Review* 138.

¹⁸⁷² Regulation 6(1) of the *Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations*, 2017 (the *Inheritance Tax Avoidance Schemes Regulations*), see HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>. See also RJP LLP 2018 <https://www.rjp.co.uk/new-anti-avoidance-rules-for-iht/>.

¹⁸⁷³ Sections 306-319 of the *Finance Act*, 2004 and Peng 2021 *Singapore Comparative Law Review* 137.

¹⁸⁷⁴ Peng 2021 *Singapore Comparative Law Review* 138.

¹⁸⁷⁵ Sections 307-310 of the *Finance Act*, 2004 include the promoter, users, and lawyers.

¹⁸⁷⁶ Section 318 of the *Finance Act*, 2004 includes any scheme, transaction, or series of transactions. See also HMRC 2022 <https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance/disclosure-of-tax-avoidance-schemes#the-tests-for-determining-an-IHT-scheme>.

¹⁸⁷⁷ In the South African context, "reportable arrangements" are provided for under ss 34-39 of the *Tax Administration Act*, however, the existing list of reportable arrangements under Item 2 in Public Notice 140 in GG 39650 of 3 February 2016 does not cater specifically for estate duty but is looked at from a broader income tax perspective.

¹⁸⁷⁸ RJP LLP 2018 <https://www.rjp.co.uk/new-anti-avoidance-rules-for-iht/>.

Arrangements for inheritance tax are notifiable under the DOTAS rules if such an arrangement is expected to provide an inheritance tax advantage as one of the main benefits of the arrangement which falls within an inheritance tax hallmark.¹⁸⁷⁹

As a general rule, the inheritance tax hallmark provides that an inheritance tax arrangement is notifiable (meaning, the HMRC must be notified thereof) if it is reasonably expected for an informed observer (who studied the arrangement) to conclude that two conditions will be met.¹⁸⁸⁰ An "informed observer" acts independently and possesses the required information and knowledge to understand the scheme and the applicable legislation involved. An informed observer is also assumed to be equipped to reach the conclusions that the inheritance tax hallmark requires.¹⁸⁸¹ The required information varies and depends on the nature of the arrangements, but includes, for example, the tax savings that are expected to arise from the arrangements; the ultimate effect and substance¹⁸⁸² of the arrangement, and any HMRC guidance that may apply. As mentioned above, for the arrangement to be notified as an inheritance tax hallmark, two conditions must be met of which both are discussed below.¹⁸⁸³

¹⁸⁷⁹ HMRC 2022 <https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance/disclosure-of-tax-avoidance-schemes#the-tests-for-determining-an-IHT-scheme>. An inheritance tax hallmark refers to the circumstances when an arrangement must be notified. Section 35 of the *Tax Administration Act* lists the "reportable arrangements" of which the Commissioner must be notified in South Africa, however, the arrangements listed are not specifically designed for estate duty but predominantly for income tax purposes.

¹⁸⁸⁰ Regulation 4(1) of the *Inheritance Tax Avoidance Schemes Regulations*. See HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made> and HMRC 2022 <https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance/disclosure-of-tax-avoidance-schemes#the-tests-for-determining-an-IHT-scheme>.

¹⁸⁸¹ See also HMRC 2022 <https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance/disclosure-of-tax-avoidance-schemes#the-tests-for-determining-an-IHT-scheme>. A "reportable arrangement" in South Africa must be reported by a "participant" who is either the person who obtains a tax benefit or the "promoter" who is principally responsible for organising, designing, and managing the arrangement (see s 34 of the *Tax Administration Act*).

¹⁸⁸² This refers to considering the substance of an arrangement over its form.

¹⁸⁸³ In addition to the specific inheritance tax hallmark, the confidentiality and premium fee hallmarks may also apply to inheritance tax schemes that result in an inheritance tax advantage, but for purposes of this study, the focus is placed on the specific inheritance tax hallmark (see HMRC 2022 <https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance/disclosure-of-tax-avoidance-schemes#the-tests-for-determining-an-IHT-scheme>).

Condition 1 refers to the main purpose¹⁸⁸⁴ of the arrangement, which must be to obtain an inheritance tax advantage regarding the specifically listed arrangements.¹⁸⁸⁵ A "tax advantage" under Condition 1 relates to the avoidance or reduction of inheritance tax in the following circumstances:¹⁸⁸⁶

- (a) When an asset is transferred into a property trust;¹⁸⁸⁷
- (b) a trust asset that is subject to the 10-year anniversary payment;¹⁸⁸⁸
- (c) a gifted asset subject to a reservation of benefits and not being subject to income tax;¹⁸⁸⁹ and
- (d) a reduction in a person's estate occurs without resulting in a chargeable transfer or PET.¹⁸⁹⁰

¹⁸⁸⁴ The main purpose of the arrangement should be to obtain the listed inheritance tax advantage. If a tax advantage only arises as a by-product of the arrangement, Condition 1 is not met.

¹⁸⁸⁵ Regulation 4(2) of the *Inheritance Tax Avoidance Schemes Regulations*, see HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>. See also RJP LLP 2018 <https://www.rjp.co.uk/new-anti-avoidance-rules-for-ih/> and HMRC 2022 <https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance/disclosure-of-tax-avoidance-schemes#the-tests-for-determining-an-IHT-scheme>. A "tax benefit" for a "reportable arrangement" in South Africa relates to the "avoidance, postponement, reduction or evasion of a liability for tax". See s 34 of the *Tax Administration Act*.

¹⁸⁸⁶ The list is compiled based on the highest risk as well as areas causing the greatest concern to the HMRC.

¹⁸⁸⁷ Regulation 4(2)(a) of the *Inheritance Tax Avoidance Schemes Regulations*. See HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>. This refers to the scheme where assets are transferred to a trust to peg the value of the donor's estate so that growth assets are transferred to a trust and are not included in the taxable estate at death. The main purpose is therefore to avoid or reduce the inheritance tax liability that would otherwise, apart from the trust arrangement, be payable.

¹⁸⁸⁸ Regulation 4(2)(b) of the *Inheritance Tax Avoidance Schemes Regulations*. See HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>.

¹⁸⁸⁹ Regulation 4(2)(c) of the *Inheritance Tax Avoidance Schemes Regulations*. See HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>. These arrangements seek to avoid inheritance tax where a gift is donated with the reservation of benefits (the donor continues to enjoy benefits post the donation being made) and there is no pre-owned asset income charge that would otherwise be payable.

¹⁸⁹⁰ Regulation 4(2)(d) of the *Inheritance Tax Avoidance Schemes Regulations*. See HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>. This refers to arrangements where an asset is removed from a person's estate without resulting in an inheritance tax liability.

Condition 2 is met when the inheritance tax arrangement involves one or more contrived or abnormal steps that a tax advantage is conditional upon.¹⁸⁹¹ It goes beyond ordinary tax planning but requires something more to gain the specific inheritance tax benefit. The arrangement must therefore involve abnormal or contrived steps that are required for a tax benefit. If abnormal or contrived steps are involved but not required to obtain the inheritance tax benefit, the condition is not met. For example, the use of a trust or a gift to a discretionary trust is not in itself abnormal or contrived, however, complex trust structures that include additional steps may be considered "contrived or abnormal" if the extent of the complexity seems unusual to go to such lengths or levels of complexity. Condition 2 will be met if such steps were required to obtain a tax benefit.¹⁸⁹² The application of Condition 2 must not be considered from an "uninformed observer's" point of view, who may consider the ordinary trust arrangement as abnormal or unusual, but should only be considered from an "informed observer's" point of view.¹⁸⁹³ As mentioned, only once both conditions are met does the arrangement become notifiable, otherwise, no declaration is required.¹⁸⁹⁴

Ordinary trust arrangements and loans to trustees of a trust or to shareholders of a company are not considered abnormal or contrived in their context. Also, the use of investment vehicles or assets that qualify for relief from inheritance tax under the *Inheritance Tax Act* is not contrived or abnormal. Therefore, normal inheritance tax planning making use of available structures and legislative provisions is not notifiable. Another useful benchmark is to consider whether the economic consequences of an arrangement are as expected. For example, when a gift is

¹⁸⁹¹ Regulation 4(3) of the *Inheritance Tax Avoidance Schemes Regulations*. See HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>.

¹⁸⁹² HMRC 2022 <https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance/disclosure-of-tax-avoidance-schemes#the-tests-for-determining-an-IHT-scheme>.

¹⁸⁹³ HMRC 2022 <https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance/disclosure-of-tax-avoidance-schemes#the-tests-for-determining-an-IHT-scheme>. See also RJP LLP 2018 <https://www.rjp.co.uk/new-anti-avoidance-rules-for-ih/>. The application of Condition 2 should specifically not be viewed from an "uninformed observer's" point of view.

¹⁸⁹⁴ Regulation 4(1) of the *Inheritance Tax Avoidance Schemes*. See HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>. See also RJP LLP 2018 <https://www.rjp.co.uk/new-anti-avoidance-rules-for-ih/>.

donated, the donor no longer enjoys any benefit to the donated property, however, if such beneficial entitlement continues, it may be a strong indicator that the scheme must be disclosed. Similarly, where an asset is transferred to a trust, the donor should no longer act or enjoy benefits as was the case when the donor owned the asset and, if such benefits continue, the scheme must be disclosed.¹⁸⁹⁵

The DOTAS rules exclude arrangements that consist of proposals for arrangements entered before 1 April 2018¹⁸⁹⁶ or similar arrangements.¹⁸⁹⁷ However, any proposal or arrangement must be evaluated against the inheritance tax hallmarks to determine if the HMRC should be notified.

Considering the above, the various measures and specific rules employed by the UK, if tailored for the South African context and adopted, may widen, and strengthen the anti-avoidance framework under the *Estate Duty Act*. South Africa does not impose a penalty on the designers or promoters of anti-avoidance schemes, and imposing a penalty on them may result in the relevant parties being held liable for the abuse of the estate duty system in South Africa and potentially deter them from continuously inventing new avoidance schemes. Furthermore, imposing a legal duty on certain people to disclose tax avoidance schemes may reduce the burden on the revenue authority to discover such schemes and to direct resources to reported schemes.

5.2.10 Conclusion

The UK inheritance tax system has endured many changes over the years that included a combined succession (recipient-based) and estate duty (transferor-based) system before 1949, followed by a transferor-only estate duty system up to

¹⁸⁹⁵ The scenario of a trust asset may potentially find application under section 3(3)(d) of the *Estate Duty Act* where the deceased could still benefit from the trust asset.

¹⁸⁹⁶ Excluded arrangements are referred to as "related arrangements" which are those entered before 1 April 2018 or when they were entered, they were aligned to established practices the HMRC had accepted. See Regulation 5(2) of the *Inheritance Tax Avoidance Schemes Regulations*. Section 36 of the *Tax Administration Act* lists the excluded arrangements from a South African point of view.

¹⁸⁹⁷ Regulation 5(1) of the *Inheritance Tax Avoidance Schemes Regulations*. See HMRC 2018 <https://www.legislation.gov.uk/ukxi/2017/1172/contents/made>.

1975 when it was replaced with a capital transfer tax, which was again replaced with an inheritance tax in 1986 which is still in force.¹⁸⁹⁸

The UK levies its wealth tax under a single act, called the *Inheritance Tax Act* in respect of both chargeable lifetime transfers and those upon death. The UK levies an estate tax upon death, although it is called an inheritance tax.¹⁸⁹⁹ The jurisdictional basis of inheritance tax is determined by the deceased person's domicile or deemed domicile, or the location of assets for non-residents.¹⁹⁰⁰

Various exemptions exist, including bequests to a spouse or civil partner or charity.¹⁹⁰¹ The scope of exemptions available is however wider than what is available in South Africa. Exemptions are divided into categories, namely those applicable to lifetime transfers only, those applicable to both lifetime transfers and transfers upon death, and those applicable to transfers on death only.¹⁹⁰² The majority of the exemptions apply to both lifetime transfers and transfers upon death, except for PET which may result in lifetime transfers not being subject to inheritance tax at all if made more than seven years before death.¹⁹⁰³ The UK also provides for an exempt threshold for inheritance tax, called the nil rate band, which is similar to the section 4A rebate in South Africa.¹⁹⁰⁴ An additional nil rate band in respect of a main residence is available if where it is bequeathed to direct descendants.¹⁹⁰⁵

The UK applies a different rate for lifetime transfers (at 20%) and for transfers upon death (at 40%), however, a credit system applies regarding the flat rate of 40% upon death, as any inheritance tax paid for a lifetime transfer is credited against the inheritance tax liability upon death.¹⁹⁰⁶

¹⁸⁹⁸ See para 5.2.1 above.

¹⁸⁹⁹ See para 5.2.2 above.

¹⁹⁰⁰ See para 5.2.3.2 and para 5.2.3.3 above.

¹⁹⁰¹ See paras 5.2.6.3 above.

¹⁹⁰² See paras 5.2.6.3.1 and 5.2.6.3.2 above.

¹⁹⁰³ See paras 5.2.6.3 and 5.2.7 above.

¹⁹⁰⁴ See para 5.2.6.1 above.

¹⁹⁰⁵ See para 5.2.6.2 above.

¹⁹⁰⁶ See para 5.2.7 above.

The UK has specific compliance requirements in respect of the payment of inheritance tax liabilities upon death and the submission of returns.¹⁹⁰⁷ The *Inheritance Tax Act* imposes certain penalties to combat non-compliance when certain obligations are not met or dealt with negligently or fraudulently.¹⁹⁰⁸ The legal framework for anti-avoidance schemes regarding inheritance tax includes general anti-avoidance rules to combat the abuse of inheritance tax, specific anti-avoidance rules to address specific avoidance schemes, and DOTAS rules to impose a legal duty on certain persons to disclose certain qualifying avoidance schemes to the HMRC.¹⁹⁰⁹

The first part of this chapter analysed the inheritance tax system of the UK. Aspects and characteristics of the UK system that will be relied on as a benchmark considering the problem areas under the *Estate Duty Act* in South Africa, will be highlighted under the conclusion to this chapter.¹⁹¹⁰ The second part of the chapter will analyse the estate tax system of the US.

5.3 Estate taxation in the United States

5.3.1 Historical development

The history of the United States (US) federal wealth transfer taxes has been a story of raising revenue instead of reforms.¹⁹¹¹ The US wealth transfer tax at death relates to the privilege of transferring property at death.¹⁹¹² The wealth transfer taxes upon death were introduced due to a pending war and were enacted and repealed three times.¹⁹¹³ It originated with a federal stamp tax¹⁹¹⁴ in 1797 on every will that offered

¹⁹⁰⁷ See paras 5.2.8.1 and 5.2.8.2 above.

¹⁹⁰⁸ See para 5.2.8.3 above.

¹⁹⁰⁹ See para 5.2.9 above.

¹⁹¹⁰ See para 5.4 below.

¹⁹¹¹ Thorndike 2016
<http://www.taxhistory.org/thp/readings.nsf/ArtWeb/F6769F770B0FC2898525803700432EE1?OpenDocument>.

¹⁹¹² Miller 2021 *Brigham Young University Law Review* 1417 and Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 118.

¹⁹¹³ Joulfaian *Estate and Gift Tax, Federal* 125.

¹⁹¹⁴ A stamp tax is a tax on the recording of legal documents like a will. See Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 118.

for a probate¹⁹¹⁵ when the property was transferred between generations. The tax only lasted for the duration of the undeclared war with France that ended in 1802, when the tax was repealed.¹⁹¹⁶ During the build-up to the Civil War, the *Revenue Act*, 1862 introduced an inheritance tax¹⁹¹⁷ on the transfer of personal assets and a succession tax on the transfer of real estate.¹⁹¹⁸ The rate of tax graduated between 1% and 6% depending on the beneficiary's relationship to the deceased person, irrespective of the bequest's value or the size of the estate.¹⁹¹⁹ Small estates below \$1 000 were exempt as well as bequests to the surviving spouse, however, bequests to charities were subject to inheritance tax at a rate of 5%.¹⁹²⁰ Once the war ended, the tax was repealed.¹⁹²¹ In 1898, in an attempt to raise revenue for the Spanish American War, a federal legacy tax was introduced and served as a forerunner to the current estate tax.¹⁹²² Bequests to a surviving spouse were exempt, as well as the first \$10 000 and applied graduated rates depending on the size of the estate and the relationship between the deceased and the beneficiary.¹⁹²³ However, once the war ended the tax was repealed.¹⁹²⁴

¹⁹¹⁵ Probate refers to the legal process whereby the executor is appointed to administer the deceased estate (Kagan 2023 <https://www.investopedia.com/terms/p/probate.asp>). This is like the administration of the estate process in South Africa that the executor is responsible for at the Master.

¹⁹¹⁶ Sparrow Capital Management 2019 <https://www.sparrowcapital.com/resource-center/estate/a-brief-history-of-estate-taxes#:~:text=Estate%20taxes%20returned%20during%20the,the%20rates%20for%20inheritance%20taxes.>

¹⁹¹⁷ An inheritance tax was levied on the beneficiary on the privilege of receiving property from the deceased person. See Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 118.

¹⁹¹⁸ Sections 124-150 of the *Internal Revenue Law*, 1864.

¹⁹¹⁹ Thorndike 2016 <http://www.taxhistory.org/thp/readings.nsf/ArtWeb/F6769F770B0FC2898525803700432EE1?OpenDocument>; Joulfaian *Estate and Gift Tax, Federal* 125 and Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 119.

¹⁹²⁰ Thorndike 2016 <http://www.taxhistory.org/thp/readings.nsf/ArtWeb/F6769F770B0FC2898525803700432EE1?OpenDocument> and Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 119

¹⁹²¹ Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 119; s 27 of the *Internal Taxes Customs Duties Act*, 1870; *Internal Revenue Act*, 1867 and s 36 of the *Customs Duties and Internal Revenue Taxes Act*, 1872.

¹⁹²² *War Revenue Act*, 1898.

¹⁹²³ *War Revenue Reduction Act*, 1901.

¹⁹²⁴ Section 7 of the *War Revenue Repeal Act*, 1902 and Sparrow Capital Management 2019 <https://www.sparrowcapital.com/resource-center/estate/a-brief-history-of-estate->

In 1916, a federal estate tax was revived to raise revenue through the *Revenue Act*, 1916. The estate tax was levied on the estate on the transfer of wealth from the estate to its beneficiaries. A \$50 000 exemption applied to all resident estates, whereas non-residents enjoyed no exemption regarding their property in the US and graduated tax rates applied.¹⁹²⁵

A tax on *inter vivos* gifts was introduced in 1932.¹⁹²⁶ The *Revenue Act*, 1935 introduced the optional valuation date election with a general rule for the valuation date at the date of death, however, the Act allowed for an alternative valuation date one year after death that was later amended to six months after the date of death.¹⁹²⁷ The *Revenue Act*, 1948 further introduced a deduction on bequests to a surviving spouse.¹⁹²⁸ The *Tax Reform Act*, 1976 created a unified estate and gift tax framework that provided for a single, graduated rate of tax on lifetime transfers as well as transfers upon death.¹⁹²⁹ The 1976 reform furthermore introduced a tax on generation-skipping transfer trusts.¹⁹³⁰

The *Economic Recovery Tax Act*, 1981 brought about various changes including unlimited deductions for spousal bequests and an increase in tax credits on gift and estate taxes.¹⁹³¹ The *Taxpayer Relief Act*, 1997 increased the unified exemption to \$345 800 and set the requirement to file an estate tax return at \$1 million and indexing thresholds and limitations for inflation.¹⁹³²

taxes#:~:text=Estate%20taxes%20returned%20during%20the,the%20rates%20for%20inhe
ritance%20taxes.

¹⁹²⁵ Thorndike 2016

<http://www.taxhistory.org/thp/readings.nsf/ArtWeb/F6769F770B0FC2898525803700432EE1?OpenDocument> and Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 120.

¹⁹²⁶ *Revenue Act*, 1932.

¹⁹²⁷ See Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 122.

¹⁹²⁸ The deduction was limited to 50% of the net value of the estate. See Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 122.

¹⁹²⁹ See Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 122.

¹⁹³⁰ The tax on generation-skipping transfer trusts arises when a transferor bequeaths property to beneficiaries two or more generations removed, in which case the skipped generation is taxed to curb the possible tax avoidance.

¹⁹³¹ See Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 123.

¹⁹³² Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 123. The position was further reinforced in the *Tax Cuts and Jobs Act*, 2017 that the exemption must be adjusted annually for inflation.

The *Economic Growth and Tax Relief Reconciliation Act*, 2001 introduced further changes of which the most significant was the eventual repeal of the estate tax. The estate threshold increased to \$3.5 million, and the repeal was scheduled to apply to persons who die from 2010 onwards whereafter the estate tax no longer applied.¹⁹³³

The estate tax was briefly repealed for a year in 2010 before the *Tax Relief, Unemployment Insurance Reauthorisation and Job Creation Act*, 2010 retroactively imposed the estate tax on any estates that were settled during the year it was repealed. The estate tax that was reinstated in 2011, was aligned to the 2001 tax laws status.¹⁹³⁴ In 2012 the estate tax became a permanent part of the *US Internal Revenue Code*, 1986 (the *Internal Revenue Code*) under Chapter 11.¹⁹³⁵

5.3.2 Overview of estate tax

The US functions under a federal legal system, and taxes are imposed on federal and state levels. Each state can determine a taxpayer's property rights and has the discretion to impose an inheritance or estate tax.¹⁹³⁶ On a federal level, wealth transfers are taxed through an estate tax, gift tax¹⁹³⁷ and generation-skipping transfer tax.¹⁹³⁸ The estate tax serves three objectives. First, to yield revenue,

¹⁹³³ Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 124.

