




An analysis of the Davis Tax Committee's proposals on inter-spousal transactions

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ABSTRACT

In the 2014 national budget speech, National Treasury announced that a tax review committee headed by Judge Dennis Davis, namely the Davis Tax Committee was established and that this committee will, during the course of 2014, review the effectivity of the Estate Duty in South Africa. The Davis Tax Committee released its first interim report on Estate Duty in 2015, and after taking into account commentary received from the public (which included various professional bodies and tax experts), the committee released its final report on Estate Duty in 2016. In these reports, the Davis Tax Committee proposed various amendments to the current Estate Duty, Donations Tax and Capital Gains Tax treatment of inter-spousal transactions. These recommendations mostly relate to the limitation or complete removal of the various abatements and exemptions available to transfers of assets between spouses.

The Davis Tax Committee argued that these recommendations resulted in a more equitable and more effective Estate Duty system. In order to assess the reasonability of these recommendations, this study analysed the reasons provided by the Davis Tax Committee, the commentary received from professional bodies and the financial impact thereof against the canons of a good tax system and the objectives of taxation. The analysis resulted in this study concluding that the recommendations will result in the Estate Duty system only being applicable to High Net Worth Individuals and therefore more vertically equitable.

However, these recommendations will result in different tax consequences for equal taxpayers based on the type of matrimonial property regime that exists between the spouses. Finally, this study also found the recommendations to create uncertainty in the tax system and that the increase in taxation of High Net Worth Individuals might result in a decrease in economic growth.

Keywords

Davis Tax Committee, Spouse, Equity, Estate Duty, Donations Tax, Capital Gains Tax, Wealth Transfer Tax, High Net Worth Individuals.

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LIST OF ABBREVIATIONS

AICPA	Association of International Certified Professional Accountants
CIAT	Inter-American Center of Tax Administrations
CGT	Capital Gains Tax
DTC	Davis Tax Committee
EU	European Union
EDA	Estate Duty Act No. 45 of 1955
FISA	The Fiduciary Institute of Southern Africa
HNWI	High Net Worth Individuals
ITA	Income Tax Act No. 58 of 1962
OECD	Organisation for Economic Co-operation and Development
SAIT	South African Institute of Tax Professionals
SARS	South African Revenue Service
VAT	Value-Added-Tax

CHAPTER 1 INTRODUCTION

1.1 Background

In National Treasury's (2011) budget review, then Minister of Finance, Mr. Pravin Gordhan, stated that the effectiveness of Estate Duty will be reviewed. According to Torpe (2015:11) this was due to the fact that Estate Duty contributed a very small portion to the tax revenue of South Africa. National Treasury's (2011) budget review showed that Estate Duty only contributes in the order of R 870 million of the total tax revenue of R790 billion. Estate Duty therefore contributed only 0.11% of the tax revenue in 2011. Thorpe (2015:11) further states that the administration of Estate Duty was very difficult and time consuming. This meant that the cost of collecting Estate Duty exceeded the income derived from Estate Duty and it was therefore not cost effective to collect the Estate Duty. Another reason for the proposed review of Estate Duty was, according to Ger (2012), the fact that Estate Duty was deemed by many experts to constitute double taxation due to the fact that Capital Gains Tax will be payable on a taxpayer's assets upon death.

From Ger (2012) it is clear that various experts expected Estate Duty to be completely removed from the South African tax system. According to Thorpe (2015:11) no further mention was made of the review of Estate Duty in any budget review or budget speech between 2011 and 2014. In National Treasury's (2014) budget review it was once again mentioned that Estate Duty will be reviewed during the course of 2014. It was also stated in the 2014 budget speech that a tax review committee headed by Judge Dennis Davis will investigate and make recommendations regarding possible tax reforms which includes a review of Estate Duty. According to Citadel Wealth Management (cited by Brink, 2017:2) the minister instructed this tax review committee to assess the South African tax system's role in supporting the national economic objectives of inclusive growth, employment, development and fiscal sustainability.

According to Loubser (2016:1) the tax review committee headed by Judge Dennis Davis, widely known as the Davis Tax Committee (DTC) released its first interim report on Estate Duty to the Minister of Finance on 13 July 2015. The DTC's (2015:25) first interim report on Estate Duty stated that the terms of the reference extended to the DTC by the Minister of Finance was to investigate whether Estate Duty was still deemed to be relevant in the context of striving towards a more equitable and progressive tax system. The interaction between Estate Duty and Capital Gains Tax also had to be considered.

In the first interim report on Estate Duty the DTC (2015:25) stated that three options exist to address the shortfalls in the current tax system, namely:

- a) A complete removal of the Estate Duty Act, thereby moving away from the concept of death being treated as a taxation event;
- b) Amending the Estate Duty Act in order for Estate Duty to become a simple, efficient and righteous system; or
- c) Implementing a new form of wealth taxation to replace the current Estate Duty Act.

The DTC (2015:33) considered the removal of the Estate Duty Act and came to the conclusion that since this Act, coupled with Donations Tax as contained in the Income Tax Act, is currently the only direct tax on wealth in South Africa. The removal of this Act will therefore not be justifiable when taking the large wealth disparity in South Africa into account.

The DTC (2015:33) also stated that the replacement of the current Estate Duty with an annual wealth tax will be too large of an undertaking for SARS and taxpayers. This, according to DTC (2015:33), is due to the following disadvantages of periodic wealth taxes:

- a) The difficulties and costs to identify, measure and value assets and liabilities on an annual or periodical basis;
- b) The high cost of compliance and collection which will render the tax inefficient;
- c) The fact that recurring wealth tax discourages entrepreneurship and saving;
- d) The fact that this may incentivise taxpayers to move their wealth offshore or to emigrate; and
- e) The tax will cause unnecessary inconvenience where taxpayers will experience cash flow problems or will be forced to sell assets in order to pay the tax, resulting in the reduction of the taxpayer's asset base and therefore reducing the taxpayer's capital growth potential.

The committee concluded that the current Estate Duty Act must therefore be modified in order to operate more effectively. The DTC's finding therefore contradicted the expectations of experts who expected a complete repeal of the Estate Duty Act.

The DTC's (2015) first interim report made various recommendations on how the Estate Duty Act should be amended. According to Farrand (2015), this includes inter alia the following:

- a) The repeal of the section 4(q) of the Estate Duty Act which allows an exemption for assets bequeathed to a person's surviving spouse should be considered;
- b) The removal of the portable primary abatement between spouses. To reduce double taxation consequences, a table for excluding dutiable inheritances from the surviving spouse's Estate Duty computation for a period of up to 10 years should be implemented;
- c) The primary abatement must be increased to R6 million per taxpayer;
- d) All interests in immovable property and companies must be removed from the application of the inter-spousal Donations Tax exemption; and
- e) The fact that South Africa changed its basis of taxation to a residence basis in 2001 means that the Donations Tax exemption for offshore assets acquired prior to becoming a South African tax resident must be revised.

Farrand (2015) stated that the first interim report was open to public comment. According to Klein (2016) the DTC released the committee's final report on Estate Duty on 25 August 2016. This report differed from the first interim report as the commentary received on the first interim report were taken into consideration.

The DTC (2016:11) focussed on answering the question of what can be regarded as an equitable combined Estate Duty package. The commission therefore examined all of the major components of the Estate Duty calculation that the DTC summarised as follows:

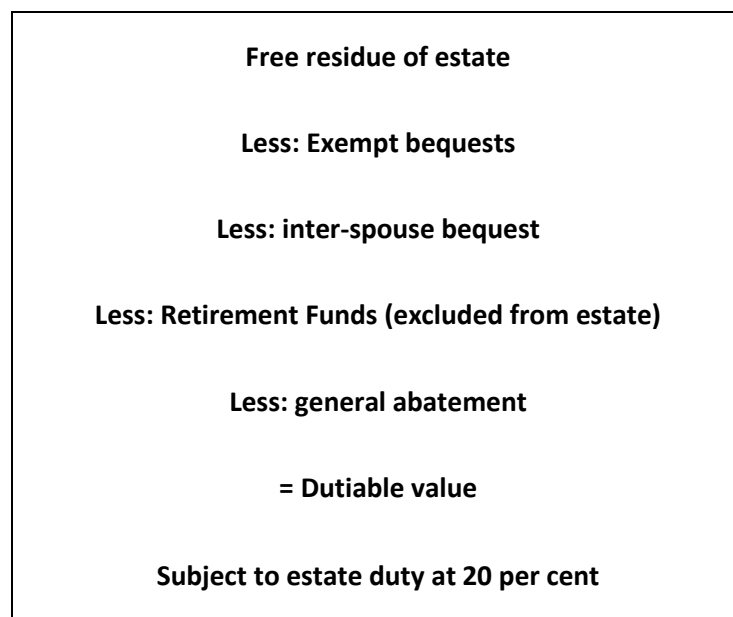


Figure 1-1: Basic Estate Duty Calculation

From Fisher-French (2016) it is clear that a large part of the report again focussed on the reform of the taxation of transfers of assets between spouses. The following is a brief discussion of the recommendation made by the DTC (2016) in the committee's final report on Estate Duty regarding the taxation of inter-spousal transfers:

- a) Withdrawal of the current inter-spousal bequest exemption as contained in section 4(q) of the Estate Duty Act;
- b) Changes to how the portable abatement between spouses, as currently included in section 4A(2) of the Estate Duty Act, functions;
- c) Paragraph 67 of the 8th schedule to the Income Tax Act that allows roll-over relief for the payment of Capital Gains Tax (CGT) when assets are transferred between spouses must be removed; and
- d) Adjustments to the current section 56(1)(a) and section 56(1)(b) of the Income Tax Act currently allowing exemptions for assets donated between spouses.

The abovementioned proposed changes will be discussed in more detail in subsequent chapters.

1.2 Motivation

According to National Treasury's 2018 budget review (2018:4) the government's expenditure was R180 billion higher than the income received for the 2017-2018 financial year. According to Reuters (2018) this deficit is equal to 4.3% of the Gross Domestic Product (GDP) of South Africa. Menon (2018) states that SARS collected about R700 million less tax revenue than estimated for the same financial year. According to Reuters (2018) the budget also aims to reduce the budget deficit to 3.5% of GDP and to reduce gross government debt to 56% of GDP by 2020. The achievement of these targets will further be hampered by the fact that, according to Mokone (2018), former Minister of Finance, Mr Malusi Gigaba, announced that R57 billion will be needed to fund free higher education program as announced by former President Jacob Zuma in December 2017.

Mr Gigaba announced that the government plans to achieve the abovementioned deficit reducing goal by using the following methods:

- a) Tax revenue collections will be raised to earn an additional R36 billion in the 2018/2019 financial year (Blair and Morton, 2018); and
- b) Government expenditure will be reduced by R85 billion over the next three financial years being 2018-2021 (Ensor, 2018).

It is therefore clear that taxes will be significantly raised in 2018. This was already shown in the 2017/2018 budget speech where the Value Added Tax (VAT) rate was increased from 14% to 15%.