¹⁹³⁴ Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 124.

¹⁹³⁵ IRS 2022 <https://www.irs.gov/privacy-disclosure/tax-code-regulations-and-official-guidance>. See also Legal Information Institute 2022 <https://www.law.cornell.edu/uscode/text/26/subtitle-B/chapter-11>).

¹⁹³⁶ Bornman *The Impact of Estate Duty and Capital Gains Tax* 53 and Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 59. A deduction is allowed against the federal estate tax liability for any state estate taxes paid (see s 2058 of the *Internal Revenue Code*).

¹⁹³⁷ A gift tax is imposed on US citizens and residents on the transfers of property, regardless of the property's location. The value of the transfers is determined based on the fair market value of the property at the date the gift was made. The gift tax is subject to an annual exclusion per donee that is indexed for inflation (\$17 000 for 2023) and the top rate is 40%. See also Chapter 12 of the *Internal Revenue Code*; Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 63 and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 474-475.

¹⁹³⁸ See Chapter 13 of the *Internal Revenue Code*; Thorpe *Is it Time to Abolish Estate Duty in South Africa?* 59 and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 475-476. Generation-skipping transfer tax was introduced in 1986 and is aimed at preventing the transfer of property to beneficiaries more than one generation removed (skip person) from the transferor. The tax is levied on direct transfers to such beneficiaries and trusts who have only skip persons as beneficiaries. The applicable tax rate is 40% and is subject to an exemption annually adjusted for inflation (\$10 million indexed for inflation from 2011, which is \$12.92

secondly, to be a backup for income tax and to reduce the erosion of the income tax base by catching the capital that bypassed income tax but is included in the deceased estate for estate tax purposes. Thirdly, the estate tax is imposed to reduce wealth concentration as it taxes the wealth owned by the wealthiest estates in society.¹⁹³⁹

The US levies an estate tax on the taxable estate¹⁹⁴⁰ of the deceased person valued at the date of death.¹⁹⁴¹ Tax residents that are US citizens that died after 31 December 2012, are subject to estate tax at a maximum marginal rate of 40%, subject to an estate tax exemption of \$10 million that is annually adjusted for inflation (which is \$12.92 million for 2023).¹⁹⁴² The same maximum rate applies to a non-resident, however, the estate tax exemption is limited to \$60 000 without any indexing for inflation.¹⁹⁴³ An estate tax liability is imposed on the worldwide property of all US citizens and residents, but only on US-sourced property in the case of a non-resident and non-US citizen.¹⁹⁴⁴

A unified estate and gift tax apply where the gift tax is levied on the transfer of the property at the time of the gift. The same top rate of 40% applies, subject to the \$10 million exemption, adjusted annually for inflation.¹⁹⁴⁵ The estate tax and gift tax

million for 2023) and is in addition to the unified gift and estate tax exemption. See also ss 2001(c) and 2010(c) of the *Internal Revenue Code*.

¹⁹³⁹ Joulfaian *Estate and Gift Tax, Federal* 125; Caron 2016 *Boston College Law Review* 823 and Soled 2020 *Florida State University Law Review* 649-650.

¹⁹⁴⁰ Section 2051 of Chapter 11 of the *Internal Revenue Code* provides that a taxable estate is determined by reducing the gross value of the estate with the available deductions (see s 2053 of Chapter 11 of the *Internal Revenue Code*).

¹⁹⁴¹ Section 2001(a) read with s 2031 of Chapter 11 of the *Internal Revenue Code*. An alternative evaluation date may be elected which will be six months after the date of death (see s 2032 of the *Internal Revenue Code*).

¹⁹⁴² Section 2001(c)(3) of the *Internal Revenue Code*; Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 477 and Miller 2021 *Brigham Young University Law Review* 1417. This is aligned with the recommendation in respect of the primary abatement to be indexed for inflation on an annual basis (see para 4.2.5 above).

¹⁹⁴³ IRS 2023 <https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax-for-nonresidents-not-citizens-of-the-united-states> and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 477. South Africa does not provide for different treatment for a non-resident, but similarly only applies a source basis to non-residents which may justify the limited relief.

¹⁹⁴⁴ Section 2001(a) read with s 2101 of Chapter 11 of the *Internal Revenue Code*. See also Rudnick and Gordon "Taxation of Wealth" 317.

¹⁹⁴⁵ Section 2001(c) of the *Internal Revenue Code*. The value of the exemption for 2023 is \$12.92 million. The same exemption does not apply to a non-resident, but they have an annual

are unified in that whatever portion of the exemption was applied regarding a lifetime gift, reduces the exemption available at death.¹⁹⁴⁶

Various exemptions and deductions apply for both residents and non-residents, however, the exemptions and deductions available to non-residents are limited in comparison to residents.¹⁹⁴⁷

Any property that is subject to estate tax will be valued at the fair market value as at the date of death.¹⁹⁴⁸ The focus of this study is on the US federal estate tax; however, many states have a state-level estate tax, in which case it will be allowed as a deduction in calculating the federal estate tax liability.¹⁹⁴⁹

The executor is the responsible party liable for the payment of the estate tax liability.¹⁹⁵⁰

The principles determining the tax base for the estate tax will be discussed below to consider the taxing event and the jurisdictional basis on which a person becomes subject to estate tax.

5.3.3 Tax base

5.3.3.1 Taxing event

The imposition of estate tax takes place upon the transfer of a deceased person's taxable estate at the date of death.¹⁹⁵¹ However, for valuation purposes, an

exclusion of \$17 000 in 2023). See also Josephson 2022 <https://smartasset.com/taxes/all-about-the-estate-tax>.

¹⁹⁴⁶ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 480.

¹⁹⁴⁷ See also s 2010(4) and (5) for the limitations on the spousal bequest to a non-residents spouse; Rudnick and Gordon "Taxation of Wealth" 317 and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 475. A similar position applies in respect of gifts to a resident spouse within an unlimited exemption in comparison to a gift to a non-resident spouse with an annual exemption of \$175 000 in 2023 and indexed for inflation). See also Burger Law Group P.C. 2021 <https://burnerlaw.com/leaving-assets-to-a-non-citizen-spouse/>.

¹⁹⁴⁸ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 482.

¹⁹⁴⁹ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 474.

¹⁹⁵⁰ Section 2002 of the *Internal Revenue Code*. There are instances where the executor is allowed to recover the estate tax that was paid on behalf of a beneficiary (see s 2016 of the *Internal Revenue Code*). See also Rudnick and Gordon "Taxation of Wealth" 316-317.

¹⁹⁵¹ Section 2001(a) of the *Internal Revenue Code*. Miller 2021 *Brigham Young University Law Review* 1417.

alternative date of six months from the date of death can be elected, provided certain requirements are met.¹⁹⁵² The gross value of the deceased estate, before any deductions are allowed, consists of the property owned by the deceased at death, as well as certain deemed property, for example, retained interests¹⁹⁵³ that may have been given away before death but is still treated as that of the deceased at the date of death. The latter property is also referred to as the "artificial gross estate".¹⁹⁵⁴

5.3.3.2 Jurisdictional basis

The levying of the federal estate tax is based on the worldwide assets of a person who is either a citizen of the US or a resident of the US by way of their domicile. For non-US residents, the estate tax is based on the location of the property (source rules) in the US.¹⁹⁵⁵

5.3.3.2.1 Domicile

The US imposes the estate tax on US citizens and US residents, however, the determination of residence for income tax and estate tax purposes is different.¹⁹⁵⁶ A resident for income tax purposes is determined based on either a physical presence test (referred to as the substantial presence test) or the green-card test.¹⁹⁵⁷ However, in contrast to income tax, a resident for estate tax purposes is based on a subjective inquiry as to the person's "domicile".¹⁹⁵⁸ A person's domicile is obtained by living permanently in a certain location and is determined based on the facts and

¹⁹⁵² Sections 2031 and 2032 of the *Internal Revenue Code*. See also Miller 2021 *Brigham Young University Law Review* 1418-1419 and para 5.3.5 below where the valuation rules are discussed in more detail.

¹⁹⁵³ See ss 2035-2041 of the *Internal Revenue Code*.

¹⁹⁵⁴ Section 2031 of the *Internal Revenue Code*; Miller 2021 *Brigham Young University Law Review* 1417-1418; Rudnick and Gordon "Taxation of Wealth" 323 and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 474. See also para 5.3.4 below.

¹⁹⁵⁵ Rudnick and Gordon "Taxation of Wealth" 323.

¹⁹⁵⁶ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 478 and Rudnick and Gordon "Taxation of Wealth" 324.

¹⁹⁵⁷ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 477-478 and Rudnick and Gordon "Taxation of Wealth" 324.

¹⁹⁵⁸ A person's domicile can either be a domicile of origin based on their country of birth or where their parents were domiciled, or a domicile of choice based on a person's strong connection with one country. See Rudnick and Gordon "Taxation of Wealth" 324.

circumstances of each case.¹⁹⁵⁹ A person can only have one "domicile" at a time and once it is obtained they must explicitly intend to leave their place of domicile for another for such a domicile to change.¹⁹⁶⁰ If uncertainty exists as to where a deceased person was domiciled, there is a rebuttable presumption that the deceased was domiciled in the country where they resided.¹⁹⁶¹

Various factors are taken into account when determining a person's domicile, for example, their immigration status, written statements of intention, time spent in the US in comparison to other countries, location of their business, family, social and religious ties and the location of their residence.¹⁹⁶² Each of the factors must be considered within the bigger picture of the deceased's circumstances and one factor on its own is not determinative.¹⁹⁶³

Special rules exist in respect of expatriates¹⁹⁶⁴ where the US, as the former country of domicile, retains the power to tax former residents who have changed their domicile.¹⁹⁶⁵ The US, therefore, retains its power to tax a person who has lost their US citizenship for tax avoidance purposes¹⁹⁶⁶ or ceased to be treated as a lawful permanent resident.¹⁹⁶⁷

¹⁹⁵⁹ IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004.

¹⁹⁶⁰ *Texas v Florida* 306 U.S. 398 (1939) and Ernst & Young *Worldwide Estate and Inheritance Tax Guide* 2023 477-478.

¹⁹⁶¹ IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004.

¹⁹⁶² Younger 2021 https://www.ey.com/en_uk/ey-frank-hirth/us-domicile-how-to-navigate-federal-and-state-rules.

¹⁹⁶³ *Texas v Florida* 306 U.S. 398 (1939); *Blodgett v Silberman* 277 U.S. 1 (1928); Younger 2021 https://www.ey.com/en_uk/ey-frank-hirth/us-domicile-how-to-navigate-federal-and-state-rules and Ernst & Young *Worldwide Estate and Inheritance Tax Guide* 2023 477-478. This has been established to pose a challenge in the case of death where a deceased cannot substantiate the position taken and a more factual test is supported.

¹⁹⁶⁴ An expatriate is regarded as a person who relinquished their US citizenship or ceases to be treated as a lawful permanent resident. See IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004.

¹⁹⁶⁵ See also Goldberg "Estate Tax Conflicts Resulting from a Change in Residence" 3.

¹⁹⁶⁶ Section 2107 of the *Internal Revenue Code*.

¹⁹⁶⁷ Section 877 of the *Internal Revenue Code*. A lawful permanent resident is defined as a U.S. green card holder who held a green card for at least eight out of the last 15 years from the year residency is terminated, see IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004. This refers to a tail provision that is also noted as a consideration for South African estate duty purposes and to serve as an anti-avoidance measure for persons who wish to manipulate their residence to save estate duty.

Special rules apply under section 2107 of the *Internal Revenue Code* to a deceased person (being a non-US citizen and non-US resident) who expatriated from the US before 17 June 2008 and within 10 years before death was subject to tax under section 877(b).¹⁹⁶⁸ The deceased will be treated as a non-resident for estate tax purposes, except that the deceased is also deemed to own and will be taxed on the share of their property of any foreign corporation situated in the US.¹⁹⁶⁹

5.3.3.2.2 Location of assets

A non-resident for tax purposes is a person who is not a US citizen and not a resident (by way of domicile) in the US.¹⁹⁷⁰ Non-residents are only subject to estate tax on their property situated in the US.¹⁹⁷¹

5.3.4 Scope of property

The gross value of an estate is determined at the time of death based on the value of all property, real or personal, tangible or intangible, wherever situated.¹⁹⁷² The gross value of the deceased estate is not limited to the property owned by the deceased person at the date of death, but also includes deemed property.¹⁹⁷³ The various types of property that constitute the gross value of the deceased estate include property owned at death; property transferred within three years before death; property transferred before death subject to a retained right of enjoyment; transfers subject to the survival of the beneficiary; revocable transferred property; annuities; joint interests; broad power of appointment held by the deceased, and life insurance policies. Each property referred to will be discussed separately below:

¹⁹⁶⁸ A Form 706-NA must be filed by the estate to report estate tax liability under IRC 2107 of the *Internal Revenue Code*. If a deceased person left the US more than 10 years before death, section 2107 of the *Internal Revenue Code* does not apply. See IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004.

¹⁹⁶⁹ The deceased must have directly or indirectly held 10% or more of voting stock, and with related interests, controlled more than 50% of the corporation. See IRS 2022 https://www.irs.gov/irm/part4/irm_04-025-004.

¹⁹⁷⁰ Section 2101 of the *Internal Revenue Code*.

¹⁹⁷¹ Section 2101 of the *Internal Revenue Code*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 478.

¹⁹⁷² Section 2031 of the *Internal Revenue Code*.

¹⁹⁷³ See ss 2035-2042 of the *Internal Revenue Code*.

- (a) *Property owned at death.*¹⁹⁷⁴ Property, including "interest in property"¹⁹⁷⁵ are referred to as the "actual" gross estate of the deceased.¹⁹⁷⁶ Examples include a partial interest held in a property, any right to income (rent, interest or a share in profits), which accrued to the deceased before death,¹⁹⁷⁷ as well as any interest in community property held by the deceased.¹⁹⁷⁸ The remaining property discussed below is deemed property that was not owned by the deceased at the date of death but is treated as such.
- (b) *Property transferred within the three years before death.*¹⁹⁷⁹ Excluded are those properties that were transferred for full and adequate consideration in money's worth. For example, property that was transferred while the donor retained the right to the income of the transferred property,¹⁹⁸⁰ or property in which the transfer was conditional upon the survival of the beneficiary while the deceased retained a reversionary interest in the property.¹⁹⁸¹ It also includes an interest in property subject to the deceased's power to alter, amend, revoke, or terminate the transfer,¹⁹⁸² as well as the proceeds of an insurance policy under certain circumstances.¹⁹⁸³ Ultimately, the test under section 2035 is whether the interest in the property would have been included in the deceased estate under sections 2036, 2037, 2038 or 2042, but for the transfer that has taken place during the three years

¹⁹⁷⁴ Section 2033 of the *Internal Revenue Code*.

¹⁹⁷⁵ *Smith v Shaughnessy* 318 US 176 (1943) explain the meaning of property to go beyond the property itself but also includes the interest in the property. "Interest" in property refers to the beneficial interest in the property. See s 2033 (1)(b) of the *Internal Revenue Code*.

¹⁹⁷⁶ Miller 2021 *Brigham Young University Law Review* 1421-1422.

¹⁹⁷⁷ Section 2033 of the *Internal Revenue Code*.

¹⁹⁷⁸ Community property is where spouses have an equal interest in the property. Only the deceased's half of the property is included in the deceased estate and not the half of the surviving spouse. However, the value of the surviving spouse's interest in the community property is adjusted to the fair market value at the date of the deceased's death, even though it is not included in the taxable estate of the deceased (see s 1014(b)(6) of the *Internal Revenue Code*).

¹⁹⁷⁹ Section 2035(a) of the *Internal Revenue Code*. Only certain interest in a property is included under s 2035 if they would have been included under ss 2036, 2037, 2038 or 2042 if the transfer shortly before death did not occur.

¹⁹⁸⁰ Section 2036 of the *Internal Revenue Code*.

¹⁹⁸¹ Section 2037 of the *Internal Revenue Code*.

¹⁹⁸² Section 2038 of the *Internal Revenue Code*.

¹⁹⁸³ Section 2042 of the *Internal Revenue Code*.

before death. If it is the case, section 2305 applies. For example, if person A transferred property to person B, but retained the right to the income of the property for the rest of person A's life, the remaining interest is included as property under section 2036 in person A's estate. However, if person A was to give away the interest within the three years before death, no property is included under section 2036 as no interest remained at death. However, section 2035 would include the remaining interest in person A's estate. If it was not for the transfer, the interest in the property would have been included under section 2036.¹⁹⁸⁴ An additional inclusion under section 2035 is to include any gift tax paid by the deceased during the three years before the deceased's date of death.¹⁹⁸⁵

- (c) *Transfers with a retained life estate.*¹⁹⁸⁶ This includes interests in property that were transferred by the deceased over which they retained an economic benefit for a period. For example, person A transfers property to a trust, subject to the condition that all trust income must be paid to person A for five years, whereafter the trust must be terminated and the property of the trust must be distributed to person B. However, if person A dies within the five years, such property is included in person A's estate as person A retained an interest (income) for a specific period (five years that did not prescribe before person A's death). If person A lived beyond the five years, there would have been no inclusion in person A's estate.¹⁹⁸⁷

¹⁹⁸⁴ Section 2035 is considered to close a gap between lifetime transfers and property at death. See Miller 2021 *Brigham Young University Law Review* 1423-1424.

¹⁹⁸⁵ Section 2035(b) of the *Internal Revenue Code*. The provision also includes into the gross estate any gift tax paid by the spouse (irrespective of the matrimonial property system applicable) during the three years before the deceased's death. This serves as an avoidance measure and equalises the effect of any giving during life in comparison to a gift at death. See also Miller 2021 *Brigham Young University Law Review* 1425.

¹⁹⁸⁶ Section 2036(a) of the *Internal Revenue Code*. The value of the gross estate shall include the value of all property to the extent the deceased has at any time made a transfer where the deceased retained for their life or any period concerning their death the income from the property or enjoyed the right to appoint beneficiaries to the property or its income.

¹⁹⁸⁷ See also Miller 2021 *Brigham Young University Law Review* 1425.

- (d) *Transfers taking place at death.*¹⁹⁸⁸ The transfer of the interest in the property is conditional upon the beneficiary surviving the deceased and the deceased retaining a reversionary interest¹⁹⁸⁹ in the property.¹⁹⁹⁰ For example, person A transferred property into a trust with person B as the income beneficiary for life and if person B dies, person A becomes the income beneficiary or, if person A no longer lives by the time of person B's death, person C or their estate will be the beneficiary. Person C will therefore only obtain possession or enjoyment of the property by surviving person A. If the value of person A's reversionary interest exceeds 5% of the value of the property transferred, the property will be included in person A's estate.¹⁹⁹¹
- (e) *Revocable transfers.*¹⁹⁹² The transfer of the property during the deceased's lifetime remains subject to the deceased's power to alter, amend, revoke, or terminate the transfer. The principle behind the provision is that, if the deceased retain the power to revoke or terminate the transfer, the deceased retained the ownership of the property.¹⁹⁹³
- (f) *Certain annuities.*¹⁹⁹⁴ The value of an annuity receivable by any beneficiary who survives the deceased under any form of contract or agreement is included in the estate, provided such annuity was payable to the deceased for his life or for a period concerning his death.¹⁹⁹⁵ The inclusion only relates

¹⁹⁸⁸ Section 2037 of the *Internal Revenue Code*.

¹⁹⁸⁹ A reversionary interest includes the return of the property into the deceased's estate and includes the property being "subject to a power of disposition by him." See s 2037(b) of the *Internal Revenue Code*.

¹⁹⁹⁰ The value of the reversionary immediately before death must exceed 5% of the value of the property. Section 2307(b) of the *Internal Revenue Code*.

¹⁹⁹¹ Since there is no certainty that person C will possess the property, the transfer of the reversionary interest remains incomplete until person A's death. See Miller 2021 *Brigham Young University Law Review* 1428.

¹⁹⁹² Section 2038 of the *Internal Revenue Code*.

¹⁹⁹³ Section 2038(a)(1) of the *Internal Revenue Code*. See also Miller 2021 *Brigham Young University Law Review* 1428.

¹⁹⁹⁴ Section 2039 of the *Internal Revenue Code*.

¹⁹⁹⁵ Section 2039(a) of the *Internal Revenue Code*.

to that part of the annuity that is proportionate to the purchase price that was contributed by the deceased.¹⁹⁹⁶

- (g) *Joint interests.*¹⁹⁹⁷ The value of any joint interest held in a property where the co-owner has the right of survivorship is included in the gross estate.¹⁹⁹⁸ However, if the joint ownership was acquired through a gift, inheritance, or bequest, only the deceased's share of the property is included in their gross estate. In all other cases, the value of the joint interest that is attributable to consideration in money's worth provided by the other owners, is excluded. Therefore, only the portion of the purchase price contributed by the deceased is included in the gross estate.¹⁹⁹⁹
- (h) *Broad power of appointment held by the deceased person.*²⁰⁰⁰ Any property over which the deceased held the power of appointment, which entails the power to decide who receives the property even though such person (the deceased) does not own the property.²⁰⁰¹
- (i) *Certain life insurance policies.*²⁰⁰² A life policy receivable by the executor of the estate is included in the gross value of the estate.²⁰⁰³ The value of the life policy that exceeds the estate tax exemption will be subject to estate tax.²⁰⁰⁴ If the proceeds of the life policy taken out on the life of the deceased are receivable by a third party, incidents of ownership²⁰⁰⁵ will determine

¹⁹⁹⁶ Section 2039(b) of the *Internal Revenue Code*.

¹⁹⁹⁷ Section 2040 of the *Internal Revenue Code*.

¹⁹⁹⁸ Section 2040(a) of the *Internal Revenue Code*.

¹⁹⁹⁹ Section 2040(a)-(c) of the *Internal Revenue Code*. Section 2040(b) provides that where spouses are co-tenants, only one-half of the value of the joint interest is included in the gross estate of the deceased. See Miller 2021 *Brigham Young University Law Review* 1432.

²⁰⁰⁰ Section 2041 of the *Internal Revenue Code*.

²⁰⁰¹ The power of appointment, therefore, belongs to someone other than the owner and is therefore not considered as an interest in property to fall within s 2033 of the *Internal Revenue Code*, see also s 2041(b) of the *Internal Revenue Code*.

²⁰⁰² Section 2042 of the *Internal Revenue Code*.

²⁰⁰³ Section 2042(1) of the *Internal Revenue Code*. This also deals with the situation where the owner of the life insurance policy is also the person insured by the policy. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 484-485 and Rudnick and Gordon "Taxation of Wealth" 328.

²⁰⁰⁴ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 484-485.

²⁰⁰⁵ The term "incidents of ownership" is defined to include the right of the insured or their estate to the economic benefits of the life insurance policy. Such benefits include the power to change

whether the policy is subject to estate tax.²⁰⁰⁶ If the deceased possessed the incidents of ownership, including a reversionary interest²⁰⁰⁷ of more than 5% of the value of the policy before the death of the deceased, the amount will be included in the estate.²⁰⁰⁸ If no incidents of ownership vest in the deceased, or where a life insurance trust²⁰⁰⁹ owns the policy on the life of the insured, no estate tax will be applicable.²⁰¹⁰ The proceeds from a life insurance policy are not regarded as an asset situated in the US with regards to a non-resident and are therefore not included in the deceased estate and not subject to estate tax.²⁰¹¹

The above retained interest rules are also applicable to the estate of a non-resident, however, limited to property situated in the US.²⁰¹²

As can be seen from the above, the scope of property included in the deceased estate is wide, but the amount that will be subject to estate tax is calculated on the

beneficiaries; cancel or surrender the policy; borrow an amount against the policy; the power to assign the policy or revoke such assignment (see s 2042(c)(2)-(3) of the *Internal Revenue Code*).

²⁰⁰⁶ Section 2042(2) of the *Internal Revenue Code*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 484-485 and Rudnick and Gordon "Taxation of Wealth" 328.

²⁰⁰⁷ A "reversionary interest" includes the possibility that the policy, or the proceeds of the policy, may revert to the deceased or their estate, or fall within the power of disposition exercisable by the deceased. See s 2042(2) of the *Internal Revenue Code*.

²⁰⁰⁸ Section 2042(2) of the *Internal Revenue Code*.

²⁰⁰⁹ A life insurance trust is an irrevocable trust that is set up where a life insurance policy is the asset of the trust which results in the policy not forming part of the donor's estate for estate tax purposes. As soon as the policy is placed in the trust, the insured no longer owns the policy as it will be managed by the trustee on behalf of the beneficiaries of the policy when the insured person dies. See Kagan 2023 https://www.investopedia.com/terms/i/insurance_trust.asp.

²⁰¹⁰ Lowndes *Tax Avoidance and the Federal Estate Tax* 323-325. The irrevocable life insurance trust purchases the policy on the life of an individual (the deceased) without the insured having any incident of ownership to the policy. The policy is irrevocable, it cannot be rescinded, amended, or modified as the trust is irrevocable which means that once the donor established the life insurance trust, the donor cannot change the terms of the policy or reclaim it. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 484-485; Kagan 2023 https://www.investopedia.com/terms/i/insurance_trust.asp and Miller 2021 *Brigham Young University Law Review* 1435-1436.

²⁰¹¹ Section 2105(a) of the *Internal Revenue Code*. South Africa does not make such a distinction and if a non-resident takes out a "domestic policy", it will be included as a deemed asset for estate duty purposes.

²⁰¹² Section 2103 read with s 2130 of the *Internal Revenue Code*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 474.

value of the taxable estate (gross value less allowable deductions).²⁰¹³ The following part discusses the valuation rules for estate tax purposes.

5.3.5 Valuations

The value of the deceased's gross estate is determined at the date of death. The general rule is to make use of the fair market value of the asset at the date of death.²⁰¹⁴ The fair market value is known to be the value voluntarily obtainable between a willing buyer and a willing seller. The value cannot be determined by a forced sale.²⁰¹⁵

An exception regarding the time (date of death) and the method (fair market value) exists under section 2032 of the *Internal Revenue Code*. The alternative date and method are not automatic, but may only apply if the executor makes a timely election on the estate tax return for an alternative valuation date if an asset is not distributed, sold, exchanged, or disposed of within six months after the date of death.²⁰¹⁶ The alternative valuation date will then be six months after the date of death and the value on that date applies.²⁰¹⁷ The election is subject to the requirements that it will decrease the value of the gross estate, and the sum of the estate tax imposed.²⁰¹⁸ Such an election is irrevocable once it is made.²⁰¹⁹

If no election is made, the default valuation date is the date of death and the fair market value on that date applies.²⁰²⁰

²⁰¹³ Section 2051 of the *Internal Revenue Code*.

²⁰¹⁴ Section 2031 of the *Internal Revenue Code*. See also Miller 2021 *Brigham Young University Law Review* 1418; Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 482 and Rudnick and Gordon "Taxation of Wealth" 330.

²⁰¹⁵ Section 2031(b) of the *Internal Revenue Code*. See also Miller 2021 *Brigham Young University Law Review* 1418 and Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 482.

²⁰¹⁶ Section 2032(d) of the *Internal Revenue Code*. See also Rudnick and Gordon "Taxation of Wealth" 330.

²⁰¹⁷ Section 2032(a)(1)-(2) of the *Internal Revenue Code*. See also Miller 2021 *Brigham Young University Law Review* 1419.

²⁰¹⁸ Section 2032(c) of the *Internal Revenue Code*.

²⁰¹⁹ Section 2032(d)(1) of the *Internal Revenue Code*.

²⁰²⁰ Section 2032(a)(3) of the *Internal Revenue Code*.

The following section will discuss the various relief mechanisms available under the estate tax regime.

5.3.6 Relief mechanisms

5.3.6.1 Estate tax exemption

The estate tax exemption for US citizens and residents is \$12.92 million (as adjusted annually for inflation).²⁰²¹ The estate tax exemption is unified with the gift tax exemption, because when lifetime transfers exceed the annual exemption for gift tax (currently at \$17 000), the excess value reduces the estate tax exemption upon death.²⁰²²

Example 4: Death in 2023 and no lifetime gifts

Person A dies in 2023 with a gross estate value of \$15 million. The allowable deductions amount to \$1 million which results in a net estate value of \$14 million. There were no lifetime gifts. The taxable estate value is \$14 million (net estate value) less \$12.92 million (estate tax exemption), which equals \$1.08 million (taxable estate value). The estate tax liability at 40% amounts to \$432 000.²⁰²³

Example 5: Death in 2023 and no lifetime gifts

Person A dies in 2023 with a gross estate value of \$8 million. The allowable deductions amount to \$1 million which results in a net estate value of \$7 million. There were no lifetime gifts. The taxable estate value is \$7 million (net estate value) less \$12.92 million (estate tax exemption), which equals (\$5.92 million). Since the estate tax exemption is \$5.92 million more than the net value, no estate tax is due.

²⁰²¹ Section 2010(3)(C) of the *Internal Revenue Code*. For 2022 the amount was \$12 060 000, see also IRS 2023 <https://www.irs.gov/za/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2023>.

²⁰²² Section 2010 of the *Internal Revenue Code*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 481 and Miller 2021 *Brigham Young University Law Review* 1445-1447.

²⁰²³ \$1.08 million x 40%.

Example 6: Death in 2023 and lifetime gifts

Person A dies in 2023 with a gross estate value of \$15 million. The allowable deductions amount to \$3 million which results in a net estate value of \$12 million. Person A made lifetime gifts worth \$4.5 million, which results in taxable gifts of \$4 483 000.²⁰²⁴ The estate tax exemption is reduced by the taxable gifts (\$12 920 000 less \$4 483 000 equals \$8 437 000). The taxable estate value is \$12 million (net estate value) less \$8 437 000 (estate tax exemption), which equals \$3 563 000 (taxable estate value). The estate tax liability at 40% amounts to \$1 425 200.²⁰²⁵

5.3.6.2 Portable estate tax exemption

If there is a predeceased spouse, any unused portion of such spouse's estate tax exemption may be carried over to the second-dying spouse's estate.²⁰²⁶ The portable exemption is only available provided the executor of the first-dying spouse filed an estate tax return and did not elect out of the portability of the deceased spouse's unused exemption (also referred to as the portability election).²⁰²⁷ When a person has more than one predeceased spouse, the portable exemption is calculated based on the last deceased spouse.²⁰²⁸

Example 7: Portable exemption, no lifetime gifts

Person A dies in 2023 with an estate value of \$15 million and leaves property to her surviving spouse (B) to the value of \$8 million. There were no lifetime gifts by person A, and no other deductions were allowed. Due to the spousal deduction, the net value of person A's estate is \$7 million.²⁰²⁹ Therefore, \$7 million of the estate tax exemption available to person A is used in their estate. Provided the executor who oversees person

²⁰²⁴ \$4 500 000 less \$17 000.

²⁰²⁵ \$3 563 000 x 40%.

²⁰²⁶ Section 2010(C)(4) of the *Internal Revenue Code*. Like the portable spousal abatement under s 4A(2) of the *Estate Duty Act* in South Africa.

²⁰²⁷ Section 2010(C)(5)(A) of the *Internal Revenue Code*. The law assumes that if no affirmative statement is made regarding the portability, it still applies, therefore only an explicit election for it not to apply will make it inoperable. See also Miller 2021 *Brigham Young University Law Review* 1448.

²⁰²⁸ Section 2010(C)(4)(B)(i) of the *Internal Revenue Code*.

²⁰²⁹ \$15 million less \$8 million.

A's estate does not elect out of the portability of the unused exemption, B will have an estate tax exemption available of \$12.92 million plus the unused portion from person A's estate of \$5.92 million (\$12.92 million less \$7 million), that equals \$18.84 million.

Example 8: Portable exemption, lifetime gifts

Person A made taxable lifetime gifts of \$7 million and has a net estate of \$2 million when she dies in 2023.²⁰³⁰ Her executor elects portability. The available deceased spouse's unused exemption to the surviving spouse (B) is \$12.92 million reduced by \$7 million (taxable gifts) and \$2 million (estate tax exemption) which amounts to \$3.92 million. The total estate tax exemption to B's estate is \$16.84 million (\$12.92 million plus \$3.92 million).

5.3.6.3 Estate tax exemption for non-residents

The same estate tax exemption does not apply to the estate of a non-resident, as in such instance, the estate tax exemption is \$60 000.²⁰³¹ The non-resident estate tax exemption is not indexed for inflation and is only available for transfers at death.²⁰³²

Example 9: Estate tax exemption for non-residents

Person A dies in 2023 with a gross estate value of \$7 million. The allowable deductions amount to \$1 million which results in a net estate value of \$6 million. The taxable estate value is \$6 million (net estate value) less \$60 000 (estate tax exemption), which equals \$5.94 million (taxable estate value). The estate tax liability at 40% amounts to \$2 376 000.²⁰³³

²⁰³⁰ The estate tax exemption that will be used by person A is \$7 million plus \$2 million which equals \$9 million.

²⁰³¹ Section 2102 of the *Internal Revenue Code*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 481 and Deloitte *US Estate and Gift Tax Rules 3*.

²⁰³² Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 481 and Deloitte *US Estate and Gift Tax Rules 3*.

²⁰³³ \$5.94 million x 40%.

5.3.6.4 Deductions

The *Internal Revenue Code* allows for various deductions against the gross value of the estate, for example, administrative expenses, debts and taxes, losses, transfers to charitable institutions, and transfers to a spouse, to determine the deceased's taxable estate.²⁰³⁴ Each of these expenses will be addressed below.

5.3.6.4.1 Administrative expenses, debts, and taxes

As a rule in the calculation of the taxable estate of a US citizen or resident, a deduction is allowed against the gross value of the estate for any amounts that are payable out of property subject to claims,²⁰³⁵ for example, funeral expenses,²⁰³⁶ administrative expenses incurred in the administration of the estate,²⁰³⁷ claims against the estate as at the date of death,²⁰³⁸ and any unpaid mortgages or debts on property included in the estate.²⁰³⁹ An additional deduction is allowed for expenses incurred in the administration of property that are not subject to claims but included in the gross value of the estate.²⁰⁴⁰ Any deduction under section 2053 of the *Internal Revenue Code* is subject to the claim being "ascertainable with

²⁰³⁴ Section 2051 of the *Internal Revenue Code* where the term "taxable estate" is defined as the gross estate less all the available deductions under ss 2053-2056 of the *Internal Revenue Code*.

²⁰³⁵ These expenses are also referred to as expenses in respect of probate assets under the management of the executor. See also s 2053 of the *Internal Revenue Code* and Miller 2021 *Brigham Young University Law Review* 1438.

²⁰³⁶ Section 2053(a)(1) of the *Internal Revenue Code*. Qualifying funeral expenses include reasonable expenses for a tombstone, monument, burial lot, and the future maintenance of such lot provided the domestic legislation allows for such an expense. This deduction is like s 4(a) of the *Estates Duty Act* in South Africa.

²⁰³⁷ Section 2053(a)(2) of the *Internal Revenue Code*. Examples of administrative expenses include executor's commissions, attorney's fees, and related expenses in administering the estate. This deduction is like s 4(c) of the *Estates Duty Act* in South Africa.

²⁰³⁸ Section 2053(a)(3) of the *Internal Revenue Code*. These claims are limited to the personal obligations of the deceased as at the date of death, together with any interest payable on such debts, for example, the deceased income tax debt. This deduction is like s 4(b) of the *Estates Duty Act* in South Africa.

²⁰³⁹ Section 2053(a)(4) of the *Internal Revenue Code*.

²⁰⁴⁰ Section 2053(b) of the *Internal Revenue Code*. These claims are also referred to as expenses for non-probate assets, which would be allowed as a deduction under s 2053(a) of the *Internal Revenue Code* if it is related to probate property. For example, termination expenses for an *inter vivos* trust which is included under s 2306(a) of the *Internal Revenue Code* or legal expenses incurred in defending the validity of an *inter vivos* trust. See also Miller 2021 *Brigham Young University Law Review* 1439.

reasonable certainty and will be paid".²⁰⁴¹ These deductions are however limited in respect of non-residents.²⁰⁴²

The deduction available to a non-resident is determined by way of a fraction of the total expenses incurred. The fraction is calculated based on the total value of property situated in the US as the numerator and the value of the deceased person's worldwide gross estate as the denominator.²⁰⁴³ The allowable portion that qualifies as a deduction is calculated by multiplying the deductible expenses by the fraction. The deduction must be supported with a certified copy of the foreign inheritance or estate tax returns that reflect the worldwide assets.²⁰⁴⁴

Example 10: Administrative expenses of a non-resident

Person A, who is a non-resident in the US, owns US-sourced property to the value of \$3 million and worldwide property worth \$8 million. The administrative expenses incurred amount to \$750 000. The fraction allowed as a deduction is calculated as follows: \$3 million divided by \$8 million which equals 0.375. The allowable administrative deduction is \$281 250.²⁰⁴⁵ Therefore, the deduction in respect of the claim of \$750 000 is limited to \$281 250.

5.3.6.4.2 Transfers to charitable institutions

Transfers at death by a US citizen or resident to a qualifying charitable organisation situated anywhere in the world qualify for a deduction regarding the entire value of the property donated.²⁰⁴⁶ A similar deduction is allowed for a non-resident donating to a qualifying charitable organisation.²⁰⁴⁷ The deduction in the case of a non-resident estate is subject to the condition that the executor includes in the return

²⁰⁴¹ Section 2053(d)(4)(i) of the *Internal Revenue Code*. No estimates are allowed.

²⁰⁴² Section 2106(a)(1) of the *Internal Revenue Code*.

²⁰⁴³ Section 2106(a)(1) of the *Internal Revenue Code*.

²⁰⁴⁴ Section 2106(b) of the *Internal Revenue Code*.

²⁰⁴⁵ $0.375 \times \$750\,000$.

²⁰⁴⁶ Section 2055 of the *Internal Revenue Code*. This deduction is like the deduction allowed under s 4(h) of the *Estate Duty Act* in South Africa.

²⁰⁴⁷ Section 2106(a)(2) of the *Internal Revenue Code*. South Africa allows for the same deduction in respect of a resident and a non-resident without any limitation to the latter.

indicating the value of the deceased person's worldwide assets at the time of his death.²⁰⁴⁸ The deduction available in the case of a non-resident is limited as it only applies to the gross assets situated in the US and provided the donation is made to a US-based charity.²⁰⁴⁹ For example, person A dies owning worldwide assets to the value of \$10 million of which \$1 million relates to property situated in the US. A donated \$3 million to a US-based charity. The deduction is limited to \$1 million based on the gross value of person A's US-sourced assets.

5.3.6.4.3 Bequests to a US spouse

A bequest to a US citizen spouse,²⁰⁵⁰ whether it is made by a US citizen or resident, or non-resident, qualifies for an unlimited deduction, provided the property is included in the gross estate of the deceased and not considered a terminable interest.²⁰⁵¹ The policy behind the spousal deduction is that married couples should be treated as an economic unit with shared marital wealth, which should not be taxed when transferred within the unit but only when transferred to a third party outside the unit.²⁰⁵² The effect is that the property will only be taxed in the surviving spouse's estate if the property was retained until the latter's death.²⁰⁵³

A terminable interest held by the surviving spouse does not qualify for the spousal deduction. A surviving spouse is considered to have a terminal interest if (1) it terminates due to a lapse of time or due to an event or the failure thereof;²⁰⁵⁴ (2)

²⁰⁴⁸ Section 2106(b) of the *Internal Revenue Code*.

²⁰⁴⁹ Section 2106(a)(2) of the *Internal Revenue Code*.

²⁰⁵⁰ In the US Supreme Court decision, *United States v Windsor* 570 US 744 (2013), the deduction regarding a bequest to a spouse is available to an opposite-sex as well as a same-sex couple who are lawfully married under state law. Before the decision, the deduction was limited to opposite-sex couples under s 1738C of the *Defense of Marriage Act*, but the above-mentioned decision led to the provision being declared unconstitutional.

²⁰⁵¹ Section 2056(a), (b)(1), (c) of the *Internal Revenue Code*. See also Miller 2021 *Brigham Young University Law Review* 1439-1444 and Joulfaian *Estate and Gift Tax, Federal* 125.

²⁰⁵² Section 2056 of the *Internal Revenue Code*. See also Miller 2021 *Brigham Young University Law Review* 1440.

²⁰⁵³ Like the rationale behind s 4(q) of the *Estate Duty Act* where the deduction for a spousal bequest is not intended to escape estate duty entirely but to merely delay it to the death of the surviving spouse. See also para 4.2.3 above.

²⁰⁵⁴ Section 2056(b)(1) of the *Internal Revenue Code*. For example, if the surviving spouse's interest expires after two years or upon remarriage or if a child does not marry by a certain age.

the interest is not solely given to the surviving spouse;²⁰⁵⁵ and (3) when the surviving spouse's interest terminates it becomes the property of another person.²⁰⁵⁶ If all three of the elements are present, the interest is a terminable interest and does not qualify for the spousal deduction.

For example, person A bequeaths the life estate²⁰⁵⁷ to his surviving spouse (B), and the remainder to his child (C). The property is included in person A's estate and the interest in the property passes to B as the surviving spouse. However, the third element is not met as the interest is terminable. The life estate is a terminable interest as it terminates upon the death of B, the property is given to another (C), and upon B's death, C enjoys the ownership of the property. The spousal deduction is therefore not allowed in person A's estate. The policy behind excluding a terminable interest from the spousal deduction runs parallel with the policy behind the spousal deduction. The spousal deduction is allowed on the basis the property is included in the surviving spouse's estate. However, in the case of a terminable interest, no property is included in the surviving spouse's estate as it terminates upon death²⁰⁵⁸ and therefore the spousal deduction is not allowed in the first-dying spouse's estate.²⁰⁵⁹

An exception to the general rule for a "terminable interest" is where the surviving spouse is given a life estate with the right to income on an annual basis, as well as a general power of appointment exercisable by the surviving spouse alone during their lifetime or at death.²⁰⁶⁰ Although the surviving spouse's interest (life estate) is a terminable interest, the general power of appointment will result in the property being included in the surviving spouse's estate under section 2041 of the *Internal*

²⁰⁵⁵ Section 2056(b)(1)(A) of the *Internal Revenue Code*.

²⁰⁵⁶ Section 2056(b)(1)(B) of the *Internal Revenue Code*.