The following figure from National Treasury’s (2018) budget review (Figure 3.2 in the review)¹ however illustrates the different sources from which the government plans to raise the additional tax revenue:

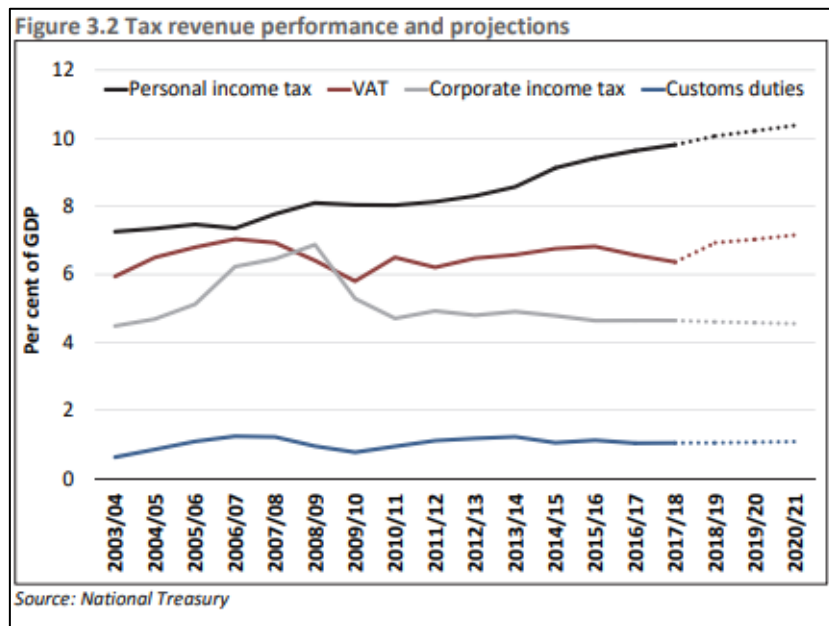


Figure 1-2: Tax Revenue performance and projections

From this figure it is clear that government plans to increase the amount of personal income taxes significantly in the following three financial years. In National Treasury’s (2016) budget review it was stated that the possible contribution of wealth taxes to the South African tax revenue will be considered. The increase in income tax revenue may therefore likely include an increase in current or implementation of new types of wealth taxes.

According to Arendse and Stack (2018) South Africa currently has the following types of wealth tax:

- a) Estate Duty (as levied by the Estate Duty Act);²
- b) Donations Tax (as levied by the Income Tax Act);

¹ Figure reference numbers and descriptions are displayed below the figures while any other figure reference numbers represent numbers used in the original source

- c) Wealth Transfer Tax (as levied by the Transfer Duty Act); and
- d) Securities Transfer Tax (as levied by the Securities Transfer Tax Act)

As mentioned above, the DTC (2015) in its first report on Estate Duty stated that Estate Duty is the only form of wealth tax in South Africa and that the most efficient method of raising more tax revenue from Estate Duty will be to modify the current Estate Duty Act rather than to implement annual Estate Duty. One can therefore conclude that the modifications as proposed by the DTC in its final report are likely to be implemented in the near future in order to assist the government in reaching their lower deficit targets. This is supported by the fact that, according to Vanek (2018), in the 2018 budget speech it was announced that the Estate Duty rate will be increased to 25% for estates where the dutiable amount exceeds R30 million. Donations of more than R30 million in aggregate during a taxpayer's lifetime will also be subject to Donations Tax at a rate of 25%.

The abovementioned Estate Duty rate increase was also included as one of the recommendations in the DTC's (2016:18) final report on Estate Duty. This can therefore be viewed as the start of government's plan to implement the DTC's recommendation on Estate Duty and one can therefore foresee the implementation of the DTC's proposed changes regarding the taxation of inter-spousal bequests and donations in the near future as a method to help reduce the budget deficit. This view can be strengthened by the fact that Van der Spuy (2018) states that government began to increase taxes paid by wealthy taxpayers (High Net Worth Individuals) in the previous few years and that it was speculated that the DTC's recommendations on Estate Duty would have been implemented in the 2018 budget speech.

It is clear that the DTC's Estate Duty report is being considered by the government. It is however likely that the implementation of the inter-spousal recommendations will be opposed by various experts in the field of taxation. This conclusion can be drawn from the fact that Loubser (2016:76) states that various professional bodies criticized the proposed changes to the taxation of inter-spousal bequests and donations as contained in the DTC's (2015) first interim report on Estate Duty. These professional bodies include inter alia the following:

- a) FISA (The Fiduciary Institute of Southern Africa);
- b) SAIT (South African Institute of Tax Professionals);
- c) STEP (Society of Trust and Estate Practitioners); and
- d) LSSA (Law Society of South Africa)

The detailed comments together with the validity of these comments made by the abovementioned professional bodies will be discussed in subsequent chapters.

1.3 Problem Statement

The DTC proposed various changes to the taxation of inter-spousal bequests and donations. According to Loubser (2016:76) various professional bodies however criticized these proposals.

The problem statement that this paper will aim to address is whether the recommendations of the DTC regarding the removal of the inter-spousal exemptions and abatements are reasonable when compared to the characteristics of a successful wealth tax system and the criticism against these recommendations.

1.4 Objectives

1.4.1 Primary Objective

The primary objective of this study is to conclude on the reasonability of the recommendations on the taxation of inter-spousal bequests and donations made by the DTC (2016) in its final report on Estate Duty when measured against the characteristics of a successful wealth tax system.

1.4.2 Secondary Objective

The secondary objectives of this study are to:

- a) Analyse the legal and tax nature of various forms of spousal relationships and marriage types (Chapter 2);
- b) Discuss the current taxation consequences of inter-spousal bequests and donations (Chapter 2);
- c) Analyse the characteristics of a wealth tax system that will be sustainable and equitable (Chapter 3);
- d) Discuss the DTC's interim and final report on Estate Duty in South Africa together with a critical discussion of the reasons provided for the proposed removals of the inter-spousal abatements and exemptions, especially the concept of equality in the tax system (Chapter 4);
- e) Describe the rationale for including inter-spousal abatements and exemptions from a commercial perspective, especially the concept of marriages as a single economic unit (Chapter 4); and
- f) Discuss the criticism on the proposed recommendations (Chapter 4).

1.5 Research Model

The abovementioned objectives will be reached by using a variety of research methodologies.

In order to reach the objectives of analysing the current taxation consequences of inter-spousal bequest, doctrinal research will be performed. This is because of the fact that Pearce et al. (cited by McKerchar, 2008:18) stated that doctrinal research can be described as a systematic process to identify, analyse, organise and synthesise laws, court cases and commentary on the law which consists of a literature study that includes the reading and detailed analysis of the reading material found. The objectives will therefore be reached by detail analysis and interpretation of the current laws regulating the taxation of inter-spousal bequests and donations.

According to Pearce et al. (cited by McKerchar, 2008:19), non-doctrinal research can be described as the study “about the law”, rather than “in the law” and therefore focus on the reasons for a law’s existence rather than the interpretation of the law by also including in the research of non-traditional legal sources. The analysis of the DTC’s recommendations together with the reasons provided and the reasons for the current tax treatment of inter-spousal transactions will be conducted by referring to non-traditional literature such as economic reasons for the implementation of the relevant taxation laws. As this analysis will be conducted to accomplish change in the current tax law, the non-doctrinal study can be classified in the reform-orientated category of non-doctrinal study as discussed in McKerchar (2008:19).

The study will however move towards an interpretive approach, as described by Dudovskiy (s.a.) to mean that the researcher is required to interpret elements of the study, when the negative consequences of the proposals of the DTC on taxpayers are considered since no direct prior research on these consequences were conducted in the past. This interpretive approach will be coupled with a quantitative method that falls in the positivism ontology when a case study analysis of the current financial position of a taxpayer’s spouse is mathematically compared to the financial position of the taxpayer’s should the DTC recommendations be implemented. The case study analysis can be viewed as a positivism ontology method due to the fact that Dudovskiy (s.a.) states that in the positivism ontology, the researcher collects and interprets data in an objective way in order to produce observable and quantifiable findings.

This study will furthermore comprise of a literature study as research method. Various sources such as articles, journals, books, law reports and legislation will be analysed to support the findings of the study.

1.6 Outline of the Study

Chapter 1: Background and scope

The background, scope, research method and progress of the study will be discussed.

Chapter 2: Definition of spouse and current tax treatment

This chapter will firstly discuss the term *spouse* from a legal and tax perspective. Different types of spousal relationships and forms of marriages will be analysed and the current tax consequences of inter-spousal bequests, asset transfers and donations will be determined for the different spousal agreement types.

Chapter 3: Characteristics of a successful wealth tax system

This chapter will discuss the characteristics of a wealth tax system that will be sustainable and will comply with the fundamental characteristics of a model tax system. Wealth tax systems currently used successfully in other countries will be assessed and the requirements for a successful wealth tax system will be determined.

Chapter 4: Evaluation of DTC's proposals

The DTC's proposals regarding changes to the taxation of these inter-spousal transactions will subsequently be discussed in light of the reasons provided in the DTC's first interim and final report on Estate Duty. This chapter will further analyse the criticism against the proposed changes received from various professional bodies and tax experts. The reasons for the current tax treatment of inter-spousal donations, asset transfers and bequests will be discussed. The recommendations of the DTC will lastly be measured against the requirements of a successful wealth tax system to determine whether the recommendations will be reasonable to implement in the pursuit of a successful wealth tax system.

Chapter 5: Summary and conclusion

This chapter will conclude on the findings of the abovementioned chapters and make suggestions on the tax treatment of inter-spousal transactions.

1.7 Conclusion

This chapter provided background to the establishment of the DTC and the reasons for the issuance of the DTC's first interim and final report on Estate Duty in South Africa.

The main proposals of the DTC's reports on Estate Duty that relates to inter-spousal transactions were summarised. It was furthermore noted that the proposals were criticised by various professional bodies and that the proposals are likely to be implemented in the near future.

CHAPTER 2 DEFINITION OF SPOUSE AND CURRENT TAX TREATMENT

2.1 Introduction

In chapter 1, the background to the DTC's recommendations, as made in the first interim and final report on Estate Duty, were discussed. The recommendations made in these reports, specifically pertaining to the tax treatment of inter-spousal transactions, and the manner in which they might be implemented in the near future, were used to motivate this study.

This study discusses the recommendations made on inter-spousal transactions. However, the current tax treatment pertaining to inter-spousal transactions must first be determined in order to explain the recommendations made, and the impact that these recommendations may result in.

Consequently, this chapter discusses the current tax treatment of inter-spousal transactions. In order to discuss the current tax treatment, it is necessary to define a *spouse* within the context of inter-spousal transactions. Furthermore, the treatment of different types of spousal relationships (matrimonial property regimes) should be determined.

This chapter will therefore aim to address the first two objectives of this study, namely to determine the current taxation consequences of inter-spousal transactions and to discuss the various relationship types that can exist between spouses.

2.2 Tax provisions currently relevant to inter-spousal transactions

The current tax treatment of inter-spousal transactions will be discussed in order to understand the impact of the DTC's recommendations.

The following tax consequences are relevant to the DTC's recommendations:

2.2.1 Estate Duty

Upon the death of one spouse, the estate of the spouse will be subject to Estate Duty. This is due to section 2 of the Estate Duty Act (45 of 1955) that states the following:

- (1) There shall be charged, levied and collected in respect of the estate of every person who dies on or after the first day of April, 1955, a duty to be known as an Estate Duty.
- (2) Estate Duty shall be charged upon the dutiable amount of the estate calculated in accordance with the provisions of this Act and shall be levied at the rate set out in the First Schedule.

The definition above states that the tax will be calculated on the dutiable amount. The dutiable amount is defined in section 4A (1) of the Estate Duty Act (45 of 1955) as follows:

(1) Subject to subsections (2) and (3), the 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.

According to SARS (2013) the dutiable estate of a person can be defined as the total value of all property of the deceased person minus all deductions in section 4 and section 4A.

The dutiable amount therefore consists of the following:

a) Property

Section 3(2) of the Estate Duty Act (45 of 1955) defines property as any right in or to movable or immovable property, whether the property is corporeal or incorporeal.