²⁰⁵⁷ The term "life estate" refers to property that a person (the life tenant) owns and may use while they are alive. However, the life tenant shares ownership with another person (the remainderman) and when the life tenant dies, the remainderman automatically receives the title to the property. See Howard 2023 <https://www.investopedia.com/terms/l/life-estate.asp>.

²⁰⁵⁸ The terminable interest is not taxed in the surviving spouse's estate under s 2033(a) of the *Internal Revenue Code*.

²⁰⁵⁹ See also Miller 2021 *Brigham Young University Law Review* 1443.

²⁰⁶⁰ Section 2056(b) of the *Internal Revenue Code*.

Revenue Code.²⁰⁶¹ Therefore, since the property is included in the surviving spouse's estate, the spousal deduction is allowed, irrespective of the terminable interest involved.

Another exception to the "terminable interest" rule is where the surviving spouse receives a "qualified terminable interest property" (QTIP).²⁰⁶² The QTIP refers to property that passes from the deceased to the surviving spouse subject to "qualifying income interest for life" and the executor elects for such property to qualify for the spousal deduction.²⁰⁶³ A "qualifying income interest for life" exists when the surviving spouse has an annual right to income and the power to appoint the property to a person other than the surviving spouse during their lifetime does not exist.²⁰⁶⁴ Where a QTIP is elected, section 2044 of the *Internal Revenue Code* includes the remainder of the property in the surviving spouse's estate, irrespective of the "terminable interest" that exists.²⁰⁶⁵ On the basis that the property will be included in the surviving spouse's estate, the spousal deduction is allowed in the first-dying spouse's estate.²⁰⁶⁶

5.3.6.4.4 Bequests to a non-US spouse

No spousal deduction is allowed for a bequest to a non-US citizen or non-US resident spouse unless a "qualified domestic trust" (QDT)²⁰⁶⁷ is established, in which case the deferral of the estate tax is allowed when the first-dying spouse who is a US citizen,

²⁰⁶¹ See para 5.3.4 (g) and (h) above for a discussion of s 2041 of the *Internal Revenue Code*.

²⁰⁶² Section 2056(b)(7) of the *Internal Revenue Code*. If the surviving spouse makes a qualified disclaimer regarding the QTIP that will be included in their estate, the spousal deduction is not allowed.

²⁰⁶³ Section 2056(b)(7)(B)(i) and (v) of the *Internal Revenue Code*. The election must be made by the executor on the estate tax return (Form 706) and such election is irrevocable.

²⁰⁶⁴ Section 2056(b)(7)(B)(ii) of *Internal Revenue Code*. A power of appointment may exist if it is exercisable at or after the death of the surviving spouse. See Miller 2021 *Brigham Young University Law Review* 1444.

²⁰⁶⁵ Section 2044(a) and (b)(1)(A) of *Internal Revenue Code*.

²⁰⁶⁶ The spousal deduction is generally mandatory in respect of a bequest to a surviving spouse, except in the case of a QTIP where an election is required. Section 2056(b)(7) of the *Internal Revenue Code*.

²⁰⁶⁷ A QDT is a trust created for a non-U.S. citizen surviving spouse to qualify for the unlimited spousal deduction. The existence of a QDT keeps the deceased's estate from being taxed at the time of death. See s 2056(d)(2) of the *Internal Revenue Code* and Legal Information Institute 2022 https://www.law.cornell.edu/wex/qualified_domestic_trust.

dies.²⁰⁶⁸ The trust must have at least one US trustee having the responsibility to withhold US estate tax from the main distributions from the trust and the deferred tax becomes payable upon the death of the second-dying spouse, unless earlier distributions were made from the trust.²⁰⁶⁹

5.3.6.5 Double taxation relief

Relief for double estate taxation is provided unilaterally through the *Internal Revenue Code*,²⁰⁷⁰ or bilaterally through the application of a tax treaty in the form of a tax credit for any death taxes paid to a foreign country by a US citizen or US resident.²⁰⁷¹ The executor can also by election apply for a deduction instead of a credit under the *Internal Revenue Code*.²⁰⁷²

Double estate taxation arises when a US citizen or resident owns property situated in a foreign country. The US, as the country of residence, taxes the worldwide property of the deceased, and the foreign country where the property is situated may tax the property as the country of source.²⁰⁷³ The US, as the country of residence is then to provide unilateral or bilateral relief from the possible double estate taxation.²⁰⁷⁴

5.3.6.5.1 Statutory relief

The statutory credit for foreign death taxes paid by a US citizen or resident to a foreign country for any property situated in that country is set out in section 2014 of the *Internal Revenue Code*.²⁰⁷⁵ No specific meaning is provided for "foreign

²⁰⁶⁸ Section 2056A of the *Internal Revenue Code*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 480.

²⁰⁶⁹ Section 2056A of the *Internal Revenue Code*. The US has estate tax treaties that may allow for increased deductions in respect of bequests to a non-US citizen spouse without the requirement to establish a QDT.

²⁰⁷⁰ Section 2014 of the *Internal Revenue Code*.

²⁰⁷¹ Rudnick and Gordon "Taxation of Wealth" 324.

²⁰⁷² See ss 2014 and 2053(d)(1) of the *Internal Revenue Code*. See also IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004. South Africa does not have a similar election and unilateral relief is limited to a credit under s 16(c) of the *Estate Duty Act*.

²⁰⁷³ IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004.

²⁰⁷⁴ OECD *Estate Tax Model* 14 and Rudnick and Gordon "Taxation of Wealth" 324.

²⁰⁷⁵ A credit for foreign death taxes paid can be claimed by completing Form 706. The foreign tax credit can be claimed for national and local death taxes imposed by a foreign jurisdiction. See

property" as any property may qualify for the relief provided it is situated in a foreign jurisdiction in which a death tax was paid.²⁰⁷⁶ The credit is limited to taxes that are similar to death taxes, including estate tax, inheritance tax, legacy tax, succession tax, or a similar transfer tax.²⁰⁷⁷ In the case that the credit is claimed, a deduction for foreign death taxes paid under section 2053(d)(1) of the *Internal Revenue Code* is not available. Both relief provisions cannot be applied; either the deduction or the credit must be claimed.²⁰⁷⁸

5.3.6.5.2 Treaty relief

If the relief available under a tax treaty is more favourable than the statutory relief regarding the estate of a US citizen or resident, the executor can make an election for the double tax relief under the tax treaty to apply, instead of the statutory relief.²⁰⁷⁹

If a tax credit in respect of double estate taxation is authorised under a tax treaty, the credit is the greater of the relief available under the tax treaty, or the credit available under the statute.²⁰⁸⁰

s 2014 of the *Internal Revenue Code* and IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004.

²⁰⁷⁶ Section 2014(a) and (b) of the *Internal Revenue Code*.

²⁰⁷⁷ Sections 2014 and 2053 of the *Internal Revenue Code*. Foreign death taxes paid to a foreign jurisdiction on property not situated in that country or on property not included in the gross estate do not qualify for a credit. The foreign taxes paid are converted to US dollars on the day it is paid by using the rate of exchange on that day. Such clarity like the type of foreign taxes and the date on which the conversion should take place to South African Rand is lacking under the *Estate Duty Act*. See para 4.2.7 above.

²⁰⁷⁸ IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004.

²⁰⁷⁹ IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004. To claim the relevant relief, Form 706 should be submitted, and it must indicate the treaty provision being invoked.

²⁰⁸⁰ IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004 read with s 2053 of the *Internal Revenue Code*. If death taxes were paid to a political subdivision or possession not covered by the tax treaty, the available credit will be the greater of the treaty relief, the statutory relief, or a combination of the treaty relief in addition to the statutory relief.

5.3.6.5.3 Limitations

Limitations on claiming a tax credit include the following:

- (a) The qualifying tax credit for foreign death taxes paid is limited to the total federal estate tax attributable to the property.²⁰⁸¹
- (b) The period allowed to submit a claim for a tax credit is four years from the date the estate tax return is filed, provided the foreign taxes were paid.²⁰⁸² If an extension was granted for payment of federal estate tax, the claim must be submitted within four years, or before the expiration of any extension on the payment due date.²⁰⁸³ Secondly, if a petition for redetermination of a deficiency was filed with the Tax Court within the required periods, the claim must be submitted within the four years or before the expiration of 60 days after the decision of the Tax Court becomes final.²⁰⁸⁴

5.3.7 Rates

The US applies a unified gift and estate tax rate as the estate tax liability is determined at death according to the unified schedule and then deducting any amount subject to gift tax on lifetime transfers.²⁰⁸⁵ All gifts and transfers on death are therefore subject to gift or estate tax while receiving a unified estate tax exemption, which is indexed annually for inflation.²⁰⁸⁶ The unified exemption for estate tax is \$12.92 million for US citizens and US residents and only \$60 000 for

²⁰⁸¹ Section 2014(b) of the *Internal Revenue Code*.

²⁰⁸² Section 2014(e) read with s 6018 of the *Internal Revenue Code*. See also IRS 2020 https://www.irs.gov/irm/part4/irm_04-025-004. Proof of the payment of the foreign death taxes must be provided to the IRS before the credit will be allowed (see s 2014(e)(2) of the *Internal Revenue Code*).

²⁰⁸³ Section 2014(e)(2) of the *Internal Revenue Code*.

²⁰⁸⁴ Section 2014(e)(1) of the *Internal Revenue Code*.

²⁰⁸⁵ Section 2001(c) of the *Internal Revenue Code*. For example, person A made \$4 million taxable lifetime gifts and dies in 2023. The available unified estate tax exemption is \$8.92 million (\$12.92 million less \$4 million).

²⁰⁸⁶ Section 2010 of the *Internal Revenue Code*.

non-residents. The estate tax exemption for non-residents is not indexed for inflation and only applies to transfers at death.²⁰⁸⁷

The following section discusses the administrative elements applicable to estate tax.

5.3.8 Administrative functions

5.3.8.1 Returns

The estate tax filing requirements of a deceased estate depend on whether the deceased person, at the time of death, was a US citizen or US resident or whether they were non-residents for estate tax purposes.²⁰⁸⁸

The executor of a US citizen or resident's estate is required to file an estate tax return (Form 706) if the gross value of the estate in respect of worldwide property exceeds the basic estate tax exemption²⁰⁸⁹ for the year in which the deceased person died.²⁰⁹⁰ The executor of a non-US citizen or US non-resident is required to file an estate tax return (Form 706-NA) if the gross value in respect of property situated in the exceeds \$60 000.²⁰⁹¹

An estate tax return must be filed within nine months after the date of the deceased person's death,²⁰⁹² unless an extension is allowed for not more than six months.²⁰⁹³

²⁰⁸⁷ Section 2102 of the *Internal Revenue Code* and Deloitte *US Estate and Gift Tax Rules* 3.

²⁰⁸⁸ Section 6018 of the *Internal Revenue Code*. South Africa makes no similar distinction between the filing requirements for a resident and a non-resident.

²⁰⁸⁹ The basic estate tax exclusion is set out in section 2010(c) of the *Internal Revenue Code*. South Africa does not have a minimum threshold for filing, but the US position is aligned with the recommendation made for South Africa. See para 4.2.9.2.2 above.

²⁰⁹⁰ Section 6018(a)(1) of the *Internal Revenue Code*. See also Miller 2021 *Brigham Young University Law Review* 1453 and Rudnick and Gordon "Taxation of Wealth" 332.

²⁰⁹¹ Section 6018(a)(2) of the *Internal Revenue Code*.

²⁰⁹² Section 6075(a) of the *Internal Revenue Code*. South Africa does not provide a timeline within which the estate duty return must be filed, however, the US position is aligned with the recommendation made for South Africa. See para 4.2.9.2.1 above.

²⁰⁹³ Section 6081(a) of the *Internal Revenue Code*.

5.3.8.2 Payment rules

The general rule for the payment of an estate tax liability is that it must be settled while the estate tax return is filed by the executor.²⁰⁹⁴ Under certain circumstances, an instalment payment agreement will be allowed where the executor can settle the estate tax liability in instalments.²⁰⁹⁵ An extension for the payment of the estate tax liability can be allowed under the following circumstances:

- (a) The general rule allows an extension of 12 months from the payment due date (the filing date),²⁰⁹⁶ as authorised by the Secretary of the Inland Revenue Service.²⁰⁹⁷
- (b) An additional extension may be allowed regarding the estate tax liability determined by the executor, or for approved instalment payments up to a maximum of 10 years, however, if a later date is allowed it may not be beyond 12 months after the due date of the last instalment.²⁰⁹⁸
- (c) An extension may be allowed for the payment of a deficiency of an estate tax liability for not more than four years from the date of payment of the deficiency.²⁰⁹⁹
- (d) An executor may elect to postpone the estate tax liability for a reversionary or remainder interest in a property included in the gross estate until six months after the termination of the interest in the property.²¹⁰⁰ If the six-month period expires, the Secretary may for reasonable cause allow for a

²⁰⁹⁴ Section 6151(a) of the *Internal Revenue Code*. See Rudnick and Gordon "Taxation of Wealth" 332.

²⁰⁹⁵ Section 6159 of the *Internal Revenue Code*. The US follows a self-assessed approach which is aligned with the recommendation made for South Africa. See para 4.2.9.3 above.

²⁰⁹⁶ The return is due nine months after the date of death unless an extension of a further six months is authorised. See s 6075(a) and s 6091 of the *Internal Revenue Code*.

²⁰⁹⁷ Section 6161(a)(1) of the *Internal Revenue Code*. The extension of 12 months is the general rule; however, a maximum of 10 years may be authorised in respect of estate tax (s 6161(a)(2) of the *Internal Revenue Code*).

²⁰⁹⁸ Section 6161(a)(1) of the *Internal Revenue Code*.

²⁰⁹⁹ Section 6161(a)(2) and (3) of the *Internal Revenue Code*. No extension is allowed if the deficiency is due to "negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax".

²¹⁰⁰ Section 6163(a) of the *Internal Revenue Code*.

further extension of not more than three years from the expiration of the six months.²¹⁰¹

- (e) The executor may elect to pay part or all the estate tax liability in two or more (but not exceeding 10) equal instalments if the estate consists of (more than 35%) of interest in a closely-held business.²¹⁰²

The payment of the estate tax liability rests upon the executor of the estate.²¹⁰³

5.3.8.3 Penalties

The *Internal Revenue Code* imposes penalties for the late filing of an estate tax return and the late payment of an estate tax liability, unless a reasonable cause for the delay exists.²¹⁰⁴ The penalty is imposed in the form of an additional tax.

The penalty for the late filing of an estate tax return is calculated, if it is filed within one month after the filing due date at 5% of the liability calculated in the return, and an additional 5% for each month (or a fraction thereof) that the return remains outstanding, limited to an aggregate of 25%.²¹⁰⁵

The penalty for the late payment of an estate tax liability is calculated, if it is paid within one month after the due date at 0.5%, and an additional 0.5% for every month (or a fraction thereof) that the payment remains outstanding, limited to an aggregate of 25%.²¹⁰⁶

²¹⁰¹ Section 6163(b) of the *Internal Revenue Code*.

²¹⁰² Section 6166 of the *Internal Revenue Code*.

²¹⁰³ Section 2002 of the *Internal Revenue Code*. South Africa has general rules for all tax types under the provisions of the *Tax Administration Act*, but specific rules are recommended, see para 4.2.9.4 above.

²¹⁰⁴ Section 6651 of the *Internal Revenue Code*. See also IRS 2022 https://www.irs.gov/irm/part20/irm_20-001-011r. South Africa does not have a late filing or payment penalty for estate duty, but it is recommended for improved voluntary compliance, see para 4.2.9.5 above.

²¹⁰⁵ Section 6651(a)(1) of the *Internal Revenue Code*. South Africa imposes a similar administrative penalty under Chapter 15 of the *Tax Administration Act* regarding income tax, but none applies to the failure to submit an estate duty return.

²¹⁰⁶ Section 6651(a)(2) of the *Internal Revenue Code*.

The penalty provisions also include penalties for the failure to file an estate tax return on time, for a wilful attempt to evade or defeat payment of estate tax,²¹⁰⁷ and for the understatement of an estate tax liability due to negligence or intentional disregard of rules and regulations.²¹⁰⁸

The understatement penalty relates to an understatement of tax of more than \$5 000, or if there is a substantial understatement²¹⁰⁹ or gross valuation misstatement.²¹¹⁰ A substantial understatement penalty increases if it is related to a gross valuation misstatement.²¹¹¹

Additional penalties that may also be imposed include a failure to submit the correct information regarding the beneficiaries that acquire property from the deceased estate.²¹¹² This information is required in addition to the estate tax return and consists of a separate filing requirement apart from the estate tax return.²¹¹³

The anti-avoidance measures available to combat estate tax avoidance are discussed below.

5.3.9 Anti-avoidance rules

The *Internal Revenue Code* does not contain any general anti-avoidance rules regarding estate tax, but additional wealth transfer taxes and specific measures were introduced over time to combat estate tax avoidance. The taxes and measures include the following:

²¹⁰⁷ See also IRS 2020 https://www.irs.gov/irm/part20/irm_20-001-011r and IRS 2022 https://www.irs.gov/irm/part20/irm_20-001-002r.

²¹⁰⁸ Section 6662 of the *Internal Revenue Code*.

²¹⁰⁹ Section 6662(d) of the *Internal Revenue Code* defines a "substantial understatement" to mean when the value of property stated on the return is 65% or less of the actual value of the property. See also IRS 2020 https://www.irs.gov/irm/part20/irm_20-001-011r.

²¹¹⁰ Section 6662 of the *Internal Revenue Code*. South Africa also has an understatement penalty under Chapter 16 of the *Tax Administration Act* that applies to estate duty.

²¹¹¹ Section 6662(h)(2) of the *Internal Revenue Code* defines a "gross valuation misstatement" to mean any property that is declared on the estate tax return at a value of 40% or less than the correctly determined value.

²¹¹² Sections 6721 and 6722 of the *Internal Revenue Code*. Form 8971 reflects the correct value of the property that is distributed to the respective beneficiaries to the IRS.

²¹¹³ IRS 2020 https://www.irs.gov/irm/part20/irm_20-001-011r.

- (a) The gift tax on *inter vivos* gifts was reintroduced in 1932 as a permanent feature in the US wealth transfer tax system.²¹¹⁴ It was introduced as a measure to combat the avoidance of estate tax by wealthy individuals by transferring wealth during their lifetimes.²¹¹⁵ In 1976, the gift tax was unified with the estate tax framework that provided for a single, graduated tax rate for lifetime gifts as well as transfers upon death. Lifetime gifts were previously made at lower tax rates, however, the planning opportunity for lifetime gifts and transfers upon death was reduced as the same tax rate applies, with corresponding exclusions.²¹¹⁶
- (b) A tax on generation-skipping transfers was introduced in 1986 to combat the gift and estate tax avoidance that occurred due to wealthy individuals transferring property to beneficiaries more than one generation removed from the transferor that passed without any tax implications for the generation between the transferor and the beneficiary.²¹¹⁷ The tax on generation-skipping transfers was imposed on direct and indirect transfers to "skip persons", as well as on trusts that only had such skipped persons as beneficiaries. The tax rate is 40%, subject to an annual exemption in addition to the estate and gift tax exemption.²¹¹⁸
- (c) The deemed property rules have been included in the *Internal Revenue Code* where property that may not exist at the date of death is included as deemed property as a measure of combating the avoidance of estate tax.²¹¹⁹

²¹¹⁴ A gift tax was initially introduced in the *Revenue Act, 1924* after which it was repealed by the *Revenue Act, 1926* until it was reintroduced by the *Revenue Act, 1932*.

²¹¹⁵ Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 122.

²¹¹⁶ Chapter 12 of the *Internal Revenue Code*. Jacobson, Raub and Johnson *The Estate Tax: Ninety Years and Counting* 122. In South Africa donations tax is levied on lifetime transfers and estate duty is levied on transfers at death to eliminate the manipulation of transfers for tax benefits. Also, both donations tax and estate duty are levied at the same tax rates.

²¹¹⁷ Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 476-477.

²¹¹⁸ Chapter 13 of the *Internal Revenue Code*. See also Ernst & Young *Worldwide Estate and Inheritance Tax Guide 2023* 476-477.

²¹¹⁹ Lowndes *Tax Avoidance and the Federal Estate Tax* 311-325.

Such provisions include retained interests, revocable transfers, and transfers in contemplation of death.²¹²⁰

5.3.10 Conclusion

Since the inception of the US federal estate tax, various additions and amendments were made to the estate tax structure that led to the unified gift and estate tax system together with the generation-skipping transfer tax in its current form.²¹²¹

The US levies an estate tax under the *Internal Revenue Code* on the transfer of the deceased person's estate at the date of death that is payable by the executor of the estate.²¹²² US citizens and residents (determined according to their domicile) are subject to estate tax on their worldwide assets, whereas a non-resident is only subject to estate tax on assets situated in the US.²¹²³ The scope of assets that can be included in a deceased estate consists of all property, as well as certain deemed property, for example, retained interests and revocable transfers.²¹²⁴

The treatment of US citizens and residents for estate tax purposes is more favourable in comparison to non-residents. Greater exclusions and wider exemptions apply to the deceased estate of US citizens and residents.²¹²⁵ The US provides for a gift and estate tax exclusion, however, the value of the exclusion for US citizens and residents is currently \$12.92 million in comparison to the \$60 000 exemption available to non-residents.²¹²⁶ The US gift tax and estate tax regimes are unified as one exemption applies to both taxes, and any taxable lifetime gifts reduce the estate tax exemption available at death.²¹²⁷

²¹²⁰ Sections 2035 to 2043 of the *Internal Revenue Code* and Lowndes *Tax Avoidance and the Federal Estate Tax* 311-318.

²¹²¹ See para 5.3.1 above.

²¹²² See para 5.3.2 above.

²¹²³ See para 5.3.3.2 above.

²¹²⁴ See para 5.3.4 above.

²¹²⁵ See para 5.3.6 above.

²¹²⁶ See para 5.3.6.1 above.

²¹²⁷ See para 5.3.6.1 above.

Various deductions are available for estate tax purposes.²¹²⁸ The most notable deductions are for bequests to a surviving spouse or a charity.²¹²⁹ An unlimited deduction is available for a bequest to a US surviving spouse, whereas no deduction is available for a bequest to a non-US surviving spouse, unless a qualified domestic trust is established.²¹³⁰

US citizens and residents, as well as non-residents, are subject to a top estate tax rate of 40%.²¹³¹ The US applies strict compliance measures to promote voluntary compliance regarding the submission of estate tax returns as well as the payment of the accompanying estate tax liability.²¹³² The *Internal Revenue Code* imposes certain penalties to combat non-compliance for the failure to submit estate tax returns or make estate tax liabilities.²¹³³ The US does not contain any general anti-avoidance measures estate tax, but has over time introduced specific avoidance measures to combat estate tax avoidance.²¹³⁴

The second part of this chapter reviewed the estate tax system of the US for purposes of making recommendations considering the problem areas under the *Estate Duty Act* in South Africa. Potential recommendations will be highlighted in the conclusion of this chapter below.

5.4 Summary of the insight gained from the UK and the US wealth transfer tax systems

This chapter reviewed the transferor-based wealth transfer tax systems of the UK and the US. Aspects and characteristics of the UK system and the US system that are relied on to address the problem areas under the *Estate Duty Act* in South Africa are highlighted below to answer the question of what direction can be taken from the UK and the US to make recommendations for a revised *Estate Duty Act*.

²¹²⁸ See para 5.3.6.4 above.

²¹²⁹ See paras 5.3.6.4.2 to 5.3.6.4.4 above.

²¹³⁰ See paras 5.3.6.4.4 above.

²¹³¹ See para 5.3.7 above.

²¹³² See paras 5.3.8.1 and 5.3.8.2 above.

²¹³³ See para 5.3.8.3 above.

²¹³⁴ See para 5.3.9 above.

5.4.1 *Insight from the UK inheritance tax system*

The paragraphs below highlight characteristics that are like South Africa's estate duty system that can be relied upon to make recommendations for a revised *Estate Duty Act*:

- (a) *Domicile vs residence*: The connecting factor of domicile for inheritance tax purposes has similarities to the concept of being "ordinarily resident" in South Africa. In both instances, the test is a subjective test based on the deceased person's intention that must be supported by objective factors. The challenge that is experienced is that it is difficult to determine, especially after the deceased passed away, what their intentions were. A significant difference is that for a person to cease their domicile in one place, it must be obtained in another place, whereas the same requirement does not apply to being ordinarily resident. A person can cease to be an ordinary resident in one place without becoming one in another place. The UK has also combined the statutory test for income tax purposes with the domicile test for inheritance tax purposes to determine a person's deemed domicile for inheritance tax purposes in certain instances. The domicile test for inheritance tax purposes has been criticised by the APPG for the reasons of being subjective and difficult to determine. For certainty, a specific test (not subject to various subjective and objective factors) using the UK statutory test as a benchmark, should be designed (including a factual day's test) for purposes of drafting a definition for "resident" under the *Estate Duty Act*.
- (b) *Potentially Exempt Transfer (PET)*: The UK has a PET regime that exempts lifetime transfers if made more than seven years before the transferor's death. This is like the exemptions for donations tax purposes under section 56(1)(c) and (d) of the *Income Tax Act*, where a lifetime donation is exempt, without any period threshold. The exempt donation is however included in the deceased person's estate as a deemed property, irrespective of the time in which it was made before death. The PET regime does not come without complexities and, on the basis that a similar approach was

previously included under the *Estate Duty Act* and subsequently removed due to the complexities and administrative difficulties involved, it may not be suitable for South Africa.

- (c) *Spousal exemption:* An unlimited exemption is allowed for transfers to a UK-domiciled spouse. The UK makes a distinction between transfers to a surviving UK-domiciled and non-UK-domiciled spouse. The exemption to a non-UK-domiciled spouse is limited to the nil rate band of £325 000, whereas South Africa makes no distinction between a resident and non-resident surviving spouse, resulting in an unlimited exemption for a bequest. Guidance can be taken from the UK, and it will bring alignment with the capital gains tax regime in South Africa where a distinction is made between a resident and a non-resident spouse.
- (d) *Charity exemption:* A wider range of exemptions exist for UK inheritance tax purposes for bequests to charities and institutions, which may also lead to a reduced rate of inheritance tax. These exemptions may prompt bequests to such charities due to the favourable treatment. South Africa's limited approach reduces the potential estate duty avoidance that may be involved. However, instead of allowing a blanket deduction, specific rules for similar treatment that do not include favouring certain charities, but instead allow a reduced rate to qualifying charities depending on the amount bequeathed, may be considered.
- (e) *Life policies:* Life policies paid out to a deceased estate are, like the estate duty provisions in South Africa, included in the deceased estate for inheritance tax purposes. However, an important distinction between the UK and South Africa is that, where a life policy is paid out to a beneficiary or written into trust it is excluded from the deceased estate and not subject to inheritance tax, whereas for South African estate duty purposes, such policies are included as deemed property in the deceased estate and subject to estate duty, exemptions and exclusions. A review is required under the

Estate Duty Act for including life policies paid out to a third party, where the deceased did not contribute and has no financial interest.

- (f) *Double tax relief:* The UK unilateral relief for double taxation gives clear stipulations under what circumstances a credit for inheritance tax or similar taxes upon death can be allowed, whereas uncertainty exists to what extent an inheritance tax paid by a beneficiary may be allowed as a credit against the estate duty liability due by the estate in South Africa. More clear guidance would be beneficial under the *Estate Duty Act* when claiming relief from double taxation.
- (g) *Returns and payments:* Inheritance tax returns are due within 12 months from the date of death, whereas the inheritance tax liability must be paid within six months after the date of death. The payment of inheritance tax liability before the enforcement of a return is similar in South Africa where no estate duty assessment is issued within the first 12 months after the date of death, but the estate duty liability must be settled in full within 12 months after the date of death. Failure to do so results in interest being payable on any unpaid estate duty unless an interest-free extension was requested. A distinction to be drawn is that the UK has a statutory deadline for the submission of the inheritance tax return providing clarity from a compliance point of view, whereas for estate duty purposes in South Africa, no due date is provided. Specific rules regarding administrative duties will provide certainty under the *Estate Duty Act*.
- (h) *Penalty regime:* The UK has a wider spectrum of penalty provisions concerning inheritance tax in comparison to the understatement penalty that applies to estate duty in South Africa. More stringent penalties may be considered from a South African point of view, especially for the non- or late submission of estate duty returns. Interest provisions do apply in the event of late payment of estate duty, but a focus is required to consider appropriate measures for estate duty purposes.

- (i) *Anti-avoidance rules:* The UK has been referred to in all the reviews of the South African estate duty provisions for its specific anti-avoidance measures regarding inheritance tax. The UK has a wide spectrum of anti-avoidance rules that include general anti-avoidance rules, specific anti-avoidance rules under the *Inheritance Tax Act*, as well as requirements for the disclosure of tax avoidance schemes (DOTAS). The DOTAS rules are focused on the reporting of notifiable arrangements as an advance measure in comparison to the existing "after the fact" anti-avoidance measure under the *Estate Duty Act* under section 3(3)(d). A demand for more specific measures exists in respect of estate duty. If the specific inheritance tax avoidance rules of the UK are tailored for the South African context and adopted, it may widen and strengthen the anti-avoidance framework under the *Estate Duty Act*. Considering the DOTAS rules, the provisions of reportable arrangements under the *Tax Administration Act* could be considered to cater for estate duty arrangements.

5.4.2 *Insight from the US estate tax system*

The paragraphs below highlight characteristics that are similar to South Africa's estate duty system, but that can be relied upon to make recommendations for a revised *Estate Duty Act*:

- (a) *Domicile vs residence:* The connecting factor for US federal estate tax is twofold. First, citizenship is unique in its application and is not followed internationally by many countries, but it is easily determined and factual. Secondly, domicile, like in the case of the UK, has similarities to the concept of being "ordinarily resident" in South Africa. The determination of "domicile" is a subjective test based on the deceased person's intention that must be supported by objective factors. If it cannot be established, for example, it is difficult to determine the intention of a deceased person, there is a rebuttable presumption that it is where the deceased person resided. For a person to be non-resident for US estate tax purposes, the person had to change their domicile to another place and cannot cease it without

obtaining a domicile somewhere else. A factor distinguishable from South Africa is when a person became a non-US citizen or non-US domiciled, they are not automatically treated as a non-resident, but the US retains its taxing right in the form of an exit estate tax charge over such former citizens or domiciled persons. The US also distinguishes between its residence tests for income tax and estate tax purposes. The income tax residence test is based on a physical day test that is more factual and not dependent on a person's subjective intention that is no longer alive to substantiate any position taken as in the case of resident for estate tax purposes. Guidance regarding the tail provision can be taken to not regard a person as a non-resident immediately, but to retain taxing rights until a certain period has passed or tax residence is obtained elsewhere.

- (b) *Life policies:* Life policies paid out to a deceased estate are, like the estate duty provisions in South Africa, included in the deceased estate for estate tax purposes. An important distinction from South Africa is that, where a life policy is paid out to a beneficiary and the deceased held no "incidence of ownership" (ownership or enjoyment), or written into trust, it is excluded from the deceased estate and not subject to estate tax. For South African estate duty purposes, such policies are included as deemed property in the deceased estate and subject to estate duty, subject to exemptions and exclusions. The rationale behind the position taken in South Africa, as discussed above,²¹³⁵ should be reviewed.
- (c) *Estate tax exemption threshold:* The US indexed its exemption threshold for inflation, whereas in South Africa no such indexing takes place, resulting in a bracket-creeping where deceased estates that are not intended to be subject to estate duty become thereto. The indexing for inflation of the primary abatement under section 4A of the *Estate Duty Act* is recommended.

²¹³⁵ See para 4.2.2.2.1 above.

- (d) *Spousal deduction:* The US provides for an unlimited deduction for a bequest to a surviving spouse, however, the deduction is unavailable or limited if the surviving spouse is a non-US spouse. South Africa makes no distinction between a resident and a non-resident spouse; however, the distinction should be considered, which will also bring alignment between estate duty and capital gains tax where the non-residents are treated more strictly.
- (e) *The distinction between resident and non-resident:* Across the entire estate tax regime, a distinction is drawn in the treatment of a US citizen or resident's deceased estate in comparison to a non-US citizen or resident. A non-resident estate is entitled to limited exclusions for estate tax as well as limitations to the available deductions. South Africa makes no similar distinction between a resident and a non-resident for estate duty purposes. A similar approach should be considered as the scope of a resident's estate is much wider than that of a non-resident as the latter is only subject to estate duty on assets situated in South Africa.
- (f) *Double tax relief:* The US has a wider scope of unilateral relief provisions under its *Internal Revenue Code* to relieve the burden of double taxation. The US does not only offer relief through its statutory provisions in the form of a credit, like in the case of South Africa, but also includes a deduction at the election of the executor. The unilateral relief is compared with the relief available under an estate tax treaty and whichever is the most beneficial is available to the executor to elect. South Africa provides no election. However, the US unilateral provisions also provide more detail for the type of tax that qualifies and the date of conversion. For purposes of the *Estate Duty Act*, similar provisions are recommended for clarity and certainty purposes.
- (g) *Returns and payments:* The US requires an estate tax return for every estate where the gross value exceeds the estate tax exemption, and it must be filed within nine months from the date of death. South Africa only

requires the submission of a return without a due date, however, such detailed provisions will provide clarity together with a minimum threshold for filing, for example, if the estate value exceeds the primary abatement to alleviate unnecessary administrative burdens on the executor and the revenue authority.

Any US estate tax liability must be paid together with the submission of the return as it operates on a "self-assessment" basis. An extension for the submission of the return can be requested for an additional six months and a payment may be extended for 12 months. In South Africa, the payment of estate duty is not linked to the return as estate duty is not a self-assessed tax, but must be paid within 12 months from the date of death, unless an assessment is issued by SARS within the first 12 months after the death, in which case it is payable within 30 days from the date prescribed in the assessment issued by SARS. The conversion of estate duty to a self-assessed tax is recommended, considering the process of administering a deceased estate, as well as the layout of the estate duty return that satisfies the definition of a "self-assessment" under the *Tax Administration Act* as it calculates the tax liability due.

- (h) *Penalty regime:* The US has a wide scope of penalty provisions for estate tax and includes penalties for the late or non-submission of the estate tax return; for no or late payment of the estate tax liabilities as well as understatement penalties. South Africa is limited to understatement penalties and a wider scope of penalties may be considered to encourage voluntary compliance.
- (i) *Anti-avoidance rules:* The US has no general anti-avoidance rules, but has over time introduced specific avoidance measures in the form of a gift tax, generation-skipping transfer tax and deeming property rules in respect of retained interests. Some of these rules correspond with existing provisions in the *Estate Duty Act*, for example, the deemed property rules under

section 3(3)(c) and (d) of the *Estate Duty Act*. The *Estate Duty Act* lacks more specific anti-avoidance measures.

- (j) *Unilateral relief provisions:* The US provides clear guidance regarding the foreign taxes that may qualify for the unilateral relief, for example, estate tax, inheritance tax, legacy tax, succession tax, or a similar transfer tax. It further provides that any foreign taxes paid should be converted to US dollars on the date of payment by using the spot rate on that day. Clarity like the type of foreign taxes, the applicable exchange rate and the date on which the conversion should take place is lacking under the *Estate Duty Act*.

This chapter discussed and analysed the UK inheritance tax system and the US estate tax system to identify aspects that can be learnt from in making recommendations for a revised *Estate Duty Act*. The following chapter will set out the final recommendations for a revised *Estate Duty Act*.

CHAPTER 6 CONCLUSION AND RECOMMENDATIONS

Abstract

This chapter provides the conclusion and recommendations to the study that are drawn from the preceding chapters, to answer the primary research question, "Through the use of a historical and comparative study, how can the *Estate Duty Act* be revised to keep up with a changing legal landscape?" The recommendations are measured against the theoretical framework discussed in Chapter 2 to promote the objectives and canons of taxation and to adhere to the *Constitution*. The analysis and relevance of the recommendations made by the Margo and Katz Commissions as well as the DTC in Chapter 3 is considered for making recommendations for the improvement of the *Estate Duty Act*. It was concluded in Chapter 4, which analysed the current problem areas under the *Estate Duty Act*, that changes to the Act are indeed required. Preliminary recommendations that may enhance the canons and objectives of taxation were considered. Insight for recommendations was sought from the comparative study done with the UK and the US in Chapter 5 to address the issues raised under the *Estate Duty Act*. This Chapter sets out the final recommendations for the *Estate Duty Act* proposed for each problem area identified in Chapter 4, and serves as a conclusion to the study.

6.1 Introduction

In Chapter 1 it was stated that this study entails the search for a revised *Estate Duty Act* in South Africa. In doing so, the previous reviews done on and development of estate duty in South Africa, as well as the existing challenges, were compared and analysed. Guidance in the search for improvements was sought through the comparative study with the UK and the US where similar wealth transfer tax systems operate. It was also stated that, if the need for a revised *Estate Duty Act* is established, recommendations will be made as part of the conclusion. Chapter 2 provided a theoretical framework regarding the objectives for and canons of

taxation, as well as constitutional considerations applicable to taxation.²¹³⁶ It was stated that estate duty fails to achieve the objectives of raising revenue to fund the government's activities or redistribute wealth.²¹³⁷ The *Estate Duty Act* was analysed to consider changes that will enhance its adherence to the canons of taxation, which represent internationally-accepted criteria for a good tax system.²¹³⁸ It was concluded that, although the provisions of the *Estate Duty Act* have not yet been under constitutional scrutiny, it does not mean some of its provisions are not potentially unconstitutional, and any recommendations made thereto must adhere to the *Constitution*.²¹³⁹ The theoretical framework is required to set the legal context in which recommendations to the *Estate Duty Act* are made.

Chapter 3 provided a brief historical overview of the development of South African estate duty legislation up to the introduction of the *Estate Duty Act*. In addition, an analysis was done on the recommendations by the Margo Commission, the Katz Commission and the DTC to determine which recommendations that were made are still relevant.²¹⁴⁰ According to the analysis, it was found that most of the Margo Commission's recommendations have been implemented, however, many of the Katz Commission's and the DTC's still bear relevance today.²¹⁴¹ Chapter 4 identified and analysed the problem areas under the *Estate Duty Act*, its adherence to the canons of taxation and its alignment with the principles laid down by the OECD.²¹⁴² It became evident that changes to the problem areas in the existing *Estate Duty Act* are indeed required, and preliminary recommendations were provided.²¹⁴³ The comparative study done in Chapter 5 on the UK inheritance system and the US estate tax system guided the lessons that can be learnt to assist in making recommendations for a revised *Estate Duty Act*.²¹⁴⁴

²¹³⁶ See paras 2.3.1, 2.3.2, 2.4.2 and 2.4.3 above.

²¹³⁷ See paras 2.3.1 and 2.3.2 above.

²¹³⁸ See para 2.4.2 above.

²¹³⁹ See para 2.5 above.

²¹⁴⁰ See paras 3.4.2, 3.5.2 and 3.6.2 above.

²¹⁴¹ See paras 3.4.3, 3.5.3 and 3.6.3 above.

²¹⁴² See paras 4.2.1 to 4.2.9 above.

²¹⁴³ See paras 4.2.1 to 4.2.9 above.

²¹⁴⁴ See paras 5.4.1 and 5.4.2 above.

Paragraphs 6.2.1 to 6.2.9 below answer the primary research question, "Through the use of a historical and comparative study, how can the *Estate Duty Act* be revised to keep up with a changing legal landscape?" by providing the recommendations resulting from this study.

6.2 Problem statement and recap of recommendations

The stagnation of the *Estate Duty Act* since its introduction has created a need for a reform thereof – a need that was also established by all the previous reviews on the *Estate Duty Act* and contemporary research done.²¹⁴⁵ The underlying issues that inform the need for a revised *Estate Duty Act* were identified and analysed in Chapter 4.²¹⁴⁶ These issues are briefly referred to below, followed by the recommendations discussed in Chapter 4 in answering the primary research question, considering the comparative study conducted in Chapter 5 so that they are properly understood.

Please note that new recommended insertions to the *Estate Duty Act* have been indicated by underlined words and sentences, for example: insertion. Recommended omissions from the *Estate Duty Act* have been indicated by striking out the words or sentences concerned, for example: ~~deletion~~.

6.2.1 Issue 1: Definition of "ordinarily resident"

6.2.1.1 The need for change

In paragraph 4.2.1.2.1 it was found that the lack of a definition for "ordinarily resident" under the *Estate Duty Act* undermines the canon of certainty when determining a deceased person's residence status. It was concluded that the reliance on case law to apply the existing intention-based test is considered insufficient due to the constantly changing circumstances of taxpayers and no guidance as to when a person becomes or ceases to be a resident.²¹⁴⁷ Paragraph

²¹⁴⁵ See paras 1.1.2, 3.4.3, 3.5.3 and 3.6.3 above.

²¹⁴⁶ See paras 4.2.1 to 4.2.9 above.

²¹⁴⁷ See paras 4.2.1.2.1.1, 4.2.1.2.1.2 and 4.2.1.2.1.3 above.

4.2.1.2 pointed out a further misalignment in a taxpayer's status depending on the tax involved, due to the *Income Tax Act* that refers to a "resident" and the *Estate Duty Act* to "ordinarily resident".²¹⁴⁸ The UK had, similar to South Africa, an "ordinarily resident test" that was, however, later on, replaced by a statutory residence definition. Paragraph 5.2.3.2.3 analysed the UK's statutory residence definition that serves as a benchmark for South Africa to provide similar clarity in determining a person's tax status through a statutory definition that applies across taxes.²¹⁴⁹

The recommendation for a statutory definition of a "resident" under the *Estate Duty Act* is set out below.

6.2.1.2 Recommendation

The concept of "ordinarily resident" is found in the *Income Tax Act*, the *Estate Duty Act*, as well as in the various estate tax treaties. The impact of a statutory definition is therefore not limited to the *Estate Duty Act*, but the recommendation below is limited to the context of the *Estate Duty Act*. It is submitted that in further research it may be considered across taxes for further alignment and certainty. Using the UK statutory residence test as a valuable benchmark to determine tax residency,²¹⁵⁰ it is recommended that the concept of "ordinarily resident" is replaced with a statutory definition for "resident" in section 1(1) of the *Estate Duty Act* that includes the principles suggested in the preliminary draft below:

"resident", means a natural person who—

(a) is a national of the Republic at the time of his or her death and is permanently based in the Republic, where such a person—

(i) is considered to be a resident from the date of birth, or

(ii) has ceased to be a resident for a period of time, and subsequently returned to the Republic,

²¹⁴⁸ See also paras 4.2.1.1 and 4.2.1.2 above for a detailed discussion on the challenges regarding the jurisdictional basis under the *Estate Duty Act*.