Section 3(3) (cA) of the Estate Duty Act (45 of 1955) is also relevant. This section states that the following will be deemed to be property of the deceased:

The amount of any claim acquired by the estate of the deceased under section 3 of the Matrimonial Property Act, 1984, against the deceased's spouse or the estate of his deceased spouse, in respect of any accrual contemplated in that section;

This paragraph is relevant to spouses married out of community of property including the accrual system.

b) Section 4 deductions

Section 4 of the Estate Duty Act (45 of 1955) provides a definition for 'net value' of an estate. The section defines the net value of an estate as the total property of an estate minus various deductions. A discussion of all the deductions in section 4 is beyond the scope of this study, but the following deductions are relevant:

i) Subsection (1A):

This paragraph states the following:

the amount of any claim against the estate acquired under section 3 of the Matrimonial Property Act, 1984 (Act 88 of 1984), by the surviving spouse of the deceased or by the estate of his deceased spouse, in respect of an accrual contemplated in that section;

This paragraph is also relevant to spouses married out of community of property including the accrual system.

ii) Subsection (q):

This paragraph states the following:

so much of the value of any property included in the estate which has not been allowed as a deduction under the foregoing provisions of this section, as accrues to the surviving spouse of the deceased: Provided that-

- (i) 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;
- (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.

According to Jacobs (2012) the abovementioned sections means that any assets bequeathed to a deceased person's surviving spouse will therefore be exempt from Estate Duty.

c) Section 4A deductions

As mentioned above, the dutiable amount is calculated, in terms of section 4A (1) of the Estate Duty Act (45 of 1955), as the net value of the estate minus R3,500,000. The Davis Committee refers to this deduction as the primary abatement.

Section 4A(2) is also relevant to this study and states the following:

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

According to Jansen van Rensburg (2015) this section allows for the unused portion of the primary abatement of the deceased spouse to be transferred to the surviving spouse. This section is referred to as the portable primary abatement by the DTC.

2.2.2 Donations Tax

Section 54 of the Income Tax Act (58 of 1962) states the following:

Subject to the provisions of section 56, there shall be paid for the benefit of the National Revenue Fund a tax (in this Act referred to as Donations Tax) on the value of any property disposed of (whether directly or indirectly and whether in trust or not) under any donation by any resident (in this Part referred to as the donor).

In terms of section 64, this tax will be charged at a rate of 20% for donations less than R30 million in aggregate within a taxpayer's lifetime while donations of more than R30 million within a taxpayer's lifetime will be taxed at 25%.

For this tax to be charged, a donation must be made. 'Donation' is defined in section 55 of the Income Tax Act (58 of 1962) to mean the following:

any gratuitous disposal of property including any gratuitous waiver or renunciation of a right
A donation will however only be subject to Donations Tax if the donation is not exempt in terms of section 56 of the Income Tax Act (58 of 1962).

Section 56(1)(a) and section 56(1)(b) of the Income Tax Act (58 of 1962) are relevant to this study. Section 56(1)(a) allows an exemption for the following donations made:

to or for the benefit of the spouse of the donor under a duly registered antenuptial or post-nuptial contract or under a notarial contract entered into as contemplated in section 21 of the Matrimonial Property Act, 1984 (Act 88 of 1984);

Section 56(1)(b) allows for the following donations to be exempt from Donations Tax:

to or for the benefit of the spouse of the donor who is not separated from him under a judicial order or notarial deed of separation;

According to Musviba (2014) the abovementioned provisions therefore exempts all donations made between spouses from Donations Tax provided that the persons are not divorced.

2.2.3 Capital Gains Tax (CGT)

When any asset is transferred between spouses, whether the asset was donated, sold or bequeathed, the transaction may attract Capital Gains Tax in the hand of the spouse who transferred the asset. This is due to the fact that paragraph 11 of the Eighth Schedule to the Income Tax Act (58 of 1962) defines a 'disposal' to mean the following:

Subject to subparagraph (2), a disposal is any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset

Paragraph 67 of the Eighth Schedule to the Income Tax Act (58 of 1962) however provides a roll-over relief when an asset is transferred between spouses. Paragraph 67(1) states the following:

(1)(a) Subject to subparagraph (3), a person (hereinafter referred to as the 'transferor') must disregard any capital gain or capital loss determined in respect of the disposal of an asset to his or her spouse (hereinafter referred to as the 'transferee').

(b) The transferee must be treated as having —

- (i) acquired the asset on the same date that such asset was acquired by the transferor;
- (ii) incurred an amount of expenditure equal to the expenditure contemplated in paragraph 20 that was incurred by that transferor in respect of that asset;

- (iii) incurred that expenditure on the same date and in the same currency that it was incurred by the transferor;
- (iv) used that asset in the same manner that it was used by the transferor; and;
- (v) received an amount equal to any amount received by or accrued to that transferor in respect of that asset that would have constituted proceeds on disposal of that asset had that transferor disposed of it to a person other than the transferee.

According to Grant Thornton (2004) the abovementioned paragraph results in capital gains being disregarded in the hands of the transferor spouse and that the receiving spouse will be deemed to have acquired the asset at the same time and for the same base cost of the transferor spouse. The receiving spouse will therefore be regarded as the original owner and Capital Gains Tax will only be incurred when the asset is sold to an outside party.

From the above mentioned it is clear that any transfer of assets between spouses will currently not be subject to any tax in South Africa.

Paragraph 84 of the 2018 Draft Taxation Laws Amendment Bill (2018) will however repeal the current paragraph 67 of the Eighth Schedule to the Income Tax Act (58 of 1962).

Section 19 of the 2018 Draft Taxation Laws Amendment Bill will however introduce section 9HB into the Income Tax Act (58 of 1962) which will state the following:

- (1)(a) Subject to subsection (3), a person (hereinafter referred to as ‘the transferor’) must disregard any capital gain or capital loss determined in respect of the disposal of an asset to his or her spouse (hereinafter referred to as ‘the transferee’).
- (b) The transferee must be treated as having—
 - (i) acquired the asset on the same date that such asset was acquired by the transferor;
 - (ii) incurred an amount of expenditure equal to the expenditure contemplated in paragraph 20 that was incurred by that transferor in respect of that asset;
 - (iii) incurred that expenditure on the same date and in the same currency that it was incurred by the transferor;
 - (iv) used that asset in the same manner that it was used by the transferor; and
 - (v) received an amount equal to any amount received by or accrued to that transferor in respect of that asset that would have constituted proceeds on disposal of that asset had that transferor disposed of it to a person other than the transferee.
- (2) For the purposes of subsection (1)—
 - (a) a person whose spouse dies must be treated as having disposed of an asset to that spouse immediately before the date of death of that spouse, if ownership of that asset is acquired by the deceased estate of that spouse in settlement of a claim arising under section 3 of the Matrimonial Property Act, 1984 (Act No. 88 of 1984); or
 - (b) a person must be treated as having disposed of an asset to his or her spouse, if that asset is transferred to that spouse in consequence of a divorce order or, in the case of a union contemplated in paragraph (b) or (c) of the definition of ‘spouse’ in section 1, an agreement of division of assets which has been made an order of court.
- (3) Subsection (1) must not apply in respect of the disposal of an asset by a person to his or her spouse who is not a resident, unless the asset disposed of is an asset contemplated in section 9J or in paragraph 2(1)(b) of the Eighth Schedule.

(4) A person must, if his or her spouse is a resident, in the case of an asset consisting of trading stock, livestock or produce contemplated in the First Schedule, be treated as having disposed of that asset for an amount received or accrued that is equal to, the amount that was allowed as a deduction in respect of that asset for purposes of determining that person's taxable income, before the inclusion of any taxable capital gain, for the year of assessment.

(5) Where a person acquires an asset that constitutes trading stock from his or her spouse that person and his or her spouse must, for purposes of determining any taxable income derived by that person, be deemed to be one and the same person with respect to the date of acquisition of that asset by that person and the amount and date of incurral by that spouse of any cost or expenditure incurred in respect of that asset as contemplated in section 11 (a) or 22 (1) or (2).

The proposed section 9HB(1) is therefore similar to the current paragraph 67 of the Eighth Schedule to the Income Tax Act (58 of 1962). Due to the tax consequences of section 9HB relevant to this study being similar to those of paragraph 67 of the Eighth Schedule, this study will further focus on the DTC's recommendations regarding paragraph 67.

2.3 Requirement that a transaction occurs between spouses

From the tax provisions mentioned above, it is clear that a transaction must occur between spouses before it will qualify for the exemptions and abatements mentioned above. The word *spouse* must therefore be defined.

Section 1 of the Estate Duty Act (45 of 1955) (hereafter referred to as Estate Duty Act) defines a *spouse* to mean the following:

in relation to any deceased person, includes a person who at the time of death of such deceased person was the partner of such person-

- (a) in a marriage or customary union recognised in terms of the laws of the Republic;
- (b) in a union recognised as a marriage in accordance with the tenets of any religion; or
- (c) in a same-sex or heterosexual union which the Commissioner is satisfied is intended to be permanent:

Provided that a marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union without community of property

Section 1 of the Income Tax Act (58 of 1962) contains a similar definition to the definition in the Estate Duty Act (45 of 1955) mentioned above. The Income Tax Act (58 of 1962) defines a *spouse* as follows:

in relation to any person, means a person who is the partner of such person -

- (a) in a marriage or customary union recognised in terms of the laws of the Republic;
 - (b) in a union recognised as a marriage in accordance with the tenets of any religion; or
 - (c) in a same-sex or heterosexual union which is intended to be permanent,
- and 'married', 'husband' or 'wife' shall be construed accordingly:

Provided that a marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union out of community of property;

The abovementioned definitions clarify that a person will only be a spouse of another person, if that person is a partner of the person, within the terms of one of the above-mentioned definitions of marriages or unions. The Income Tax Act (58 of 1962) does not define the abovementioned relationship types. This study therefore aims to discuss the requirements a relationship must comply with in order to qualify as one of the categorical relationship types mentioned above.

a) A marriage or customary union recognised in terms of the laws of the Republic

i) Marriage recognised in terms of the laws of the Republic

In the case of *Minister of Home Affairs and Another v Fourie and Another* (2005) the judge defined common law marriage as follows:

a union of one man with one woman, to the exclusion, while it lasts, of all others

The judge in the abovementioned case furthermore stated that due to the fact that the common law is not self-enforcing, the Marriage Act (25 of 1961) must be invoked in order for a union, as mentioned above in the common law definition, to be formalised.

This relationship type is therefore regulated by the Marriage Act (25 of 1961). The Marriage Act (25 of 1961) determines the requirements for a relationship to be regarded as a marriage. This includes the following:

- 1) The marriage must be solemnized by a marriage officer;
- 2) The parties to the intended marriage must not be “minors” as defined in this Act;
- 3) No lawful objections against the marriage must be raised;
- 4) The parties to the intended marriage must produce their identity documents or prescribed declaration;
- 5) The parties must be legally allowed to be married to each other; and
- 6) The marriage officer must formally solemnize the marriage by means of the marriage formula.

A detailed discussion of the abovementioned requirements is not in the scope of this study. The requirement of the marriage formula is however relevant to this study.

Section 30 of the Marriage Act (25 of 1961) states that the marriage officer may use any marriage formula usually observed by the religious denomination or organisation, provided that the formula is approved by the Minister of Home Affairs. The section provides for a

general formula to be used in the absence of another approved formula. This formula is as follows:

Do you, A.B., declare that as far as you know there is no lawful impediment to your proposed marriage with C.D. here present, and that you call all here present to witness that you take C.D. as your lawful wife (or husband)?

and thereupon the parties shall give each other the right hand and the marriage officer concerned shall declare the marriage solemnized in the following words:

I declare that A.B. and C.D. here present have been lawfully married.

The judge in the *Minister of Home Affairs and Another v Fourie* (2005) case, noted that the usage of the words *wife* and *husband*, together with the common law definition referring to a relationship between a man and a woman, meant that the Marriage Act (25 of 1961) did not provide any mechanism for people of the same sex to be married.

It is therefore clear that the Marriage Act (25 of 1961) only allows for, and regulates, heterosexual marriages (marriages between two persons of the opposite sex).

Before the judgement in the *Minister of Home Affairs and Another v Fourie* (2005) case, the phrase 'marriage recognised in terms of the laws of the Republic' therefore only meant heterosexual marriages that complied with the Marriage Act (25 of 1961).

The fact that no provision was made for same-sex marriages in the Marriage Act (25 of 1961), was however found to be unconstitutional by the judge in the *Lesbian and Gay Equality Project and Eighteen Others and the Minister of Home Affairs, the Director General of Home Affairs and the Minister of Justice and Constitutional Development* (2005) case. In this case it was ruled that Parliament must rectify these defects.

Parliament responded to this ruling by issuing the Civil Unions Act (17 of 2006). Section 2 of the Civil Unions Act (17 of 2006) states that the objectives of the Act are:

- (a) to regulate the solemnisation and registration of civil unions, by way of either a marriage or a civil partnership; and
- (b) to provide for the legal consequences of the solemnisation and registration of civil unions.

According to JD Lekhuleni (2016:23) the requirements for a civil union is generally the same as the requirements for a marriage in terms of the Marriage Act (25 of 1961) as discussed above. The primary difference between these relationships is the fact that a civil union may be registered between parties in a same-sex relationship,

Therefore, it can be concluded that civil partnerships and marriages in terms of the Civil Unions Act (17 of 2006), as well as marriages in terms of the Marriage Act (25 of 1961),

can be viewed as marriages recognised in terms of the laws of the Republic, and will therefore comply with the definition of *spouse* as stipulated above.

ii) Customary union recognised in terms of the laws of the Republic;

The Recognition of Customary Marriages Act (120 of 1998) regulates customary unions. Section 1 of this Act defines 'customary marriage' as follows:

a marriage concluded in accordance with customary law

According to Phiri (2017), a customary marriage can be defined as a marriage that is negotiated, celebrated or concluded in terms of the indigenous African customary law in South Africa.

It is therefore clear that the marriages in terms of the customary law will comply with the definition of 'spouse' as defined above. A discussion of the customary law in South Africa regulating marriages is beyond the scope of this study. According to Department of Justice and Constitutional Development (2011), the following requirements must be met in order to recognise a relationship as a customary union:

- 1) The persons who intend to marry must both be older than 18;
- 2) Both parties must consent to the marriage under customary law;
- 3) The parties must negotiate and celebrate the marriage in accordance with the requirements of the customary law;
- 4) If one of the parties is a minor, the person's parents, legal guardian or other substitute as provided for by the Act must consent to the marriage;
- 5) The parties must not be prohibited from marrying each other because of the fact that they are blood relatives or affiliated in a way prohibited by the Recognition of Customary Marriages Act (120 of 1998); and
- 6) Neither of the parties must be already married in terms of any civil marriage.

The Department of Justice and Constitutional Development (2011) states that the payment of lobola is not required for the marriage to be valid, but that it will assist the parties in proving that the marriage was negotiated in accordance with customary law.

b) In a union recognised as a marriage in accordance with the tenets of any religion

South African laws do not currently regulate religious marriages. According to Schoeman Louw (2014), Muslim persons and persons from other religions must conduct a separate civil

marriage ceremony in addition to the religious marriage ceremony, in order to recognise the marriage as legal and protected, in terms of South African laws.

Therefore, paragraph (b) of the definition of a *spouse* in section 1 of the Income Tax Act (58 of 1962) regards persons married in terms of religious marriages as spouses even though the marriage is not regarded as a marriage in terms of South African laws.

c) In a same-sex or heterosexual union which is intended to be permanent

Currently, South African tax legislation does not make provision for the specific definition of *intended to be permanent* within its guidelines.

Other South African laws do not give any guidance on the meaning of “permanent relationship” due to the fact that, according to Anon (2013a), common law marriages, otherwise known as cohabitation, are not recognised in South Africa. This view is supported by the DTC’s (2015:49) interim report stating that the Income Tax Act (58 of 1962) is the only South African legislation that recognises permanent relationships.

From the DTC’s (2015:49) first interim report on Estate Duty, it is clear that the Commissioner will have the discretion of determining whether the relationship will be regarded as permanent.

However, it can be argued that the taxpayer will be required to prove that the relationship can be regarded as permanent, in addition to providing proof that the taxpayer will qualify for the spousal abatements and exemptions. This is due to the fact that section 102(1) of the Tax Administration Act (28 of 2011) states the following:

A taxpayer bears the burden of proving-

- (a) that an amount, transaction, event or item is exempt or otherwise not taxable;
- (b) that an amount or item is deductible or may be set off;
- (c) the rate of tax applicable to a transaction, event, item or class of taxpayer;
- (d) that an amount qualifies as a reduction of tax payable;
- (e) that a valuation is correct; or
- (f) whether a 'decision' that is subject to objection and appeal under a tax Act, is incorrect.

From the DTC’s (2016:13) final report it is furthermore clear that it is difficult to define a *permanent relationship* and that there is not a one-size-fits-all definition which can be applied to clarify the meaning. This difficulty may be ascribed to the diversity of South African families.

Therefore, it is clear that the definition of *spouse* is very broad and encompasses the majority of permanent relationship types. The fact that the definition of *spouse* is very broad is also mentioned as one of the reasons in the DTC’s (2015:49) first interim report used to motivate the committee’s view that the spousal abatements and exemptions may be abused. However, this is discussed in further detail in chapter 4.

2.4 Forms of matrimonial property regimes and the tax impact

The forms of matrimonial property regimes in South Africa must be discussed due to the fact that, even though the inter-spousal abatements and exemptions are not affected by the types of matrimonial property regimes that exists between the spouses, the impact of the proposed DTC changes might be different, in relation to the different types of property regimes, seeing that the tax treatment (inclusions) of such various relationships differ.

Jassiem (2010:26) states that the matrimonial property regimes that are available to spouses in South Africa are the following:

2.4.1 Marriages in community of property

According to De Jong and Pintens (2015:551) this type of matrimonial property system will apply to a marriage or civil union unless the persons entered into a legal contract before their marriage to agree on the matrimonial property system that will be applicable to their marriage.

A marriage that is within community of property will, according to Anon (2013b), give rise to a joint estate between the married persons where all assets and liabilities (including assets and liabilities that was in the party's name before the marriage as well as assets and liabilities accumulated during the marriage) will be deemed to be owned in equal proportion (50% each) by both parties.

This is supported by the fact that section 17(1) of The Deeds Registries Act (47 of 1937) states the following:

(1) From the commencement of the Deeds Registries Amendment Act, 1987, immovable property, real rights in immovable property and notarial bonds which would upon transfer, cession or registration thereof form part of a joint estate shall be registered in the name of the husband and the wife, unless that transfer, cession or registration takes place only in the name of a partnership, and the husband or wife is involved therein only in the capacity of partner in that partnership.

However, certain assets can be excluded from the joint estate in some circumstances. According to Joubert and Kuhne (1999), the following assets may be excluded from the joint estate:

- a) Assets received as a gift or inherited and specifically excluded from the joint estate in terms of an exclusion clause;
- b) Assets excluded in terms of an ante nuptial agreement;
- c) Fideicommissary assets or a usufruct right;
- d) Claim for damages that does not relate to a patrimonial loss;

- e) Property that both spouses are not legally able to acquire;
- f) Cost paid that relates to matrimonial proceedings;
- g) Insurance policies and the proceeds of these policies;
- h) Benefits granted by the Friendly Societies Act 25 of 1956; or
- i) Some forms of wedding gifts such as the engagement ring.

The abovementioned assets will therefore remain the property of only one spouse. The tax treatment of these assets will therefore also differ from the assets that form part of the joint estate.

2.4.2 Marriages out of community of property

The proviso to the definition of *spouse* as discussed above states that a marriage or union in terms of subsection (b) or (c) of the definition will be deemed to be a marriage or union out of community of property unless it can be proved that the marriage or union should be in community of property.

According to Jassiem (2010:35), The Matrimonial Property Act (88 of 1984) allows for two types of Marriages out of community of property namely:

- a) Marriages out of community of property including the accrual system.
- b) Marriages out of community of property excluding the accrual system.

2.4.2.1 Marriages out of community of property including the accrual system;

Jassiem (2010:35) states that a marriage out of community of property will be deemed to include the accrual system unless the parties agree, in terms of an ante nuptial agreement, that the accrual system will be excluded.

Section 3 (1) of the Matrimonial Property Act (88 of 1984) states the following:

At the dissolution of a marriage subject to the accrual system, by divorce or by the death of one or both of the spouses, the spouse whose estate shows no accrual or a smaller accrual than the estate of the other spouse, or his estate if he is deceased, acquires a claim against the other spouse or his estate for an amount equal to half of the difference between the accrual of the respective estates of the spouses.

Jassiem (2010:35) states that the abovementioned provision implies that both parties will retain ownership over their separate assets, and will therefore remain liable for their separate liabilities.

However, the party whose estate shows the smallest growth will be entitled to 50% of the difference between the accrual in the parties' estates.

Accrual of estate is discussed in section 4 of the Matrimonial Property Act (88 of 1984). This section defines the accrual of an estate of a spouse as the difference between the net asset value (assets minus liabilities) at termination of the marriage and the net asset value at commencement of the marriage (taking into account the time value of money at a rate equal to the consumer inflation rate).

2.4.2.2 Marriages out of community of property excluding the accrual system

According to Anon (2016) an antenuptial agreement stating that the marriage is out of community of property without the accrual system means that the parties does not share any of their assets or liabilities or the growth of their assets or liabilities with each other at the time of dissolution of the ante nuptial agreement. This is supported by Jassiem (2010:36) where it is stated that each person will be the owner of his or her separate assets and will be responsible to repay his or her own debt.

2.5 Conclusion

In this chapter the various tax provisions that are relevant to inter-spousal bequests, donations and transfers were discussed. It was however also determined that inter-spousal transactions will currently not be subject to any tax in South Africa due to the various exemptions and abatements that are available.

The definition of *spouse* as contained in the Estate Duty Act (45 of 1955) and Income Tax Act (58 of 1962) was discussed. This definition was assessed to be wide and open to liberal interpretation.

The chapter further analysed the different types of matrimonial property regimes that is available in South Africa and it was determined that the current tax implications will not differ for the property regimes. The ownership of the assets will however differ and the inter-spousal transactions will therefore be differently impacted by the DTC's proposed amendments.

CHAPTER 3 CHARACTERISTICS OF A SUCCESSFUL WEALTH TAX SYSTEM

3.1 Introduction

In the previous chapter, the current tax treatments of inter-spousal transactions were discussed. The chapter furthermore analysed the definition of *spouse* for South African tax purposes. The different types of relationships which are included in this definition were also discussed briefly. Various types of matrimonial property regimes were furthermore explained, with note that the impact of the DTC's recommendations on Estate Duty will be different for each matrimonial property regime as the tax inclusions, exemptions and abatements differ based on to the matrimonial property regime that exists between the spouses.

In order to assess the DTC's recommendations related to inter-spousal transactions, the characteristics of a successful wealth transfer tax system must be determined. As per the secondary objective of this study identified in chapter 1 (paragraph 1.4.2), this chapter will aim to identify the characteristics that a wealth tax system, and more specifically a wealth transfer tax system, must possess in order to be effective. This chapter will therefore firstly define wealth transfer tax, outlining the differences between wealth transfer tax and net wealth tax. The chapter will further discuss the primary objectives of tax and the characteristics of an effective tax system, and finally the wealth transfer tax systems in various other countries will be briefly analysed.