²¹⁴⁹ See also para 3.5.2.9 above.

²¹⁵⁰ See para 5.2.3.2.3 above.

then the person is considered to be a resident from the date the person becomes a resident in the Republic again; or

- (b) is a national of the Republic and spends more than 183 days in aggregate in a year of assessment in the Republic, where such person is considered to be a resident from the 184th day, unless the person proves his or her tax residency in another country; or
- (c) spends more than 91 days in aggregate in the Republic in three consecutive years of assessment (such a person is considered to be a resident from the start of the fourth year of assessment); or
- (d) in the case of a foreigner, is a person who obtains permanent residence in the Republic (such person is considered to be a resident from the day permanent residence is obtained); or
- (e) if none of the above tests applies, if such a person has the closest connections with the Republic based on facts and circumstances during a year of assessment. The criteria to determine the closest connection with the Republic include:
 - (i) more than fifty per cent of the person's time (whether business or personal) was spent in the Republic during the year of assessment;
 - (ii) a permanent home is available in the Republic;
 - (iii) the person's spouse or children lives in the Republic;
 - (iv) the children attend schools in the Republic;
 - (v) the person is employed or self-employed in the Republic;
 - (vi) more than fifty per cent of the person's monetary investments are in the Republic;
 - (v) the person is a member of clubs and/ societies or other similar activities/organisations in the Republic;

Provided that if a deceased person dies during the year of assessment, the criteria under paragraphs (a) to (d) for that particular year of assessment, must be calculated from the start of the year of assessment up to the day of death.

- (f) A South African national or tax resident who left the Republic and no longer has a permanent home available in the Republic, is deemed to remain a resident in the Republic even if he or she is not physically present in the Republic for more than 183 days in aggregate during any period until three years have elapsed from the end of the year in which the person left the Republic: Provided that if such person produces evidence that he or she has obtained tax residence in another country (during the three years), the person

is deemed not to be a resident of the Republic from the day he or she obtains the foreign tax residence.²¹⁵¹

The above test is based on facts and physical presence with no reliance on a person's intention to determine his or her residence for tax purposes in South Africa. From 1 March 2006, the physical presence test under the *Income Tax Act* changed from a three-year test to a five-year test.²¹⁵² The reason for the change was to align with international practice and to make South Africa more attractive for expatriates.²¹⁵³ However, current international practice favours a 183-day presence to trigger tax residence or, in the case of a longer period exceeding one year, the period is three years.²¹⁵⁴

The statutory definition may be administratively burdensome to prove the necessary physical presence or, where applicable, the closer connection to South Africa. However, when measured against the benefit of certainty without relying on a person's intention and the reduced inequity in tax consequences, it may serve to be a viable solution to replace the existing intention-based test. It was found in paragraph 4.2.1.2.2 that a statutory residence test, based on facts that are easily determined and quantified, is aligned with the OECD standards and results in certainty to determine a person's tax residence.²¹⁵⁵ The factual determination that is not reliant on a person's subjective intention or the Commissioner's interpretation thereof promotes the canon of equity. Furthermore, the proposed three-year rule for a person to remain a tax resident after leaving South Africa serves as a specific anti-avoidance rule. This rule continues to regard a person as a tax resident unless that person becomes a tax resident in a foreign country, in which case tax residence in South Africa will cease. This prevents the existing concern where a person ceases tax residence in South Africa without becoming a tax resident elsewhere.

²¹⁵¹ Underlining indicates original knowledge contribution to the field of law.

²¹⁵² Section 3(1)(i) of the *Revenue Laws Second Amendment Act* 32 of 2005.

²¹⁵³ National Treasury *Memorandum on the Revenue Laws Second Amendment Bill, 2005* Clause 1.

²¹⁵⁴ OECD 2023 <https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/>. The shorter periods may be ascribed to the change in the global environment where people move around more frequently.

²¹⁵⁵ See Arendse, Stark and Renaud 2015 *Southern African Business Review Special Edition Tax Stories* 15.

Should the above definition be considered, it will result in many consequential amendments where any reference to "ordinarily resident" in the *Estate Duty Act* must be replaced with "resident". From an estate tax treaty perspective, a provision may be required to provide that any estate tax treaty that refers to "ordinarily resident" should be read to include the new definition of "resident" in the *Estate Duty Act*.

In addition to the test for a "resident", it is recommended to provide further clarity as to when a person will be regarded as a non-resident. The following may apply:

"non-resident", means a natural person in the Republic at the date of death, if such person for a year of assessment, is—

- (a) a foreigner who never became a resident according to one of the above tests under the definition of "resident";
- (b) a resident who spent less than 91 days in the Republic during that year of assessment;
- (c) a person who left the Republic and took up tax residence in another country where such person is considered to be a non-resident from the day the person became a tax resident in that other country.²¹⁵⁶

It is concluded that, although this study is limited to a search for a revised *Estate Duty Act*, the above combined test for determining a resident may be considered in the wider tax context, and the existing two separate concepts of "resident" and "ordinarily resident" be replaced with the new statutory definition to include the proposed tests and bring greater alignment across taxes in South Africa.

6.2.2 Issue 2: The scope of property

6.2.2.1 The need for change

6.2.2.1.1 Property of a non-resident

In paragraph 4.2.2.1 it was noted that, in the case of a non-resident, a wider scope of property is included for CGT purposes in comparison to estate duty purposes. The relevant property relates to indirect interests in the form of shares held in a

²¹⁵⁶ Underlining indicates original knowledge contribution to the field of law.

foreign company that owns South African immovable property, which results in any CGT payable on such property not qualifying as a deduction for estate duty purposes.²¹⁵⁷ It was further concluded that the misalignment may open a planning opportunity to escape estate duty due to unequal treatment.²¹⁵⁸ An analysis with the UK supports the inclusion of such indirect interests into an estate for estate duty purposes to avoid planning opportunities and reduce uncertainty.²¹⁵⁹

To bring alignment between CGT and estate duty and to close potential gaps for estate duty avoidance, the recommendation in paragraph 6.2.2.2.1 is made.

6.2.2.1.2 Life policies

In paragraphs 4.2.2.2.1 to 4.2.2.2.3 various issues were analysed regarding section 3(3)(a) of the *Estate Duty Act* and the following conclusions were reached:

- (a) The underlying rationale to include a life policy as deemed property even if the deceased made no contribution and enjoyed no benefit therefrom, is flawed.²¹⁶⁰
- (b) Clarity is required as to when a premium is considered to be paid and by whom.²¹⁶¹
- (c) Horizontal equity is lacking regarding the beneficiary who is liable for the estate duty on the life policy by not taking into account the beneficiary's circumstances.²¹⁶²
- (d) Difficulty exists with regard to the collection of the estate duty if the beneficiary is a non-resident situated outside South Africa.²¹⁶³

²¹⁵⁷ Section 3(2) of the *Estate Duty Act* and para 2(b) of the Eighth Schedule to the *Income Tax Act*.

²¹⁵⁸ See para 4.2.2.1 above.

²¹⁵⁹ See para 4.2.2.1 above.

²¹⁶⁰ See paras 4.2.2.2.1 and 4.2.2.2.2 above and Davis, Beneke and Jooste *Estate Planning* 2.4.2.1.

²¹⁶¹ See para 4.2.2.2.2 above.

²¹⁶² See para 4.2.2.2.2 above.

²¹⁶³ See para 4.2.2.2.3 above.

The treatment under the UK and US regimes analysed in paragraphs 5.2.4 and 5.3.4 favours the exclusion of life policies paid out to third parties.

The recommendation to provide clarity to the provisions on life policies are set out in paragraphs 6.2.2.2.2 and 6.2.2.2.3 below.

6.2.2.2 Recommendation

6.2.2.2.1 Property of a non-resident

It is recommended that the treatment of a non-resident for CGT and estate duty purposes should be aligned by including indirect interests in South African immovable property under section 3(2) of the *Estate Duty Act*. This will ensure that interests held in South African property through foreign structures are included for estate duty purposes, which not only promotes the canon of equity in that a non-resident will be treated similarly for CGT and estate duty purposes, but will also serve as a potential specific anti-avoidance rule. Any CGT liability on foreign property²¹⁶⁴ will be included as a debt due that results in a deduction for estate duty purposes. The insertion in section 3(2) after paragraph (b) of the *Estate Duty Act* may look as follows:

- (2) "Property" means any right in or to property, movable or immovable, corporeal or incorporeal, and includes—

(a)-(b) ...

(bB) immovable property situated in the Republic held by the deceased if the deceased is not a resident in the Republic at the date of death, or any interest or right of whatever nature of that person to or in immovable property situated in the Republic including rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits and other natural resources: Provided any interest in immovable property situated in the Republic includes any equity shares held by a person in a company or ownership or the right to ownership of a person in any other entity or a vested interest of a person in any asset of any trust if—

²¹⁶⁴ The inclusion of the foreign property may be due to the deceased being a resident by way of physical presence for CGT purposes or due to the deceased being a non-resident but the indirect interest in a company owning foreign immovable property (see para 4.2.2.1 above).

- (i) 80 per cent²¹⁶⁵ or more of the market value of those equity shares, ownership or right to ownership or vested interest, as the case may be, at the time of disposal thereof is attributable directly or indirectly to immovable property situated in the Republic or any interest or right of whatever nature to or in immovable property situated in the Republic including rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources in the Republic; and
- (ii) in the case of a company or other entity, the deceased (whether alone or together with any connected person in relation to the deceased), directly or indirectly, holds at least 20 per cent²¹⁶⁶ of the equity shares in that company or ownership or right to ownership of that other entity.²¹⁶⁷

6.2.2.2.2 Life policies

In the search for a more justified approach regarding life policies where the estate duty liability is based on the deceased's property as at the date of death and not merely on benefits payable to a third party, recommendation is made for consideration to adapt section 3(3)(a) and section 3(3)(a)(i) of the *Estate Duty Act* as follows:

(3) Property which is deemed to be the property of the deceased includes—

- (a) so much of any amount due and recoverable under any policy of insurance which is a 'domestic policy', payable to any other person (excluding the deceased estate), which is effected by the deceased upon the life of the deceased as exceeds the aggregate amount of any premium or consideration proved to the satisfaction of the Commissioner to have been paid by any person who is entitled to the amount due under the policy, together with interest at six per cent per annum calculated upon such premiums or consideration from the date of payment to the date of death and all premiums of the policy are paid directly or indirectly by the deceased, or where the deceased only paid some of the premiums, the amount due and recoverable under any policy of insurance in proportion to the aggregate of the premiums paid directly or indirectly by the deceased: Provided that the foregoing provisions of this paragraph shall not apply in respect of any amount due and recoverable under a policy of insurance, if the amount due under such policy is—

²¹⁶⁵ The percentage is aligned to the percentage used for CGT purposes.

²¹⁶⁶ The percentage is aligned to the percentage used for CGT purposes.

²¹⁶⁷ Underlining indicates original knowledge contribution to the field of law. The recommended inclusion is using the same wording as para 2(b) of the Eighth Schedule to the *Income Tax Act*.

- (i) ~~the amount due under such policy is recoverable by the surviving spouse or child of the deceased under a duly registered ante-nuptial or post-nuptial contract; or~~
- (ii) below the value of R2 million;²¹⁶⁸ or

Considering the above recommendation, the exclusions under section 3(3)(a)(iA) and (ii) may become superfluous as they will already be excluded to the extent that they fall outside the scope of the above recommendation. Any policy paid to the deceased estate is already included in the estate under section 3(2) of the *Estate Duty Act* and the deeming provisions are limited to third party payments meeting the recommended criteria as set out under section 3(3)(a) above, which eliminates any confusion that prevails under the existing wording of the Act. The recommendation enhances the canon of simplicity and certainty by only targeting policies in which the deceased has an interest at the date of death and simplifying the estate duty calculation in respect thereof.

Furthermore, in the case where the policy is paid into the estate, the main tax burden is suffered by the residuary heirs without the same suffered by the legatees. To alleviate the possible hardship and promote fairness, an exempt threshold of R2 million is proposed to only make a life insurance policy subject to estate duty if the value of the life policy proceeds exceeds R2 million.²¹⁶⁹

6.2.2.2.3 Payment of the estate duty liability on life policies

To address the estate duty avoidance concern regarding non-resident beneficiaries situated outside South Africa, a "withholding tax" is proposed to avoid the potential risk and to ensure the tax base is protected. However, although the risk may be greater in respect of a non-resident beneficiary, the same may apply for resident beneficiaries as the executor does not have control over the funds that are paid

²¹⁶⁸ Underlining indicates original knowledge contribution to the field of law. An alternative option may be to provide an exempt threshold in respect of the total amount of life policies, however, the administrative challenges that may arise in determining the dutiable portion for each policy after applying the exemption will need to be considered and have not been analysed in this study.

²¹⁶⁹ The value of R2 million is for academic purposes of this study and another value may serve more justifiable based on statistical analysis that might be done outside the scope of this study.

directly to the beneficiary. A combined solution to the risk of non-payment of the estate duty liability consists of a withholding tax for all insurance policy proceeds, whether paid to a resident or a non-resident beneficiary. Although the withholding tax creation may result in an administrative burden to SARS and the paying financial institution, as well as a cost implication to design the necessary systems and forms, the more efficient collection of increased revenue may override the corresponding burden.

It is accepted that the paying financial institution would not know whether the estate will be subject to an estate duty liability and therefore it is suggested that a provisional flat rate withholding tax of 10% from the life policy proceeds be applied. Should the life policy end up not being dutiable, the 10% withholding tax is not too harsh to create a financial burden. A refund of the overpayment will be available through the normal channels without further legislative considerations. If the life policy remains dutiable, the outstanding portion remains payable under the normal payment rules. Considering the recommendation under paragraph 6.2.2.2.2 above for an exempt threshold, the withholding tax only becomes applicable for policy payouts greater than the threshold of R2 million. A withholding tax supports the revenue objective of taxation and minimises the potential non-payment of estate duty. However, the benefit will have to be measured against the costs involved to ascertain if it is feasible. The introduction of a withholding tax may be catered for by the insertion of the following section after section 11 of the *Estate Duty Act*:

11A Withholding of estate duty

- (1) Any person who is required to pay the property referred to in section 3(3)(a) to any person other than the executor, must deduct or withhold an amount from the policy, the amount of tax at a rate of ten per cent as a provisional payment of tax for which the recipient may be liable for.
- (2) The person from whom an amount was deducted or withheld in terms of subsection (1), is deemed to have received the amount so deducted or withheld.
- (3) The amount deducted or withheld in terms of subsection (1), must be paid to the Commissioner before the end of the month following the month during which that amount was so deducted or withheld.

- (4) The payment contemplated in subsection (3) is a payment made on behalf of the person in respect of his or her liability under section 11(b)(i).
- (5) The person who pays to the Commissioner any amount contemplated in subsection (3), must, together with the payment, submit a return to the Commissioner.^{2170 2171}

The above recommendation may assist taxpayers to comply as well as enhance the collection of revenue in a simple and efficient manner.

6.2.3 Issue 3: The section 4(q) deduction

6.2.3.1 The need for change

The continuation of the preferential treatment of a surviving spouse has been reviewed by the Margo and Katz Commissions as well as the DTC.²¹⁷² Paragraph 4.3.3.3 analysed the constitutionality of the existing deduction and set out an argument for the provision, which is aligned to international standards, to be considered constitutional.²¹⁷³ However, the uncertainty in respect of the application of the provisos to section 4(q)²¹⁷⁴ and the possible estate duty avoidance in respect of a non-resident surviving spouse were identified for a review.²¹⁷⁵

The UK and the US provides an unlimited exclusion for a resident spousal bequest, but a limited exclusion for a non-resident surviving spouse.²¹⁷⁶ South Africa makes no similar distinction under the *Estate Duty Act*, which may result in potential estate duty avoidance. However, a similar limitation exists for CGT purposes where rollover relief is available for a disposal to a resident spouse, but not for a non-resident spouse.²¹⁷⁷

²¹⁷⁰ The return may consist of a similar type of submission as an EMP201 in respect of employees' tax where the insurer discloses to SARS the withholdings that were done on a monthly basis.

²¹⁷¹ Underlining indicates original knowledge contribution to the field of law.

²¹⁷² See paras 3.2.3, 3.3.3, 3.4.3.2 and 3.6.2.1 above.

²¹⁷³ OECD Inheritance Taxation in OECD Countries 78.

²¹⁷⁴ See paras 4.2.3.4 and 4.2.3.5 above.

²¹⁷⁵ See para 4.2.3.6 above.

²¹⁷⁶ See paras 5.2.6.3, 5.3.6.4.3 and 5.3.6.4.4 above.

²¹⁷⁷ See para 4.2.3.6 above.

The paragraph below provides the recommendations for section 4(q) to bring clarity and certainty to its application.

6.2.3.2 Recommendation

On the basis that it is argued in this study that section 4(q) should be retained, it is submitted that, through a limitation in the form of a capped amount, any concern of abuse can be minimised and the loss of revenue due to the preferential treatment can be reduced. However, instead of a fixed capped amount, relief in the form of a percentage, based on the net value of the estate before the section 4(q) deduction, is proposed. This will ensure that, if section 4(q) may become superfluous due to the minimal amount allowed as a deduction, a large estate will not be discriminated against.

In respect of the first proviso, a specific exclusion is recommended for a bequest price payable to the deceased estate to ensure the "spirit" is upheld and that the avoidance of estate duty is limited. Recommendations regarding the second proviso are aimed at bringing clarity to the application of the proviso. The following changes are proposed to section 4(q):

- (q) so much of the value of any property included in the estate, limited to fifty per cent of the net value excluding this deduction, which has not been allowed as a deduction under the foregoing provisions of this section, as accrues to the resident surviving spouse of the deceased: Provided that the deduction allowable under the provisions of this paragraph shall be—
 - (i) ~~the deduction allowable under the provisions of this paragraph shall be reduced by so much of any amount as the resident surviving spouse is required in terms of the will of the deceased to dispose of to any other person or trust (excluding any amount payable to the deceased estate);~~
 - (ii) ~~no deduction shall be allowed under the provisions of this paragraph in respect of any property which accrues to a trust established by the deceased for the benefit of the surviving spouse, if the trustee of such trust has a discretion to allocate such property or any income therefrom to any person other than the surviving spouse limited to the extent that the resident surviving spouse had a vested right in any property which is held in a trust, or any income deriving therefrom established by the~~

deceased that cannot be defeated by a trustee's discretion to any person other than the surviving spouse.²¹⁷⁸

The above recommendation promotes the canon of certainty by providing greater clarity through the wording of the law. The retention of the deduction may be seen as not enhancing the canon of equality between married couples and single persons. However, the limitation to the deduction may reduce the inequality, while still adhering to the original purpose of the provision and keeping the *Estate Duty Act* aligned to international standards.

6.2.4 Issue 4: The meaning of "accrual" under the *Estate Duty Act*

6.2.4.1 The need for change

Paragraph 4.2.4 identified the fact that the *Estate Duty Act* does not define the meaning of "accrual", specifically taking into account the impact of the law of succession.²¹⁷⁹ Clarity regarding the point at which a beneficiary becomes unconditionally entitled to an inheritance must be established to determine the available deductions in calculating the estate duty liability.²¹⁸⁰

The paragraph below sets out the recommendation to provide clarity through a statutory definition of "accrual" for estate duty purposes.

6.2.4.2 Recommendation

Based on the analysis done, an "accrual" is considered to take place when a right vest unconditionally²¹⁸¹ and takes place at the time of death (*dies cedit*) if the benefit is adiated and no suspensive condition is attached thereto.²¹⁸² Even though the enforceability of the benefit (*dies venit*) only arises once the L & D account is

²¹⁷⁸ Underlining indicates original knowledge contribution to the field of law.

²¹⁷⁹ See also paras 4.2.4.3 and 4.2.4.4 above.

²¹⁸⁰ Specifically, s 4(h) and (q). See paras 4.2.4.6.1 and 4.2.4.6.2 above.

²¹⁸¹ See para 4.2.4.2 above.

²¹⁸² See paras 4.2.4.3 and 4.2.4.4 above.

approved, it does not make the personal right obtained at death a conditional right.²¹⁸³

In the search for certainty as to when an inheritance is considered to accrue to a beneficiary, the introduction of the following definition under section 1(1) of the *Estate Duty Act* is recommended:

"accrual" is defined to mean a vested right in respect of which a beneficiary is unconditionally entitled to a complete real or personal right as at the date of death, as the approval of the liquidation and distribution under section 35(12) of the Administration of Estate Act, 1965 is not considered a suspensive condition but a mere time clause. The ownership of the benefit, and the transmissibility and immediate enjoyment of the right are not requirements for it to be considered to have accrued. A right subject to a suspensive condition is only considered to accrue when all restrictions are lifted, or conditions are met.²¹⁸⁴

The above definition supports the policy intention of section 4(h)(i) of the *Estate Duty Act*, where a PBO must be approved at the time of death for the bequest to be deducted for estate duty purposes. Paragraph 4.2.4.6.1 pointed out that the approval of a PBO at the time of death creates an anomaly with respect to a PBO created in a will which will not be approved at the time of death.²¹⁸⁵ It is therefore recommended that the wording of section 4(h)(i) of the *Estate Duty Act* should be amended as follows:

any public benefit organisation which is exempt from tax in terms of section 10(1)(cN) of the Income Tax Act, 1962 (Act 58 of 1962), as at the date of death; or in the case of a public benefit organisation created in the will of a deceased person and only approved after the date of death is for purposes of this Act deemed to be exempt as at the date of death: provided the approval is obtained before the liquidation and distribution account is distributable under section 35(12) of the Administration of Estates Act, 1965; or²¹⁸⁶

The above recommendation is considered to promote the canon of certainty and clarity regarding the timing of the accrual of an inheritance to determine the correct qualifying section 4(h) deduction. It is further considered to enhance the canon of equity in that, for purposes of the deduction available for estate duty, no unjustified

²¹⁸³ See para 4.2.4.3 above.