3.2 Difference between wealth transfer tax and net wealth tax

Cremer and Pestieau (2009:1) differentiate between net wealth tax and wealth transfer tax by stating that net wealth tax is applied periodically on a person's net wealth, whereas wealth transfer tax is only collected when wealth (assets) are transferred between taxpayers.

Didwania (2014) defines a person's net wealth as:

The amount by which the aggregate value of all the assets, wherever located, belonging to the assessee on the valuation date, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date which have been incurred in relation to the said assets.

Matobela (2012:9) states that inheritance tax, Estate Duty, donations and gift tax as well as Capital Gains Taxes are examples of wealth transfer tax. According to Matobela (2012:9), Value-Added Tax (VAT) can, in some instances, be regarded as a form of wealth transfer tax.

The DTC's recommendations regarding inter-spousal transactions only relate to wealth transfer tax, and as such, this study will therefore focus on wealth transfer tax.

3.3 Objectives of taxation

In order to assess whether the DTC's recommendations will be conducive to the general objectives of taxation, these objectives must first be defined.

According to Momoniat (s.a.:17), the primary objective of taxation, is to fund the expenditure priorities of government by raising sufficient revenue through the tax system. However, the secondary objective of taxation is to assist in dealing with market failures. Momoniat (s.a.:17) further explains that the secondary objective (dealing with market failures) mostly refer to tax assisting in accounting for situations where the market price does not account for social costs that arise from the production and consumption of products or services (externalities). From Momoniat (s.a.:17), it is clear that the tax incentives and tax penalties are therefore also used to address certain socio-economic consequences of the consumption and production or rendering of certain goods and services.

The objectives of taxation, as described by Mamoniat above, is supported by Muller (2010:37) who states that taxation is an important an instrument, that the government uses it to finance public expenditure, and that taxation is used to assist in reaching various socio-economic objectives.

National Treasury (s.a.:4) discussed the objectives of the South African tax system in the terms of reference issued to the Davis Tax Committee as the following:

- a) The primary objective of taxation is the raising of revenue to fund government expenditure;
- b) Social objectives such as the building of an inclusive and cohesive society can be promoted by the tax system which raise revenue that can be used to distribute wealth and resources;
- c) A tax on production or consumption can also be implemented to assist in internalising various unwanted externalities in order to address market failures. Tax can therefore be implemented to, for example, assist in mitigating pollution or the consumption of products that may be harmful;
- d) Behaviour of people can be changed by implementing taxes. Taxes can be implemented to, for example, discourage unwanted behaviours such as smoking or encourage wanted behaviours such as saving;
- e) Taxation can also be used to assist in economic growth. This can be achieved by implementing targeted tax incentives that will encourage investment; and

f) Taxation can assist in the international competitiveness of South Africa.

The objectives of taxation will subsequently be discussed.

3.3.1 Revenue to fund public expenditure

Akrani (2011) defines public expenditure as follows:

The expenditure incurred by public authorities like central, state and local governments to satisfy the collective social wants of the people.

Muller (2010:37) states that this expenditure is funded from loans, government charges, administration fees, inflation induced by government and taxation.

The following extract from National Treasury's (2018:17) Main Budget Framework (Table 1 in the Framework) of 2018 shows the composition of South Africa's national revenue:

R million	Audited outcome			Revised estimate	Medium-term estimates		
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Revenue (National Revenue Fund)							
Tax revenue (gross)	986 295.0	1 069 982.6	1 144 081.0	1 217 306.8	1 344 964.5	1 454 795.3	1 581 926.3
Departmental and other receipts, and repayments	30 899.6	57 273.7	33 263.8	33 229.1	24 585.2	19 271.3	20 876.0
Less: Southern African Customs Union (SACU) payments ¹	51 737.7	51 021.9	39 448.3	55 950.9	48 288.6	46 281.2	60 147.1
Total revenue	965 456.9	1 076 234.4	1 137 896.4	1 194 585.0	1 321 261.1	1 427 785.4	1 542 655.1

Figure 3-1: Revenue from taxation

From the figure above, it can be noted that tax revenue is the most significant contributor to the total national (government) income in South Africa.

This also supports the fact that the main objective of taxation in South Africa is to generate revenue for public expenditure.

The following extract from Table A1.5.1 from National Treasury (2017:23) shows the amounts of taxation revenue arising from Estate Duty and Donations Tax:

R million	Donations tax	Estate duty	Securities Transfer Tax (STT)	Transfer duties	Total
2012/13	82	1 013	3 272	4 278	8 645
2013/14	113	1 102	3 784	5 489	10 487
2014/15	167	1 489	4 150	6 666	12 472
2015/16	135	1 982	5 531	7 396	15 044
2016/17	280	1 619	5 553	8 208	15 661
Percentage of total					
2012/13	0.9%	11.7%	37.8%	49.5%	100.0%
2013/14	1.1%	10.5%	36.1%	52.3%	100.0%
2014/15	1.3%	11.9%	33.3%	53.4%	100.0%
2015/16	0.9%	13.2%	36.8%	49.2%	100.0%
2016/17	1.8%	10.3%	35.5%	52.4%	100.0%
Percentage year-on-year growth					
2013/14	37.3%	8.7%	15.7%	28.3%	21.3%
2014/15	48.1%	35.1%	9.7%	21.4%	18.9%
2015/16	-19.3%	33.2%	33.3%	11.0%	20.6%
2016/17	107.9%	-18.3%	0.4%	11.0%	4.1%

Figure 3-2: Revenue from Estate Duty and Donations Tax

From the figure above, it can be seen that revenue from Donations Tax was a mere R280 million, while the revenue from Estate Duty equalled R1.6 billion in the 2016/2017 financial period. The revenue derived from Estate Duty and Donations Tax are therefore not a material contributor to the total tax revenue of about R1.14 trillion, as it contributes only about 0,16% of the total tax revenue of the country.

Therefore, it can be reasoned that the primary objective of Estate Duty and Donations Tax is not necessarily to raise revenue for government expenditure.

3.3.2 Socio-economic objectives

According to Muller (2010:38), taxes can assist in reaching socio-economic objectives which include, amongst others, economic growth, reprising and redistribution of wealth and resources.

a) Economic growth

From Temkin (s.a.) it is clear that the tax policy of a country can have an impact on the economic growth as well as the employment rate. This is supported by Thorpe (2015:21), who states that taxation policies can be structured to support economic growth, prevent high levels of inflation, create employment opportunities, and encourage investment.

b) Reprising

According to Gash (2011:14), reprising refers to taxes that are charged in order to control the consumption of certain products such as tobacco or alcohol. Kolitz (2013:9) makes it clear that sin taxes in South Africa were initially implemented in an attempt to discourage people from using alcohol and tobacco. Stafford (2018) argues that the newly implemented 'sugar tax' may be regarded as a sin tax.

c) Redistribution of wealth and resources

According to Gash (2011:15), the tax system is used to distribute wealth more equally throughout the population by charging higher rates to high-income and wealthy citizens, opposed to the lower rates charged to citizens of lower income. This view is supported by Thorpe (2015:20) who states that the government uses taxation in order to ensure that all citizens have equal opportunities in the achievement of economic aspirations, and further, to reduce the control of economic power of wealthy South African citizens.

3.4 Criteria for a good tax system

The renowned economist Adam Smith (1776) developed, in his treatise called "An Inquiry into the Nature and Cause of the Wealth of Nations", four attributes (referred to as the four canons or four maxims) of a good taxation system. These attributes are equity, certainty, convenience in payment, and economy in collection. Muller (2010:43) notes that these principles were later restated by other economists, and became the most acknowledged attributes of taxation. Therefore, the DTC's recommendations can be measured against these canons. Subsequently, these canons will be discussed in further detail.

3.4.1 Equity/Equality

Muller (2010:43) explained the equity canon as the principle that taxpayers must contribute to the tax revenue of the country in proportion to the revenue that they earn while functioning under the protection of the government. Downer (2016:4) underlines this notion, stating that equality implies that the tax burden which a person bears must be in direct proportion to the benefits which a person receives from government expenditure. The Inter-American Center of Tax Administrations (CIAT) (s.a.) simplified the interpretation of equity to mean that wealthy persons must pay more tax than poor persons.

From the above definitions, it is clear that two approaches exist. According to Muller's (2010:43) and CIAT's definitions, equity means that the tax burden of a taxpayer is linked to the revenue (income) and wealth of the taxpayer, while within the Downer (2016:4) definition, equity means

that the tax burden of a taxpayer is linked to the utilisation of government expenditure by the taxpayer. Muller (2010:43) underscores this, stating that the following approaches exist:

a) The Benefit Principle

According to Matobela (2012:3) the benefit principle means that the persons who benefit most from the services rendered by the government must pay the most tax. Martinez-Vazquez (2001:4) added that no individual will sacrifice any economic benefits to taxes under the benefit principle, seeing that the taxes that the person pays will be equal to the benefit or gain which the individual receives from the services rendered to the person by the government. Martinez-Vazquez (2001:4) further builds on this notion, stating that tariffs and user charges for direct services from government are based on the benefit principle. Muller (2010:43) supports this by stating that benefit taxes are usually levied in the form of toll fees, license fees, admission charges to museums and some tuition and school fees.

Muller (2010:43) clarifies that benefit tax does not support the objective of redistribution of wealth as mentioned in 3.3.2.

b) The Ability-to-Pay Principle

According to Matobela (2012:3) the Ability-to-Pay Principle, means that wealthy citizens and citizens of higher income, should pay more tax, and that taxes paid are viewed as a sacrifice made by taxpayers. Chauke *et al.* (2017:406) adds that the Ability-to-Pay Principle also refers to the concept of vertical and horizontal equity in the tax system.

According to Martinez-Vazquez (2001:2), horizontal equity refers to the requirement that equal individuals must be treated equally while vertical equity refers to the requirement that unequal individuals must be treated unequally. This is supported by Muller (2010:45) who states that horizontal equity requires taxpayers with equal ability (wealth and income) to pay equal amounts of tax while vertical equity requires taxpayers with larger ability (wealth and income) to pay a higher portion of their income as taxes than taxpayers with less ability. These concepts will be briefly discussed below:

i) Horizontal equity

As mentioned above, the concept of horizontal equity means that equal taxpayers must bear equal tax liability. Auerbach and Hassett (1999:4) states that it is important to determine when taxpayers will be regarded as being equal and what is meant with the requirement of equal taxpayers being treated equally.

A detailed discussion of the measurement of equality is beyond the scope of this study and the measurement will therefore only be discussed briefly below.

Anderson (1985:363) states that the equal taxpayers are taxpayers who earn similar amounts of income. Income is also shown to represent the ability of the taxpayer to pay taxes. Anderson (1985:363) further argues that horizontal equity must be measured based on a more comprehensive method of measuring income, rather than the statutory taxable income of the person. Anderson (1985:364) defined this comprehensive income as the adjusted gross income minus investment income plus other tax preference items that was excluded from the adjusted gross income.

Coetzee (1995:46) argues that this approach negates all other forms of discrimination such as the fact that a one-breadwinner family was not viewed as being equal to a two-breadwinner family.

Auerbach and Hassett (1999:4) reasons that groups of equal persons may be classified based on characteristics such as the family structure, age or region of reference of the taxpayers. Auerbach and Hasset (1999:4) further shows that the social welfare of the taxpayer must be considered when determining the equality of the taxpayers.

ii) Vertical equity

Coetzee (1995:16) states that vertical equity refers to the mechanism of progressive tax systems, which is implemented as an indirect method of distributing the wealth of rich persons to the less rich.