²¹⁸⁴ Underlining indicates original knowledge contribution to the field of law.

²¹⁸⁵ See para 4.2.4.6.1 above.

²¹⁸⁶ Underlining indicates original knowledge contribution to the field of law.

differentiation is made between a PBO created before death and one created at death.

6.2.5 Issue 5: Primary abatement

6.2.5.1 The need for change

6.2.5.1.1 Primary abatement

In paragraph 4.2.5.1 it was found that a major fiscal drag resulted from the primary abatement under section 4A of the *Estate Duty Act*, available to residents and non-residents, which has not been adjusted for inflation since 2007. This resulted in many deceased persons becoming subject to estate duty instead of limiting the burden of the estate duty to the wealthy of society.²¹⁸⁷ The comparative study in paragraphs 5.2.6.1 and 5.3.6.1 supports an annual adjustment of an abatement for inflation, as well as a higher exempt threshold for residents compared to non-residents on the basis that a non-resident is not taxed on a worldwide basis but on a source basis, which is similar to the basis of taxation under the *Estate Duty Act*.

Paragraph 6.2.5.2 below sets out the recommendation for the primary abatement to provide clarity regarding the value of the abatement as well as the distinction between a resident and a non-resident.

6.2.5.1.2 Portable abatement

In paragraph 4.2.5.3 it was argued that the section 4A(2) portable abatement between spouses lacks justification as the deduction under section 4(q) is considered sufficient for bequests between spouses.²¹⁸⁸ Although paragraph 5.2.6.1 pointed out that both the UK and the US allow for a portable exemption, the

²¹⁸⁷ See para 4.2.5.2 above. See also OECD *Inheritance Taxation in OECD Countries* 82 and paras 3.2.3, 3.3.3 and 3.4.3 for the reviews of the previous Commissions of Enquiry that support an increased one-off exempt threshold.

²¹⁸⁸ See also para 3.6.2.3 above.

remainder of the OECD countries, however, limit the relief in respect of a spousal bequest, without portable transfers.²¹⁸⁹

The paragraph below sets out the recommendation in respect of the portable abatement regarding a surviving spouse.

6.2.5.2 Recommendation

On the basis that the primary abatement should be aimed at exempting small estates to reduce unnecessary administrative burdens as well as producing an equalising effect on the distribution of wealth, the primary abatement should be adjusted for inflation to reflect its real value. The single abatement promotes the canons of simplicity, certainty and equality by not limiting the preferential treatment to spouses and by lifting the administrative burden of accessing the abatement.²¹⁹⁰ A distinction is made between a resident and a non-resident to limit the available exempt amount in respect of both due to the different bases of taxation that apply.²¹⁹¹

The following amendment to section 4A(1) is recommended for consideration:

~~Subject to subsections (2) and (3), [T]he dutiable amount of the estate of any person shall be determined by deducting from the net value of that estate, as determined in accordance with section 4, an amount of R3,5 million. who is—~~

- (a) resident in the Republic at the date of death shall be determined by deducting from the net value of that estate, as determined by section 4, an amount of R8,5 million which Rand value shall be calculated with due allowance for any difference which may exist in the value of money at the promulgation of this amendment and the year of assessment in which the deceased died, and for that purpose the weighted average of the consumer price index as published from time to time in the *Gazette* serves as *prima facie* proof of any change in the value of money; or
- (b) non-resident in the Republic at the date of death shall be determined by deducting from the net value of that estate, as determined by section 4, an amount of R8,5 million.²¹⁹²

²¹⁸⁹ OECD *Inheritance Taxation in OECD Countries* 82-83.

²¹⁹⁰ See para 4.2.5.3 above.

²¹⁹¹ Non-residents are taxed on a source basis whereas a resident is taxed on a worldwide basis.

²¹⁹² Underlining indicates original knowledge contribution to the field of law. The value of R8.5 million was calculated based on the inflation rate applicable since 2007.

The distinction between a resident and a non-resident is considered justified based on the different bases of taxation. However, to address the existing fiscal drag in both instances, it is suggested to increase the abatement in general to its present value. The proposal to only increase the abatement for a resident with inflation going forward will allow for the differentiation to take effect.

Regarding the portable abatement between spouses, it is recommended, based on the reasons provided in paragraph 4.2.5.3, to withdraw the portable abatement through the deletion of section 4A(2) to (6), which is argued will enhance the canon of equality and address concerns of abuse and avoidance by making a larger primary abatement available to all deceased persons.²¹⁹³

6.2.6 Issue 6: Valuation rules

6.2.6.1 The need for change

6.2.6.1.1 Listed and unlisted shares

Paragraph 4.2.6.2 concluded that the different valuation rules for listed and unlisted shares result in uncertainty when considering the deductibility of the CGT liability for estate duty purposes, especially when an asset is sold by the executor after the date of death in the liquidation of the estate.²¹⁹⁴ Unlisted shares are included at the market value at the date of death, excluding post-death growth, meaning the CGT payable by the deceased estate (which is a separate taxpayer for income tax purposes) on the growth in the value of the shares after the date of death is not allowed as a deduction for estate duty purposes.²¹⁹⁵ For other property, the selling price is included, resulting the CGT liability being deductible under section 4(c) of the *Estate Duty Act*, as the full value of the asset sold was included for estate duty purposes.²¹⁹⁶

²¹⁹³ See para 4.2.5.3 above.

²¹⁹⁴ Roeleveld 2015 *SAJAR* 158. See also ss 5(1)(a) and 5(1)(f) *bis* of the *Estate Duty Act*.

²¹⁹⁵ See para 4.2.6.2 above.

²¹⁹⁶ See paras 4.2.6.2, 5.2.5 and 5.3.5 above; McAllister 2022 *Integritax* 99 and OECD *Inheritance Taxation in OECD Countries* 101-103.

The recommendation for alignment in the valuation of the assets is set out in paragraph 6.2.6.2.1 below.

6.2.6.1.2 Ceasing limited interests

The valuation of a ceasing limited interest is different for estate duty and donations tax purposes.²¹⁹⁷ The complex valuation method under the *Estate Duty Act* does not adhere to the canon of equity and simplicity due to the basis on which the valuation is done and the beneficiary is required to pay for benefits before having the enjoyment thereof. It was concluded in paragraph 4.2.6.3 that similar outcomes may be obtained if the valuation is done over the life expectancy of the deceased in a much simpler way.²¹⁹⁸ In addition, the existing valuation rules for a ceasing limited interest result in an estate duty avoidance scheme, including the one-year *usufruct* scheme.²¹⁹⁹ No guidance is given by the UK where the limited interest holder is considered to be the absolute owner of the property and a limited interest.²²⁰⁰

The recommendation for the valuation of a ceasing limited interest is set out in paragraph 6.2.6.2.2 below.

6.2.6.2 Recommendation

6.2.6.2.1 Listed and unlisted shares

To address the gap in law created by the different valuation rules applicable to unlisted shares, it is recommended that section 5(1)(a) of the *Estate Duty Act* be deleted together with an amendment to section 4(c) to exclude any deduction for capital gains tax purposes.²²⁰¹ Such an approach is aligned with section 9HA of the *Income Tax Act* for the deemed disposal at the date of death. The result is that no

²¹⁹⁷ See para 4.2.6.3 above; s 11(a)(i) read with s 5(1)(b) of the *Estate Duty Act* and s 62(1)(a) of the *Income Tax Act*.

²¹⁹⁸ See para 4.2.6.3 above.

²¹⁹⁹ See para 4.2.6.4 above; Meyerowitz 2009 *The Taxpayer* 150 and Davis, Beneke and Jooste *Estate Planning* 12.3.

²²⁰⁰ See para 5.2.5 above. Only if there is an immediate post-death interest may a valuation become applicable.

²²⁰¹ See paras 4.2.6.2 and 4.2.6.5 above.

post-death growth in the value of assets will be considered for estate duty purposes as concluded in paragraph 4.2.6.2.

The deletion of the specific provision under section 5(1)(a) of the *Estate Duty Act* will result in the general rule under section 5(1)(g) of the *Estate Duty Act* to apply. This means that the market value as at the date of death must be used in respect of any asset not specifically provided for under section 5 of the *Estate Duty Act*.

The consequential amendment to section 4(c) of the *Estate Duty Act* could be as follows:

- (c) all costs which have been allowed by the Master in the administration and liquidation of the estate (excluding any capital gains tax liability arising after the date of death), other than expenses incurred in the management and control of any income accruing to the estate after the date of death;²²⁰²

The proposal is considered to enhance the canon of simplicity by reducing specific provisions that may cause misalignments and possible unjustified differentiation in valuation methods. The proposal for a general rule across all assets is therefore also considered to enhance the canon of equity.

6.2.6.2.2 Ceasing limited interests

Considering the analysis in paragraph 4.2.6.3 on the valuation of a ceasing limited interest and more specifically, a ceasing *usufruct*, the following recommendation is made to adhere to the canons of equality, certainty and simplicity, as well as introducing a potential specific anti-avoidance rule. It is recommended that paragraph (b) of section 5(1) be substituted by the following:

- (b) in the case of any such fiduciary, usufructuary or other like interest in property as is referred to in paragraph (a) of section 3(2), an amount determined by capitalising at twelve per cent the annual value of the right of enjoyment of the property in which the deceased held any such fiduciary, usufructuary or other like interest, to the extent to which the person who upon the cessation of the said interest of the deceased in consequence of the death of the deceased becomes entitled to any right of enjoyment of such property of whatever nature, over the expectation of life of the deceased.²²⁰³

²²⁰² Underlining indicates original knowledge contribution to the field of law.

²²⁰³ Underlining indicates original knowledge contribution to the field of law.

The above recommendation promotes the canons of simplicity and certainty in valuing a limited interest over the life expectancy of the deceased immediately prior to death without taking into account the life expectancy of the beneficiary or a shorter fixed period.

It is further proposed that the transferor-based approach should similarly be provided for in respect of the person who is liable for the estate duty liability on the ceasing limited interest. The following recommendation is made to section 11 of the *Estate Duty Act* to hold the executor liable on behalf of the deceased estate instead of the recipient of the ceasing limited interest:

The person liable for the duty shall be—

- (a) where duty is levied on property of the deceased which falls under subsection (2) of section ~~three~~ 3—
 - (i) as to any property referred to in paragraph (a) (excluding any fiduciary, usufructuary or other like interest) or (b) of that subsection, the person to whom any advantage accrues by the death of the deceased;²²⁰⁴

However, it is acknowledged that potential estate duty avoidance schemes may be designed for exempt beneficiaries under section 4(h) and (q), where the *usufruct* is transferred to such beneficiaries for a limited period before it is transferred to the ultimate beneficiary. It is therefore recommended, in addition to the above, that the following changes to section 4(h) and (q) be made to serve as specific anti-avoidance measures to combat estate duty avoidance schemes in respect of usufructs:

- (h) the value of any property included in the estate (excluding a usufructuary interest under section 3(2)(a) of this Act that is granted subject to a fixed period) which has not been allowed as a deduction under any other provision of this section which accrues or accrued to—...
- (q) so much of the value of any property included in the estate (excluding a usufructuary interest under section 3(2)(a) of this Act that is granted subject to a fixed period) which has not been allowed as a deduction under the

²²⁰⁴ Underlining indicates original knowledge contribution to the field of law. The executor will therefore be liable under s 11(a)(ii) as such ceasing limited interest will be included within the ambit of "any other property".

foregoing provisions of this section, as accrues to the surviving spouse of the deceased: Provided that—...²²⁰⁵

The above recommendation ensures that an estate duty avoidance scheme that utilises transfers under section 4(h) and (q) as an intermediary step in a usufructuary bequest to avoid estate duty, is prevented. However, the limited exclusion in respect of a period, ensures that where lifelong transfers are made, which does not result in an avoidance scheme, the deductions are still allowed. The latter addresses criticism against a proposal previously made by the National Treasury that it unfairly penalised all other *usufructs* unrelated to attempts to save estate duty that was set up for legitimate reasons.²²⁰⁶

6.2.7 Issue 7: Unilateral relief for double taxation

6.2.7.1 The need for change

Cross-border estates may have double tax consequences and due to the limited tax treaty network for estate duty, unilateral relief under section 16(c) of the *Estate Duty Act* must be relied on.²²⁰⁷ Paragraph 4.2.7.2 analysed the uncertainty that exists regarding the application of section 16(c), as it lacks guidance regarding the scope of death duties that may qualify for relief,²²⁰⁸ qualifying foreign property,²²⁰⁹ the relevant exchange rate to be used,²²¹⁰ the date on which the conversion should be done,²²¹¹ the method to calculate the foreign death duty attributable to the foreign property,²²¹² the period in which the relief can be sought, and the method to calculate the limitation regarding the possible relief.²²¹³ Paragraphs 5.2.6.6 and 5.3.6.5 provided useful guidance to South Africa as both the UK and the US have specific rules regarding the scope of the qualifying taxes, the method that must be

²²⁰⁵ Underlining indicates original knowledge contribution to the field of law.

²²⁰⁶ See para 4.2.6.4 above.

²²⁰⁷ See para 4.2.7.1 above.

²²⁰⁸ See para 4.2.7.2.1 above.

²²⁰⁹ See para 4.2.7.2.2 above.

²²¹⁰ See para 4.2.7.2.3.2 above.

²²¹¹ See para 4.2.7.2.3.2 above.

²²¹² See para 4.2.7.2.3.3 above.

²²¹³ See para 4.2.7.2.3.4 above.

used to attribute foreign tax to the relevant property and the period in which relief can be claimed.

The following section provides the recommendations for section 16(c) to address the issues identified and listed above.

6.2.7.2 Recommendation

The following recommendations are proposed regarding the unilateral relief that is sought under section 16(c) of the *Estate Duty Act*. To provide clarity regarding the scope of qualifying foreign taxes, as well as the exchange rate that should be used, the following definitions for "death duties" and "spot rate" under section 1(1) of the *Estate Duty Act*²²¹⁴ is recommended:

"death duties", for purposes of section 16(c) of this Act, include an estate tax, an inheritance tax, a stamp duty on an inheritance, as well as a gift tax levied upon the death of the deceased, but excluding any foreign income taxes (including capital gains tax).²²¹⁵

and

"spot rate", means the appropriate quoted exchange rate at a specific time set out in section 16(c) of this Act, by an authorised dealer in foreign exchange for the delivery of currency.²²¹⁶

The above provides clarity as to the type of foreign taxes that may apply, irrespective of who paid it, as well as the exchange rate that must be used to convert the foreign death duty value to South African Rands. Furthermore, considering the issues identified and discussed in paragraph 4.2.7.2 above, the recommendations for consideration to improve section 16(c) of the *Estate Duty Act* are as follows:

16. Deduction of transfer duty and donations tax

There shall be deducted from any duty payable under this Act—

- (c) without in any way modifying or adding to the rights of any person under an agreement entered into by the Government of the Republic with the

²²¹⁴ See para 4.2.7.2.1 above.

²²¹⁵ Underlining indicates original knowledge contribution to the field of law.

²²¹⁶ Underlining indicates original knowledge contribution to the field of law.

Government of any other country or territory relating to the prevention of or relief from double taxation in respect of estate duty, any amount of any death duties proved to the satisfaction of the Commissioner to have been paid to any other State in respect of any property situate outside the Republic property that is similarly defined or treated as in the Republic and included in the estate of any person who at the date of his death was ordinarily resident in the Republic: Provided that the deduction under this paragraph shall not exceed the duty imposed on such property by this Act or attributable to the foreign property as per the formula below, which can be calculated as follows:

$x = a/b$ multiplied by c ,

where

x = estate duty attributable to the foreign property

a = value of the foreign property included in the net value of the estate

b = net value of the estate in the Republic

c = estate duty payable on the dutiable amount:

Provided that the relief sought is subject to the following conditions:

- (i) no relief is automatically allowed but must be applied for;
- (ii) relief is limited to death duties paid in respect of the same asset that is also subject to estate duty in the Republic;
- (iii) any amount of foreign death duties that is claimed as a credit in any currency other than the currency of the Republic must be translated to the currency of the Republic by applying the spot rate on the date on which the foreign death duty was paid; and
- (iv) any application for a credit in respect of a foreign death duty paid against the estate duty payable in the Republic must be made within three years after the date the estate duty was assessed by SARS or within five years from the date the estate duty return under section 7(1) was submitted where it constitutes a self-assessment.²²¹⁷

The above suggestions promote the canon of certainty by providing clear guidance on how and when relief from double taxation can be claimed.

²²¹⁷ Underlining indicates original knowledge contribution to the field of law.

6.2.8 Issue 8: Anti-avoidance rules

6.2.8.1 The need for change

Paragraph 4.2.8 pointed out the fact that the *Estate Duty Act* does not contain any general anti-avoidance rules, which have drawn attention since the earliest Commissions of Enquiry as discussed in Chapter 3.²²¹⁸ The limited specific anti-avoidance rules were further noted to provide ample opportunity for estate duty avoidance schemes without combatting provisions. Various specific provisions were analysed that include a limitation to the deduction in respect of spousal and charitable bequests;²²¹⁹ the introduction of deeming provisions when a person ceases to be a resident;²²²⁰ including household goods in the estate as a percentage of the estate's housing property,²²²¹ and providing a clear scope for the expenses that will qualify within the scope of funeral expenses, subject to a limitation.²²²²

Paragraph 5.2.9 sets out the guidance from the UK on specific anti-avoidance rules, general anti-avoidance rules, as well as disclosure programmes which, if tailored to the South African context, may strengthen the anti-avoidance framework under the *Estate Duty Act*.

The recommendations in respect of specific anti-avoidance rules are set out below.

6.2.8.2 Recommendation

The need for specific avoidance rules has already been addressed in this chapter in relation to the proposed deeming provision when a person ceases to be a resident,²²²³ a limitation in respect of the deduction for a bequest to a surviving spouse,²²²⁴ as well as an avoidance rule to combat the one-year *usufruct* scheme by excluding from the section 4(h) and (q) deductions any *usufruct* that is transferred

²²¹⁸ See paras 3.4.2.8, 3.5.2.8 and 3.6.2.8 above.

²²¹⁹ See paras 4.2.8.3.2, 4.2.8.3.1 and 6.2.3.2 above.

²²²⁰ See para 4.2.8.3.3 and 6.2.1.2 above.

²²²¹ See para 4.2.8.4.1 above.

²²²² See para 4.2.8.4.2 above.

²²²³ See para 4.2.8.3.3 and the recommendation in para 6.2.1.2 above.

²²²⁴ See para 6.2.3.2 above for the recommendation.

subject to a period.²²²⁵ Additional anti-avoidance measures relevant to the *Estate Duty Act* include a limitation to the deduction for charitable bequests;²²²⁶ the inclusion of household goods in the estate as a percentage of the estate's housing assets²²²⁷ and clarity on qualifying funeral expenses, subject to a limitation.²²²⁸

In paragraph 4.2.8.3.2 it was found that the relief for charitable bequests may result in potential estate duty avoidance. The deduction under section 4(h) of the *Estate Duty Act* is unlimited, which may result in possible estate duty avoidance, however, such avoidance may be justified as the funds are utilised for the benefit of the public. Such justification must be measured against the potential estate duty avoidance.²²²⁹ Aligned to the UK and the US, it is recommended that the existing section 4(h) be retained, however, to address the concern of abuse, a limitation may be introduced in the following way to only allow a deduction of 50% on the bequeathed property:

- (h) the value of any property included in the estate (excluding a usufructuary interest under section 3(2)(a) of this Act that is granted subject to a period)²²³⁰ not exceeding fifty per cent of the value of the property, which has not been allowed as a deduction under any other provision of this section which accrues or accrued to—...²²³¹

To address the potential abuse regarding household and personal use assets where the valuation thereof may be difficult to verify and result in an administrative burden, it is recommended that such assets be included in the estate as a percentage of the housing assets or, if no immovable assets are owned, the equivalent of a year's rental value where the deceased resided prior to death should be used. The following recommendation is made for consideration to section 5 by including an additional provision:

²²²⁵ See paras 4.2.8.3.2, 4.2.8.3.1 and the recommendation in para 6.2.6.2.2 above.

²²²⁶ See paras 4.2.8.3.2, 4.2.8.3.1 and 6.2.6.2.2 above.

²²²⁷ See para 4.2.8.4.1 above.

²²²⁸ See paras 4.2.8.4.2, 5.2.6.5 and 5.3.6.4.1 above.

²²²⁹ OECD *Inheritance Taxation in OECD Countries* 111-112; see also paras 3.4.2.8, 3.5.2.7, 3.5.2.8 and 3.6.2.8 above.