The principle of vertical equity is measured by comparing the post-tax income of taxpayers (Berliant & Strauss, 1985:182). The Organisation for Economic Co-operation and Development (OECD) (2001:19) states that the measurement of vertical equity will raise similar issues as the measurement of horizontal equity. The OECD (2001:20) further argues that uncertainty regarding the definition of income (comprehensive income or taxable income) and the allowances allowed in the measurement of equality exists.

The fact that vertical equity refers to the mechanism of redistribution the wealth of rich persons to the less fortunate are also similar to the secondary objective of taxation namely the redistribution of wealth and resources.

It is however argued by the OECD (2001:20) that the promotion of vertical equity often results in the decrease in efficiency of the tax system due to the fact that the utilisation of

labour and capital resources may be discouraged while tax evasion and avoidance are prompted.

Equity can also be regarded as an important canon in achieving the primary objective of taxation due to Castro and Rizzo (2014:2) stating that taxpayers are likely to understate their income when they feel that the tax system is inequitable.

3.4.2 Certainty

Downer (2016:5) states that Adam Smith found that the tax liability of a taxpayer must be certain and not arbitrary. According to Muller (2010:50), this means that the amount of tax, as well as the manner and timing of the payment of tax must be clear so that no doubt or uncertainty may exist regarding a taxpayer's tax liability.

Muller (2010:50) further explains that the Certainty of Law is linked to the principle of legality. According to Cliffe Dekker Hofmeyr (2017), the principle of legality means that the law must be certain, clear and stable, and that reasonable notice must be given before a law is enacted. Individuals must also be permitted to rely on the meaning of a law until the law is explicitly changed.

3.4.3 Convenience in payment

Kabinga (2016:5) states that convenience of payment means that taxes must be levied in a manner and at a time that is most convenient for the taxpayer. Muller (2010:51) adds that taxes should be levied in a manner that takes into account the liquidity of the taxpayer, based on the fact that taxes on unrealised assets will create a situation where assets must be valued. This will, in turn, result in possible liquidity inconsistencies. According to The Association of International Certified Professional Accountants (AICPA) (s.a.) convenience of payment will assist in ensuring compliance, seeing that taxpayers are less likely to pay their tax if it is inconvenient.

3.4.4 Economy in collection

Downer (2016:6) states that economy in collection refers to the fact that all costs relating to tax compliance must be minimised. Muller (2010:52) refers to this maxim as the requirement that revenue collection must be cost effective. Cost effectivity in this instance, implies that the cost of compliance to tax revenue ratio must be as low as possible in order to prevent a situation where most of the revenue collected is spent on collection of the revenue.

3.4.5 Other canons

The Knowledge Team (2016) explains that even though Adam Smith only identified four canons, various other economists identified additional canons. These canons are the following:

- a) Canon of Productivity;
- b) Canon of Elasticity;
- c) Canon of Simplicity;
- d) Canon of Diversity; and
- e) Canon of Desirability or Expedience

3.5 Wealth transfer taxes in other countries

Other countries also collect various forms of wealth transfer tax. The most prominent wealth transfer tax collecting countries will firstly be determined and the systems of these countries will briefly be discussed. The reasons behind the recent abolition of wealth transfer taxes in various other countries will be analysed.

3.5.1 Determination of the countries with successful wealth transfer taxation systems:

The following extract of figure 3 in EY's (2014) Cross-country Review of Taxes on Wealth and Transfers of Wealth shows the composition of wealth taxes in the different European Union (EU) member states namely France (FR), Spain (ES), United Kingdom (UK), Belgium (BE), Denmark (DK), Italy (IT), Poland (PL), Greece (EL), Portugal (PT), Bulgaria (BG), Finland (FI), Malta (MT), Hungary (HU), Netherland (NL), Romania (RO), Germany (DE), Luxembourg (LU), Latvia (LV), Cyprus (CY), Ireland (IE), Slovenia (SI), Slovakia (SK), Czech Republic (CZ), Austria (AT), Estonia (EE), Lithuania (LT), Croatia (HR) and Sweden (SE).

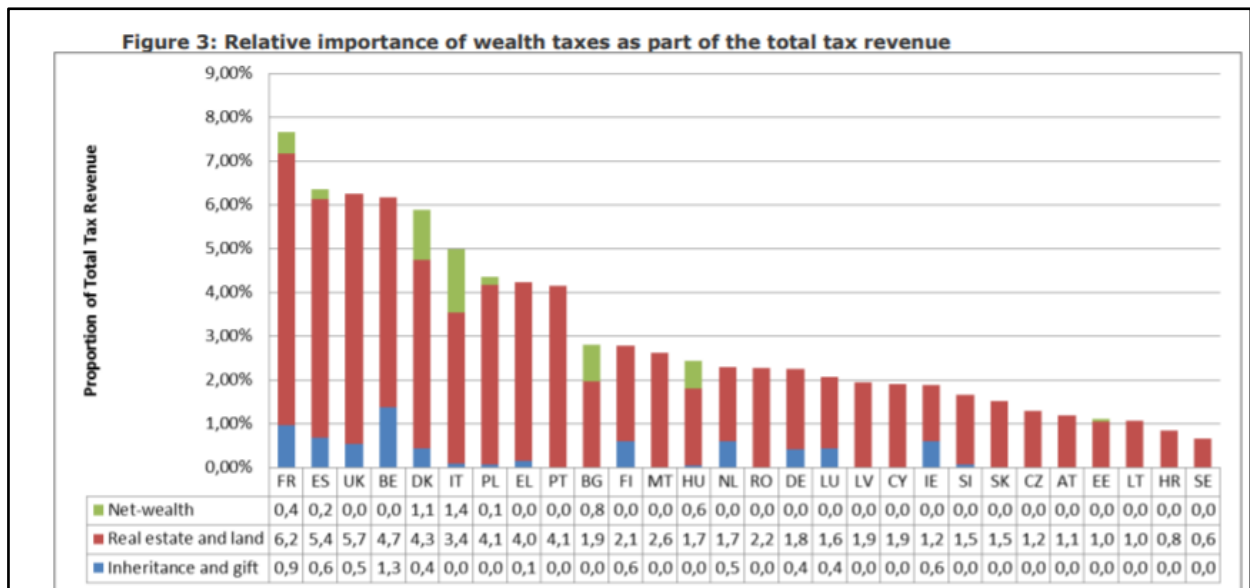


Figure 3-3: European Union countries revenue from wealth transfer tax

For this discussion, only inheritance and gift taxes will be used to assess the efficiency of wealth transfer taxes.

From the figure above it is clear that Belgium and France can be regarded as the most prominent collectors of wealth transfer tax as 1.3% of Belgium's and 0.9% of France's total tax revenue is derived from wealth transfer tax. Due to the wealth transfer tax collections in these countries being the most prominent, the inheritance tax systems of France and Belgium will be briefly discussed.

3.5.1.1 Belgium

From the EY Report (2014:100) it is clear that Belgium charges inheritance tax at the death of a taxpayer. The heir of the taxpayer is responsible for the payment of the tax. Inheritance taxes are also calculated on a sliding scale based on the taxable amount and the scales are different in the different tax regions of Belgium (Brussels-capital region, Flemish region and Walloon region). The sliding scales also vary depending on the relationship that the deceased had with the inheritor. The following table shows tax rates applicable to the various regions:

a) Brussels-capital Region

Relationship with the deceased	Tax rates
The spouse, legal cohabitant and the ascendants or descendants	3% - 30%
Brothers and sisters	20% - 65%
Uncles, aunts, nieces or nephews	35% – 70%
Any other persons	40% - 80%

Table 3-1: Brussels-capital Region tax rates

b) Flemish Region

Relationship with the deceased	Tax rates
The spouse, legal cohabitant and the ascendants or descendants	3% - 27%
Brothers and sisters	30% - 65%
Any other persons	45% - 65%

Table 3-2: Flemish Region tax rates

c) Walloon Region

Relationship with the deceased	Tax rates
The spouse, legal cohabitant and the ascendants or descendants	3% - 30%
Brothers and sisters	20% - 65%
Uncles, aunts, nieces or nephews	25% – 70%
Any other persons	30% - 80%

Table 3-3: Walloon Region tax rates

From the above, it is clear that spouses, legal cohabitants and ascendants or descendants are taxed at significantly lower rates. EY (2014:103) states that a more favourable rate is applied when the family dwelling is inherited by the ascendants or descendants and fully exempt when inherited by the spouse or legal cohabitant of the deceased in the Brussels region. The reason

for the reduced rate for ascendants or descendants relates to the principle of 'care' while the exemption for spouses is implemented to avoid the spouse having to dispose of the family home in order to pay the inheritance taxes.

PWC (2018b) adds that gift taxes also vary depending on the region and that in the Flemish and Brussels regions gifts of movable property are taxed at a flat rate of 3% when the gift is made to the spouse, descendants or ascendants of the deceased and at a rate of 7% for all other individuals.

The discussion above highlights the fact that Belgium implemented various favourable mechanisms to reduce the taxes charged on inheritances made to the spouse and other dependants of a deceased person.

3.5.1.2 France

EY (2014:197) states that France charges both inheritance and gift tax. The heirs or the beneficiaries of the assets are responsible to pay the taxes. The French inheritance and gift tax are based on sliding scales. EY (2014:197) illustrates the tax scales below to be relevant to inheritance and gift taxes.

Tax rates:

Succession or gift in a direct line:

Fraction Between		Rate
-	€ 8,072	5%
€ 8,072	€ 12,109	10%
€ 12,109	€ 15,932	15%
€ 15,932	€ 552,324	20%
€ 552,324	€ 902,838	30%
€ 902,838	€ 1,805,677	40%
€ 1,805,677	above	45%

Gifts between spouses or civil partners:

Fraction Between		Rate
-	€ 8,072	5%
€ 8,072	€ 15,932	10%
€ 15,932	€ 31,865	15%
€ 31,865	€ 552,324	20%
€ 552,324	€ 902,838	30%
€ 902,838	€ 1,805,677	40%
€ 1,805,677	above	45%

Gift or succession between brothers and sisters:

Fraction Between		Rate
-	€ 24,430	35%
€ 24,430	above	45%

Between relatives of the fourth degree or further a rate of 55% applies to the total value of the gift/estate.

Between relatives all other relations a rate of 60% applies to the total value of the gift/estate.

Figure 3-4: French tax rates

From the scales above, it can be seen that all inheritances will be subject to the same rates, regardless of the relationship between the heir and the deceased person.

EY (2014:159) and PWC (2018a) however state that all bequests to spouses will be exempt from inheritance tax while the first €100,000.00 (about R1.6 million) of bequests made to the direct dependants of the deceased persons will be exempted for inheritance tax purposes. According to EY (2014:59), these exemptions were also implemented as a result of the 'care' principle.

It is clear from the scales above that gift taxes to spouses will be subject to lower tax rates than gifts to other persons.

3.5.2 Other general observations from the report

EY (2014:23) states that the following is relevant for EU countries:

- a) Inheritances to spouses and children are largely exempt from inheritance tax due to large exemptions;
- b) In 11 of the 18 countries the surviving spouse is fully exempt from inheritance tax; and
- c) Children are fully exempted from inheritance tax in 7 of the 18 countries.

EY (2014:23) further states that the reason for the generous exemptions to spouses and children are mostly due to the social need of most citizens to take care of their close relatives before and after their death. Another reason cited is the fact that a family is often seen as a single tax unit as opposed to the different persons in the family being viewed as separate tax units.

3.6 Reason for abolished wealth transfer tax systems

EY (2014:27) states that seven EU states abolished inheritance and wealth taxes from 2000 to 2014. These states include Cyprus, Italy, Slovakia, Portugal, Sweden, Austria and the Czech Republic. The taxes in Italy, Slovakia, Portugal, Sweden and Czech Republic were abolished due to the fact that the gift and inheritance taxes were largely avoided, raised little revenue, were not efficient and necessitated the incurring of large administration fees by government. The tax in Czech Republic was abolished to compensate for an increase in the VAT rate while the tax in Austria was abolished due to a Supreme Court finding the fact that the valuation of real estate assets differed from other assets for wealth transfer tax purposes unconstitutional.

It can be argued that the wealth transfer tax system of the states were abolished due to the fact that the gift and inheritance taxes were largely avoided, raised little revenue and were not efficient, therefore resulting in the tax systems not complying to the canon of economy in collection. These

tax systems also did not contribute to the achievement of the primary objective of taxation as the systems raised very little revenue.

The tax system of Austria can be viewed as not achieving the canons of certainty and vertical equity. This is due to the fact that the system in Austria resulted in different tax consequences depending on the type of asset, therefore resulting in the equal taxpayers paying unequal taxes and the tax liability of taxpayers being uncertain.

Duff (2005:74) states that Canada, New Zealand and Australia also abolished wealth transfer taxes. The reasons for the abolishment of wealth transfer taxes in these countries will be discussed briefly below.

According to Duff (2005:89-102), the Canadian taxation laws started to treat death as a disposing event for Capital Gains Tax purposes which created a form of double taxation and that other forms of wealth transfer taxes were subsequently abolished. This is supported by the statement made by Ravel (2016) that the introduction of Capital Gains Tax resulted in Canada only treating death as a different form of taxable event and not in the complete removal of all forms of death taxes.

Duff (2005:107) described that the following contributed to the abolishment of Australian wealth transfer taxes:

- a) The fact that exemptions were not increased in line with inflation resulted in small estates being subject to tax. This resulted in extreme financial hardships for citizens, especially citizens of the small farming communities of Australia, who were forced to sell their farms in order to pay the taxes;
- b) Commonwealth and State duties were not integrated, therefore resulting in a form of double taxation; and
- c) The taxes were easily avoided by the more sophisticated taxpayers, therefore resulting in the most of the tax burden being placed on the small and medium sized estates.

The Australian wealth transfer tax system can therefore be seen not to contribute to the canon of vertical equity as the tax resulted in the small and medium sized estates bearing the tax burden, rather than the sophisticated taxpayers who can afford to implement various taxation structures in order to avoid their wealth transfer tax liability. The fact that the small and medium sized estates contributed the most to the wealth transfer tax revenue is also counterproductive to the objective of redistribution of wealth as discussed above.

According to Green and McKay (1980:240), the abolishment in New Zealand mostly occurred as a result of the fact that the moderate size estates contributed the most to the wealth transfer tax revenue. These medium sized estates mostly consisted of farms due to rapid land price

escalations in New Zealand. The farmers who were subject to wealth transfer tax argued that the rapid land price escalations did not provide them with adequate opportunity to prepare for these taxes to be paid, resulting in the farmers being forced to sell their farms to pay their tax liabilities. The government decided to amend the exemption level for all estates from \$25,000 to \$250,000 (about R240 000 to R2.4 million) which resulted in a significant decrease in revenue being collected from wealth transfer taxes. Due to the fact that wealth transfer taxes did not contribute significant revenue, the decision was made to abolish wealth transfer taxes completely.

It can be argued from the above that the reasons for net wealth taxes being abolished in these countries mostly relates to the wealth tax system not adhering to the basic principles of taxation (tax canons) as mentioned above and not being productive towards the achievement of the objectives of taxation.

3.7 Conclusion

This chapter aimed to identify and discuss the characteristics that should be present in a wealth transfer tax system to be successful and effective. Even though a model wealth tax system cannot be created, this chapter found that the four tax canons for a good tax system as established by Adam Smit are relevant to wealth transfer tax systems.

The chapter further examined the inheritance tax systems used in France and Belgium where the principles of care and a family being regarded as a single tax unit were also found to be factors contributing to gifts and bequests to the surviving spouse and children of the deceased person largely being exempt from wealth transfer tax.

It was further found that the abolishment of wealth transfer tax in various countries can be linked to the system not adhering to the basic principles of a good tax system.

The chapter lastly found that a wealth transfer tax system should comply with the basic principles of taxation and assist in the reaching of the primary and secondary objectives of taxation in order to be successful and that the failure to do so might result in the tax becoming ineffective, therefore resulting in the possible repeal thereof.

CHAPTER 4 EVALUATION OF THE DTC PROPOSALS

4.1 Introduction

Chapter 3 aimed to discuss the characteristics of a successful wealth transfer tax system. It was found that the general requirements (canons) of a good tax system as developed by Smith (1776) will however also be relevant to wealth transfer tax systems and that a wealth transfer tax system can furthermore be measured by its ability to contribute to the reaching of the objectives of taxation.

In chapter 4, the recommendation made by the DTC in its first interim and final report on Estate Duty regarding the treatment of inter-spousal transactions will be discussed. Furthermore, the reasons for the recommended treatment provided will be analysed against the requirements as discussed in chapter 3 and the criticism against these recommendations made by various professional bodies and tax professionals. The validity of the criticism made by the professional bodies and tax professionals will also be assessed in order to address the secondary objective in chapter 1 (par 1.4.2) of this study.

In chapter 1, the recommendations made by the DTC were briefly discussed. This section will however discuss these recommendations more thoroughly together with the criticism against these recommendations.

4.2 The first interim report

4.2.1 Recommendations made

4.2.1.1 Estate Duty

The DTC made the following recommendations:

a) Inter-spousal exemption

The DTC (2015:51) recommended that section 4(q) of the Estate Duty Act be repealed. As discussed in chapter 2, this section allows for the total amount of assets that were bequeathed to the spouse of the taxpayer to be exempt for Estate Duty purposes. The removal of this provision will therefore result in inter-spousal bequests being subject to Estate Duty.

The DTC (2015:51) firstly reasoned that this exemption must be removed due to the fact that taxpayers use this section together with section 4(m) of the Estate Duty Act to significantly

reduce their Estate Duty liability. Section 4(m) of the Estate Duty Act (45 of 1955) states the following:

4. The net value of any estate shall be determined by making the following deductions from the total value of all property included therein in accordance with section 3, that is to say

(m) The value of any usufructuary or other like interest in property and of any right to an annuity charged upon property, included as property of the deceased under section 3 (2) (a), if such interest or right was created by a predeceased spouse of the deceased and-

(i) the property over which the deceased enjoyed such interest or right formed part of the estate of such predeceased spouse; and

(ii) no deduction in respect of the value of such interest or right was allowable in the determination of the net value of the estate of the predeceased spouse under the provisions of paragraph (q) of this section

The DTC's (2015:29) second reason for the repeal is based on the fact the South African Estate Duty system contains allowances that allow most taxpayers to defer their Estate Duty liability until all spouses die.

Furthermore, South Africa is, based on the revenue collected from Estate Duty by other countries, underperforming in terms of Estate Duty revenue collection (DTC, 2016:30). It was found in 3.3.1 above that Estate Duty and Donations Tax only contributed about 0.16% of the total tax revenue of South Africa. When compared to Belgium and France where gift and inheritance taxes contribute about 1.3% and 0.9% to the total tax revenue of these countries respectively, South Africa can be seen as underperforming regarding wealth transfer taxes, therefore supporting this view of the DTC.

b) Repeal of the portable inter-spousal abatement

As discussed in chapter 2, section 4A(2) of the Estate Duty Act (45 of 1955) allows for the unused portion of a deceased spouse to be transferred to the surviving spouse, therefore effectively allowing a R7 million abatement for the combined assets of both spouses.

The DTC (2015:51) proposed that the abovementioned abatement must be withdrawn from the Estate Duty Act and that the surviving spouse's primary abatement must be allowed as a deduction from the first dying spouse's estate for Estate Duty purposes. The amount of the abatement of the surviving spouse that was utilised by the first dying spouse will then be subtracted from the abatement available to the surviving spouse upon his/her death. This recommendation can also be viewed as a type of portable abatement, however the timing of the utilisation of the combined abatements of both spouses will differ from the current portable abatement due to the proposed repeal of section 4(q) of the Estate Duty Act (45 of 1955) resulting in the spouses being forced to use the primary abatement of the surviving spouse to

reduce the Estate Duty liability of the first-dying spouse. This recommendation will therefore only allow taxpayers to defer their Estate Duty liability to the death of the second spouse.

The DTC (2015:48) motivates the withdrawal of the inter-spousal portability of the primary abatement by stating that the portability of the primary abatement promotes inequality in the Estate Duty system as it discriminates against single parent households. The DTC (2015:48) further states that the number of single parent households increased since 1997.

To substantiate the claim that the single parent households are discriminated against by the portability of the primary abatement, the DTC (2015:48) used the following illustration:

Estate value	Current	Current	Difference	Effective rate	Effective rate
	Single	Married		Single	Married
3 500 000	-	-	-	-	-
5 000 000	300 000	-	300 000	6,00	-
7 000 000	700 000	-	700 000	10,00	-
10 000 000	1 300 000	600 000	700 000	13,00	6,00
20 000 000	3 300 000	2 600 000	700 000	16,50	13,00
30 000 000	5 300 000	4 600 000	700 000	17,67	15,33
40 000 000	7 300 000	6 600 000	700 000	18,25	16,50
50 000 000	9 300 000	8 600 000	700 000	18,60	17,20
100 000 000	19 300 000	18 600 000	700 000	19,30	18,60

Figure 4-1: Estate Duty liability by estate value

From the calculation shown above, it can be seen that, even though the value of the net assets of the households are equal, a single parent household will pay more Estate Duty than the spouses in a spousal relationship in cases where the value of the estate exceeds R3.5 million. This might indicate that the canon of equality is not met as taxpayers who are equal do not pay equal tax. It can however be seen that the single parent will in all instances only pay a maximum of R700 000 more than the married persons, irrespective of the total value of the

estates, resulting from the additional R3.5 million primary abatement of the second spouse. Whether the abovementioned taxpayers are equal may, in light of the measurement of horizontal equity as discussed in chapter 3, however be questionable since assets are shared between two spouses as opposed to one single parent.

The DTC (2015:48) further motivated the removal of the portable abatement by stating that the number of children growing up in single parent families are constantly increasing. Hall and Sambu (2016) states that the percentage of children living with both parents declined to 35% in 2014 from 39% in 2002. From Jones (2011) it is also clear that children with fathers that are absent but still alive increased from 42% in 1997 to 48% in 2009. It can therefore be reasoned that the number of single parent households increased from 1997 to 2015.

The DTC (2015:51) acknowledges that their recommendation to repeal section 4(q) of the Estate Duty Act, together with the change to the portable primary abatement (allowing the first dying spouse to utilise the primary abatement of the surviving spouse if the estate value of the first-dying spouse exceeds the amount of the primary abatement) may result in a form of double taxation. The double taxation occurs due to the following:

- i) When the first spouse dies, the asset will be included in the net value of the person's estate. The value of this asset will then either reduce the primary abatement available to the spouses (the R3.5 million primary abatement plus the R3.5 million of the surviving spouse that may be utilised by the first-dying spouse) or be subject to tax (on the amount exceeding R7 million).
- ii) Upon the death of the surviving spouse, the assets inherited from the first-dying spouse will also be included in the net assets of the surviving spouse and will be taxed accordingly. The fact that all or part of the primary abatement of the surviving spouse was already utilised by the first-dying spouse will result in a larger dutiable amount and therefore larger Estate Duty liability in the hands of the surviving spouse.