²²³⁰ For completeness' sake, the recommendation to s 4(h) in respect of the usufruct is also repeated here to provide a holistic view of the recommendation to the provision.

²²³¹ Underlining indicates original knowledge contribution to the field of law.

- (h) Subject to paragraph (g), any jewellery, furniture or household items must be valued and included in the estate at five per cent of the value of the immovable property in the estate unless the Commissioner is satisfied that a different value is more accurate and a true reflection of the value of such property in the estate: Provided that if no immovable property is owned by the deceased, five per cent of the annual rental value must be used.²²³²

The percentage-based inclusion is considered more equitable because the bigger an estate, the more likely a greater percentage of household goods may be in existence. The canon of convenience is also promoted that an automatic inclusion of 5% can be done without requiring valuations unless the executor is of the view that a higher or lower value applies in which case a market value valuation at the date of death must be done to adjust the automatic inclusion.

The possible abuse of section 4(a) regarding funeral expenses can be addressed through the following recommended changes:

- (a) so much of the funeral, tombstone and death-bed expenses of the deceased which is limited to the cost of the hearse, the coffin, the burial plot, the transfer cost of the body to its burial place, the cost of cremation, medical expenses (includes medical bills, medicines and nursing services) directly related to the deceased's last illness which the Commissioner considers to be fair and reasonable limited to the actual costs incurred not exceeding five per cent of the gross value of the estate;²²³³

The above recommendation is considered to provide clarity as to the scope and extent of the expenses allowed which enhances the canon of certainty. The limitation regarding the allowable deduction mitigates any potential abuse.

Regarding the possibility of disclosure programmes for estate duty, like those in the UK, it is agreed that, if the UK's rules are tailored to the South African context, it may strengthen the anti-avoidance framework under the *Estate Duty Act*. It is, however, noted that the reportable arrangement provisions under sections 35-39 of the *Tax Administration Act* contain a similar framework, however, the focus is mostly on income tax. The reportable arrangements that are currently listed under section 35 of the *Tax Administration Act* do not include an arrangement in respect of estate duty, however, nothing in the wording of the *Tax Administration Act* precludes the

²²³² Underlining indicates original knowledge contribution to the field of law.

²²³³ Underlining indicates original knowledge contribution to the field of law.

extension of such arrangements. It is therefore concluded that, although similar provisions could be considered for inclusion under the *Estate Duty Act*, the same purpose can be achieved by utilising the existing provisions under the *Tax Administration Act* and in future, as estate duty schemes are identified, include such schemes into the scope of section 35 that sets out the arrangements that must be reported.

6.2.9 Issue 9: Administrative provisions

6.2.9.1 The need for change

Administrative challenges under the *Estate Duty Act* are highlighted in paragraph 4.2.9.1 by the overarching administration of a deceased estate process that is supervised by the Master where strict timelines must be adhered to. Paragraph 4.2.9.2 discussed the provisions under the *Estate Duty Act* which cause delays in finalising an estate. Such provisions include the absence of a timeline in which an estate duty return should be submitted,²²³⁴ the uncertainty regarding the obligation to submit an estate duty return,²²³⁵ the type of assessment involved,²²³⁶ the due date for the payment of the liability,²²³⁷ the limited penalty²²³⁸ and tax administration provisions under the *Estate Duty Act*.²²³⁹

The recommendations with respect to each issue are summarised below before the recommendations are provided in paragraph 6.2.9.2.

6.2.9.1.1 Returns

Paragraph 4.2.9.2.1 set out the misalignment between the strict timelines prescribed by the Master and the lack of timelines under the *Estate Duty Act* causing delays to ensure the correct claims are provided for in the L & D account.²²⁴⁰

²²³⁴ See para 4.2.9.2.1 above.

²²³⁵ See para 4.2.9.2.2 above.

²²³⁶ See para 4.2.9.3 above.

²²³⁷ See para 4.2.9.4 above.

²²³⁸ See para 4.2.9.5 above.

²²³⁹ See para 4.2.9.6 above.

²²⁴⁰ See also OECD *Inheritance Taxation in OECD Countries* 100.

Guidelines from the UK and the US in paragraphs 5.2.8.1 and 5.3.8.1 provided that the submission of the UK inheritance tax return must be done within 12 months from the end of the month of death, and the US estate tax return within nine months after the date of the deceased person's death. Regarding the obligation to submit a return, the US only requires the return if the gross value of the estate exceeds the basic estate tax exemption for the year in which the deceased person died.²²⁴¹

Recommendations regarding clarity with respect to the timeline and the obligation to submit an estate duty return are set out in paragraph 6.2.9.2.1 below.

6.2.9.1.2 Assessments

The existing approach where an executor has to wait for SARS to issue an assessment regarding a dutiable estate causes huge delays. Paragraph 4.2.9.3 identified backlogs and capacity constraints at SARS as the root cause for the delays with no resolution in the foreseeable future. Both the UK and the US operate on a self-assessed basis, where the submission of a return and the payment of the liability takes place without having to wait for the revenue authority to issue an assessment.²²⁴²

Recommendations regarding the conversion of estate duty to a self-assessment system are set out in paragraph 6.2.9.2.1 below.

6.2.9.1.3 Payment rules

In paragraph 4.2.9.4 it was found that the payment provision under section 9C of the *Estate Duty Act* is limited to when an assessment is issued within 12 months after death. However, section 9C is silent on the obligation to pay within 12 months after the date of death if no assessment is issued within that twelve-month period after death, in which case interest becomes payable under section 10(1) of the *Estate Duty Act*. The approach by the UK and the US set out in paragraphs 5.2.8.2 and 5.3.8.2, encourages clear payment rules, circumstances where an extension

²²⁴¹ See paras 4.2.9.2.2 and 5.3.8.1 above.

²²⁴² See paras 5.2.8.1, 5.3.8.2, 5.4.1 and 5.4.2 above.

may be granted, and detailed rules relevant to deferred arrangements. The criteria to request an interest-free extension have also been criticised as vague and hindering compliance,²²⁴³ and the existing rules for deferred payment arrangements in the *Tax Administration Act*²²⁴⁴ were found insufficient for estate duty purposes, which may need specific criteria under the *Estate Duty Act*.²²⁴⁵

Recommendations regarding the payment rules under the *Estate Duty Act* are set out in paragraph 6.2.9.2.2 below.

6.2.9.1.4 Penalty provisions

Paragraph 4.2.9.5 pointed out the fact that the *Estate Duty Act* does not contain any penalty provisions in respect of the late or non-payment of the liability as well as the late or non-submission of the estate duty return. The issue of whether the executor should be held liable in their personal capacity was addressed in paragraph 5.2.8.3, and found applicable and aligned to international standards if the default is their fault.²²⁴⁶ Guidance from the UK and the US supports an extensive penalty regime for the late or non-submission of returns, incorrect filing of information, and the late payment of a liability.²²⁴⁷

Paragraph 6.2.9.2.3 sets out the recommendation with respect to the penalty provisions under a revised *Estate Duty Act*.

6.2.9.1.5 Tax administration provisions

The administrative provisions regarding estate duty are predominantly set out in the *Tax Administration Act* where a generic approach is followed that does not cater for the specific context of estate duty.²²⁴⁸ Specific areas of concern include the absence of filing timelines for the estate duty return,²²⁴⁹ the type of assessment,²²⁵⁰ and

²²⁴³ See para 4.2.9.4 above.

²²⁴⁴ Sections 167 and 168.

²²⁴⁵ See para 4.2.9.4 above.

²²⁴⁶ See also OECD *Inheritance Taxation in OECD Countries* 99-100.

²²⁴⁷ See paras 5.2.8.3 and 5.3.8.3 above.

²²⁴⁸ See para 4.2.9.6 above.

²²⁴⁹ See paras 4.2.9.2 and 6.2.9.1.1 above.

²²⁵⁰ See paras 4.2.9.3 and 6.2.9.1.2 above.

deferred payment arrangements that were already discussed.²²⁵¹ However, when considering write-off provisions, specifically temporary write-offs, various issues may arise if such a write-off is reinstated. It was found in paragraph 4.2.9.6 that it should have limited application, but currently no such limitation is provided. It is proposed that, instead of introducing new provisions under the *Estate Duty Act*, it may be more reasonable to merely add a limitation to the existing provisions of the *Tax Administration Act*. However, since this study is limited to the search for a revised *Estate Duty Act*, recommendations to the *Tax Administration Act* fall outside the scope of this study.

The various recommendations regarding administrative challenges discussed under paragraph 6.2.9.1 above are set out below.

6.2.9.2 Recommendations

6.2.9.2.1 Returns and assessments

A conversion of estate duty to a self-assessment tax impacts on the provisions dealing with the submission of a return, the issue of an assessment, and the payment of a liability. The first step relates to the submission of a return, and it is recommended that section 7 of the *Estate Duty Act* stipulates the requirement on the executor to submit a return that consists of a self-assessment. The following draft provisions could be considered to achieve such an outcome:

7. Submission of return and payment of tax

- (1) Every executor shall submit to the Commissioner a return within nine months from the date of death of the deceased—
 - (a) disclosing the information as may be required to calculate the estate duty liability, which includes: the property and deemed property of the deceased as at the date of death in terms of section 3, any deduction under section 4; the dutiable amount as well as any abatement or credit available; and

²²⁵¹ See paras 4.2.9.4 and 6.2.9.1.3 above.

- (b) calculate the estate duty liability and pay the duty payable to the Commissioner on the date prescribed in section 9C or calculate the refund due to the deceased estate:

Provided that —

- (i) the return is only required if the gross value of the estate exceeds the primary abatement under section 4A(1);
 - (ii) if the Commissioner is satisfied that an extension is reasonable, it may be granted up to a maximum of an additional six months.
- (2) (a) Unless a return was submitted, a notice of assessment shall be deemed to have been issued in terms of section 7(1) in respect of the estate of every person—
- (i) if the value of the estate does not exceed the amount determined by the Minister by notice in the *Gazette* contemplated in section 18(3) of the Administration of Estates Act, 1965, on the date on which a death notice is given to the Master in terms of section 7 of that Act; or
 - (ii) in every other case, on the date on which the estate has become distributable in terms of section 35(12) of the Administration of Estates Act, 1965.
- (b) If additional property is found in respect of an estate within five years from the date contemplated in subparagraph (i) or (ii) and a supplementary liquidation and distribution account is required in terms of section 35 of the Administration of Estates Act, 1965, paragraph (a) shall not apply and the return in terms of section 7(1) shall be deemed to have been submitted in respect of the estate on the date on which the supplementary liquidation and distribution account has become distributable in terms of section 35(12) of the Administration of Estates Act, 1965.
- (c) If additional property is found in respect of an estate more than five years after the date contemplated in subparagraph (i) or (ii) and a liquidation and distribution account is required in terms of section 35 of the Administration of Estates Act, 1965, the additional property shall be subject to an estate duty as if that property were the sole property of the estate of the deceased and as if the death of the deceased occurred on the date on which the additional property was reflected in the supplementary liquidation and distribution account. The return under section 7(1) shall be deemed to have been submitted on the date on which the additional property was reflected in the supplementary liquidation and distribution account.²²⁵²

²²⁵² Underlining indicates original knowledge contribution to the field of law.

Based on the above, the estate duty return submitted by the executor within the set timeline will serve as the original assessment by calculating the estate duty liability. The conversion to a self-assessment renders some of the provisions under section 9 of the *Estate Duty Act* redundant as it is no longer a SARS assessment. The provisions regarded as deemed self-assessments could be absorbed as set out above to retain such self-assessment provisions, which may result in the deletion of section 9 of the *Estate Duty Act*. It is also suggested that the existing provisions where additional assets are found within five years or after five years be retained as such circumstances remain relevant.²²⁵³ The recommendations in the conversion of estate duty to a self-assessed tax are considered to enhance the canons of certainty in that the executor can determine the estate duty liability upfront and make the necessary payment, without having to wait for SARS to issue an assessment.²²⁵⁴ It will further result in minimal administration by SARS and reduce the delays in the administration of an estate, which approach is supported by the OECD.²²⁵⁵ This is further enhanced by limiting the obligation to submit an estate duty return to when the gross value of the estate exceeds the primary abatement, which reduces unnecessary administrative burdens regarding smaller estates, and reduces the strain on resources at SARS to audit every estate case.

6.2.9.2.2 Payment rules

Building on the recommendation in paragraph 6.2.9.2.1 for a self-assessment system, where the estate duty return is regarded as the original assessment, clear guidelines are required regarding the payment of the liability. Considering the proposal that the estate duty return must be submitted within nine months from

²²⁵³ Should a non-disclosure or under-valuation of an asset be identified, SARS could raise an additional assessment under Chapter 8 of the *Tax Administration Act* within the set timelines.

²²⁵⁴ See para 4.2.9.3 above.

²²⁵⁵ See para 4.2.9.3 above. Although this study is limited to recommendations for a revised *Estate Duty Act*, it is also for completeness' sake worth noting that stricter timelines should be introduced for the last income tax return of the deceased under a public notice for the submission of an income tax return to provide that the income tax return be submitted within six months from the date of death.

the date of death in the context of a self-assessment, the following general rule for the time for payment is proposed under section 9C:

9C. Payment of duty

The duty payable under this Act shall be paid within two months from the date the return is submitted in terms of section 7(1).²²⁵⁶

Due to the fact that the estate is being wound up and the deceased is not a continuing taxpayer, difficulty may arise in settling the estate duty liability promptly due to circumstances beyond the control of the executor. To consider deferred payment arrangements, it is recommended that, in addition to section 167 of the *Tax Administration Act*, which provides a generic framework, a specific provision regarding the qualifying criteria is made under *the Estate Duty Act*. This in effect means that the general rules for an instalment payment agreement provided for under section 167 of the *Tax Administration Act* will continue to apply when considering an agreement for estate duty purposes, and only the general criteria under section 168 of the *Tax Administration Act* could be replaced for estate duty purposes with the specific requirements under the *Estate Duty Act*. The following could be considered by adding a new section:

9C(1A). Instalment payment agreements

- (1) Subject to section 167 of the Tax Administration Act, 2011, the Commissioner may enter into an instalment payment agreement for estate duty, only if—
- (a) a minimum deposit of ten per cent of the estate duty liability is paid by the original due date prescribed by section 9C (subject to the discretion of the Commissioner if the minimum percentage is not considered reasonable);
 - (b) proof of the hardship that the estate duty liability creates in the estate;
 - (c) the maximum period allowed for the agreement is five years;
 - (d) an agreement for deferral is only allowed if the estate duty liability is in relation to immovable property.

²²⁵⁶ Underlining indicates original knowledge contribution to the field of law.

- (2) The deferred arrangement granted under subsection (1) is granted interest-free for the first six months where after interest at the official rate is payable for the remainder of the deferred period until the full liability is settled.
- (3) If the Commissioner deems it necessary, the executor must provide security.²²⁵⁷

If any failure takes place on the part of the executor to make the necessary payment within the required timeline, the interest provisions under section 10 of the *Estate Duty Act* apply.

Section 10(2) of the *Estate Duty Act* deals with interest-free extensions, however, as was pointed out in paragraph 4.2.9.4, clarity is required regarding qualifying circumstances and the meaning of a "reasonable deposit".²²⁵⁸ It was concluded that, instead of relying on a reasonable deposit that may be subject to different interpretations, a deposit should instead consist of a percentage of the final anticipated liability. The following could be considered:

10. Payment of interest

- (1) If any duty remains unpaid at the expiration of the period prescribed in terms of section 9C, there shall be payable, in addition to the unpaid duty, interest at the official rate per annum on the amount of unpaid duty calculated from the date of the expiration of the said period to the date of payment.
- (2) Subject to subsection (3), whenever the Commissioner is satisfied that the delay in the payment of duty within the period prescribed in terms of section 9C has not been occasioned either by the executor or by any person liable for the duty, the Commissioner may allow an extension of time within which the duty may be paid without interest if, before the expiration of the said period or such further period as the Commissioner may allow—
 - (a) a deposit is made of fifty per cent of the estate duty liability calculated under section 7(1);
 - (b) application is made in writing to the Commissioner for such extension of time; and
 - (c) one of the following circumstances apply:
 - (i) the estate is involved in a court case which will impact the estate duty liability;

²²⁵⁷ Underlining indicates original knowledge contribution to the field of law.

²²⁵⁸ See paras 4.2.9.4 and 6.2.9.1.3 above.

- (ii) the executor is seriously ill, in an accident or deceased;
 - (iii) a natural or human-made disaster;
 - (iv) the estate is illiquid where more than fifty per cent of the value of the estate consists of immovable property;
 - (v) an illiquid estate where unforeseen delays occur in the selling of the property; or
 - (vi) a SARS processing delay.
- (3) An automatic interest-free extension of six months from the date of payment is granted if seventy-five per cent of the final estate duty liability is paid within six months after the date of death.²²⁵⁹

The recommendation amends the rate of interest, which has since the inception of the *Estate Duty Act* been 6%, but to align the rate of interest to all other interest provisions under fiscal legislation, the official rate is recommended. The canon of certainty is promoted through more clarity with respect to the circumstances under which an extension may be requested. It should not be a provision that can just be relied upon to delay payment but only under the specific provisions. Legislative guidelines provide clarity and certainty. The automatic provision is to provide an alternative to encourage speedy compliance and efficient administration of an estate.

6.2.9.2.3 Penalty provisions

From a South African perspective, it was concluded in paragraph 4.2.9.5 that a wider scope of penalties should be introduced for non-compliance under the *Estate Duty Act*, for example, the non-submission of the estate duty return, the late payment of the estate duty liability, as well as the incorrect disclosure of information on the estate duty return.²²⁶⁰ If the non-compliance is due to the fault of the executor, the penalty should be imposed against the executor personally and not against the estate. Provision for the remission of penalties should be made where a justifiable reason can be provided for the position taken.

²²⁵⁹ Underlining indicates original knowledge contribution to the field of law.

²²⁶⁰ See also para 6.2.9.1.4 above.

The following recommendations are made for a wider penalty regime under a revised *Estate Duty Act*. Although the non-submission of the estate duty return could merely be listed in the public notice in terms of section 210 of the *Tax Administration Act*, it is submitted that a monthly recurring penalty may have harsh consequences on the liquidity of the estate, and a one-off penalty is proposed. The same is proposed regarding the late payment of the estate duty liability. If the fault of the non-compliance can be attributed to the executor, the executor should be held personally liable. In the absence of any penalty and remission provisions under the *Estate Duty Act*, the following is proposed:

30. Penalties for non-compliance

- (1) If SARS is satisfied that a natural person fails to file a return under section 7(1) within the required timeline, SARS must impose a ten per cent penalty on the dutiable amount of the estate.
- (2) If SARS is satisfied that an amount of estate duty was not paid as and when required, SARS must, in addition to any other penalty or interest for which a person may be liable, impose a penalty equal to ten per cent of the amount of unpaid estate duty.
- (3) If the executor is responsible for the non-compliance in respect of the penalty imposed under subsections (1) or (2), the executor will be personally liable for the penalty imposed, unless sufficient proof is provided to the satisfaction of the Commissioner that such non-compliance was not occasioned by the executor and resulted from circumstances beyond the executor's control.
- (4) SARS may, in respect of a penalty imposed under subsection (1) or (2), remit the penalty or a portion thereof if SARS is satisfied that—
 - (a) reasonable grounds for non-compliance exist; and
 - (b) the non-compliance has been remedied.²²⁶¹

In conclusion, it is acknowledged that the extension of the penalty regime may be subject to the credibility of SARS and its ability to administer such a penalty regime effectively, otherwise, it may result in a heavy administrative burden if objections to incorrectly imposed penalties must be dealt with.

²²⁶¹ Underlining indicates original knowledge contribution to the field of law.

6.3 Concluding remarks

The main objective of this study was to identify the need for a revised *Estate Duty Act* and to make the necessary recommendations that will adhere to the canons of taxation through equity, certainty, simplicity and convenience. The analyses done in Chapter 4 established both the need for a revised *Estate Duty Act* and that such a change is both possible and desirable. The recommendations made to the *Estate Duty Act* are aimed at aligning the Act to the canons and objectives of taxation, the *Constitution*, as well as the international standards reflected in the OECD principles. The comparative study on the transferor-based wealth transfer tax systems of the UK and the US provided useful guidance to address the need for a revised *Estate Duty Act*. It was suggested that the UK's specific definition of a "resident" provide valuable guidance for clarity in South Africa. The US provides an overarching system where the treatment between a resident and a non-resident is highlighted, whereas similar provisions were considered for South Africa. Various compliance-related provisions from both the UK and the US were used to design similar provisions for South Africa to bring clarity and certainty under the *Estate Duty Act*. It was also concluded that, although it is possible to make the *Estate Duty Act* an all-encompassing Act, in light of the *Tax Administration Act*, it was found that in some instances like assessments, deferred payments, and penalty provisions, specific provisions should be included under the *Estate Duty Act*, but the majority of the administrative provisions could remain under the *Tax Administration Act*. Instead of duplicating provisions, the *Tax Administration Act* can continue to serve its purpose across taxes as far as possible.

The study aligned with the OECD's recommendation to reform existing provisions of a wealth transfer tax, and provided a framework that could be used as a benchmark which has been referred to and customised to the *Estate Duty Act*. The study provided various original proposals for consideration in drafting a revised *Estate Duty Act*. However, the proper design of the relevant law and its related consequences as indicated by this study should be noted by the National Treasury in liaison with SARS.

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