To mitigate this double taxation, the DTC (2015:51) suggests that a table should be developed that allows for the assets that were already taxed in the estate of the predeceased spouse to be excluded from the estate of the surviving spouse for up to 10 years. It is however questionable whether the administration of this table will comply with the canon of economy in collection (discussed in Chapter 3) as additional administration will be required to ensure that the assets qualify for the exemption due to the fact that the surviving spouse inherited the assets from the predeceased spouse less than 10 years ago.

4.2.1.2 Donations Tax

Chapter 2 highlighted the fact that inter-spousal donations are exempt from Donations Tax as a result of section 56(1) (a) and section 56(1) (b) of the Income Tax Act (59 of 1962).

The DTC (2015:52) recommends that, due to the fact that it is impossible for a reasonable exemption amount for donations between spouses to be determined, the inter-spousal exemptions as provided for in section 56(1)(a) and section 56(1)(b) be retained. The DTC (2015:52) however advised that, in order to protect the Estate Duty system to be rendered vulnerable to abuse by assets being donated between spouses, the exemptions must be amended to exclude the following:

- a) Donations of interests in either fixed property or companies; and
- b) Donations of assets as a *donatio mortis causa*.

The DTC (2015:51) therefore recommends that donations of interest in fixed property and companies as well as any *donatio mortis causa* (as defined by Bansal (2018:667) to mean a gift with a view of death or “deathbed gift”) must not qualify for the exemptions allowed by section 56(1)(a) and section 56(1)(b) of the Income Tax Act (58 of 1962).

Section 56(1)(c) of the Income Tax Act (58 of 1962) however exempt any property disposed of under a donation as a *donatio mortis causa* from Donations Tax. This exemption will render the recommendations of the DTC regarding the amendments to section 56(1)(a) and 56(1)(b) ineffective. To prevent taxpayers from utilising this exemption to reduce their Donations Tax liability, the DTC (2015:52) recommended that section 56(1)(c) of the Income Tax Act must also be repealed.

The reason stated by the DTC (2015:52) can be interpreted to mean that the Estate Duty will be avoided by means of inter-spousal donations between spouses before the death of the first-dying spouse. This is supported by DTC (2015:52) stating that a major concern is the substantial donation of cash in the anticipation of death. If the DTC’s recommendation regarding the removal of section 4(q) of the Estate Duty Act is implemented, the concerns of the DTC could be valid as it may result in the donation, rather than bequest, of assets to the surviving spouse in order to avoid the payment of the Estate Duty. The validity of the abovementioned concerns can be illustrated by the following illustration of the difference in tax implications that arise when assets are bequeathed before the death of the first-dying spouse as opposed to being subject to Estate Duty as a result of the repeal of section 4(q). For this illustration, it is assumed that the net asset value of the deceased spouse is R10 million. This is because any amount below R3.5 million will not be subject to Estate Duty due to the primary abatement allowed by section 4A of the Estate

Duty Act (45 of 1955). It is also assumed that the deceased person distributed all but R6.5 million to the surviving spouse in order to fully utilise the R3.5 million primary rebate.

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

From the illustration above, it can be seen that by donating the assets to the spouse just before the death of the spouse, the Estate Duty liability of the predeceased spouse can be significantly reduced.

4.2.1.3 Criticism against the recommendations

The DTC’s statement that section 4(q) and section 4(m) is frequently used together to reduce Estate Duty seems to be misleading as proviso (ii) to section 4(m) states that the usufruct will not be exempt if the right was allowed as a deduction in terms of section 4(q) in the estate of the predeceased spouse. This is supported by De Swart *et al.* (2016:1065), stating that section 4(m) is not frequently used as the usufruct is in most cases exempt from tax in terms of section 4(q) in the hands of the predeceased spouse.

Allaway and Fischer (2014) provided an example of how the structure of usufruct and section 4(q) is usually set-up. From this example the following is noted:

- a) When the first spouse dies, a usufruct over a property is bequeathed to surviving spouse while the bare dominium is bequeathed to a family trust.
- b) The value of this right is calculated in terms of section 5(1)(b) of the Estate Duty Act (45 of 1955) and will be dependent on the life expectancy of the surviving spouse. The value of the bare dominium will be calculated in terms of section 5(1)(c) as the amount by which the fair market value of the asset exceeds the value of the usufruct as determined in section 5(1)(b).

- c) Since the usufruct is bequeathed to the surviving spouse, it will be exempt from Estate Duty in terms of section 4(q) of the Estate Duty Act while the bare dominium bequeathed to the family trust will be included in the net assets of the deceased spouse and taxed accordingly.
- d) As the receiving spouse ages, the value of the usufruct declines, until the estimated life expectancy as estimated on the time of the death of the first-dying spouse is reached by the surviving spouse, where the value of the usufruct will be nil.
- e) When the second spouse dies (assuming the spouse did not remarry), the value based on the remaining period of the usufruct will, in terms of section 3(2) (a) of the Estate Duty Act (45 of 1955), be included in the estate of the deceased. Since the amount qualified for the section 4(q) exemption in the estate of the predeceased spouse, this usufruct will not qualify for the exemption allowed by section 4(m) and will be taxed accordingly.

From the abovementioned, the effectiveness of the usufruct structure will depend on the surviving spouse not dying within a short period of time from the first spouse. This is supported by Allaway and Fischer (2014) stating that the particular circumstances of the taxpayer's affairs should be assessed in order to determine whether the structure will be beneficial.

The South African Institute of Tax Professionals (SAIT) (2015:6) furthermore argues that the second reason provided by the DTC, namely that spouses are able to defer their tax liability until all spouses die, assumes that a tenancy exists where spouses only bequeaths their assets to successive surviving spouses. SAIT (2015:6) however disagrees with this view of the DTC and states that, even though spouses are permitted exemptions for inter-spousal bequests, this does not necessarily result in all assets being bequeathed to the spouse. SAIT (2015:6) further claims those spousal bequests are usually accompanied by bequests to children.

SAIT's argument can be substantiated by the fact that Thekiso (2018) states that 90% of South Africans die intestate. Crouth (2018) agrees with this statistic and states that 70% of South Africans does not have wills and that 90% of estates will be subject to intestate succession.

Section 1(1) (c) of the Intestate Succession Act (81 of 1987) states the following:

1. If after the commencement of this Act a person (hereinafter referred to as the 'deceased') dies intestate, either wholly or in part, and-
 - is survived by a spouse as well as a descendant-
 - (i) such spouse shall inherit a child's share of the intestate estate or so much of the intestate estate as does not exceed in value the amount fixed from time to time by the Minister of Justice by notice in the Gazette, whichever is the greater; and
 - (ii) such descendant shall inherit the residue (if any) of the intestate estate;

Anon (2017) explains that the abovementioned provision will result in the surviving spouse inheriting the highest of R250 000 or a child's share. The remaining estate will be inherited in equal portions by the descendants of the deceased person.

Since most of South African residents die intestate, the most of the estates will therefore also be partly bequeathed to the children of the deceased, thereby supporting SAIT's view.

It must however be borne in mind that the Global Wealth Report by Credit Suisse (2018:51) found that only approximately 3.2% of South Africans have a net worth of more than \$100,000 (approximately R1.4 million). The percentage of South Africans with a net worth of more than R3.5 million, the current primary abatement for Estate Duty purposes, will therefore be even less than 3.2%. A possibility exists that the persons who are liable for Estate Duty might form part of the 10% of persons not dying intestate, but rather bequeathing their entire estates to their surviving spouses.

Another important issue relating to the recommendations made by the DTC was raised by FISA (2015:7) where it was stated that married persons are legally responsible to support each other. This may therefore result in a claim, in terms of the Maintenance of the Surviving Spouse Act (27 of 1990), being instituted against the estate of the predeceased spouse. Section 2 of the Maintenance of the Surviving Spouse Act (27 of 1990) states the following:

2. (1) If a marriage is dissolved by death after the commencement of this Act the survivor shall have a claim against the estate of the deceased spouse for the provision of his reasonable maintenance needs until his death or remarriage in so far as he is not able to provide therefor from his own means and earnings.
- (2) The survivor shall, in respect of a claim for maintenance, not have a right of recourse against any person to whom money or property has been paid, delivered or transferred in terms of section 34 (11) or 35 (12) of the Administration of Estates Act, 1965 (Act No. 66 of 1965), or pursuant to an instruction of the Master in terms 25 of section 18 (3) or 25 (1) (a) (ii) of that Act.
- (3) (a) The proof and disposal of a claim for maintenance of the survivor shall, subject to paragraphs (b), (c) and (d), be dealt with in accordance with the provisions of the Administration of Estates Act, 1965 (Act No. 66 of 1965).
(b) The claim for maintenance of the survivor shall have the same order of 3) preference in respect of other claims against the estate of the deceased spouse as a claim for maintenance of a dependent child of the deceased spouse has or would have against the estate if there were such a claim, and, if the claim of the survivor and that of a dependent child compete with each other, those claims shall, if necessary, be reduced proportionately.
(c) In the event of a conflict between the interests of the survivor in his capacity as claimant against the estate of the deceased spouse and the interests in his capacity as guardian of a minor dependent child of the deceased spouse, the Master may defer the claim for maintenance until such time as the court has decided on the claim.
(d) The executor of the estate of a deceased spouse shall have the power to enter into an agreement with the survivor, heirs and legatees, including the creation of a trust, and in terms of the agreement to transfer assets of the deceased estate, or a

right in the assets; to the survivor or the trust, or to impose an obligation on an heir or legatee, in settlement of the claim of the survivor or part thereof.

From section 2, as quoted above, the following is relevant:

- a) The surviving spouse will be entitled to claim an amount reasonably required for the maintenance of the person from the estate of the deceased person;
- b) The claim amount will only be granted to the extent that the surviving spouse's own means and earnings are not sufficient for the spouse's maintenance;

The abovementioned is supported by the judge in the *Oshry NO and Another v Feldman* (2010) stating that, if the deceased estate of the first-dying spouse has the means to support his/her spouse, the obligation to do so will be transferred to the spouse's deceased estate provided that the surviving spouse does not possess the means and earnings to support himself or herself.

Section 3 of the Maintenance of Surviving Spouse Act (27 of 1990) determines the factors that must be considered when the reasonable maintenance needs of the surviving spouse are determined. Section 3 states the following:

3. In the determination of the reasonable maintenance needs of the survivor, the following factors shall be taken into account in addition to any other factor which should be taken into account:
 - (a) The amount in the estate of the deceased spouse available for distribution to heirs and legatees;
 - (b) the existing and expected means, earning capacity, financial needs and obligations of the survivor and the subsistence of the marriage; and
 - (c) the standard of living of the survivor during the subsistence of the marriage and his age at the death of the deceased spouse.

The abovementioned provision was interpreted by the judge in *Oshry NO and Another v Feldman* (2010) who stated that, in the determination of a maintenance award, the court will always consider the needs of the surviving spouse against the ability of the spouse's estate bearing the obligation to maintain the surviving spouse.

Section 1 of the Maintenance of Surviving Spouse Act (27 of 1990) defines *survivor* as the surviving spouse in a marriage dissolved by death.

From the abovementioned definition it can be seen that only persons who were in a marriage prior to the death of the first-dying spouse are granted the right to institute a maintenance claim against his/her predeceased spouse's estate. The judge in *Volks NO v Robinson* (2005) supported this view by stating that the Act only recognised legally recognised marriages and does not include life partners. Legally recognised marriages were discussed in chapter 2 above and include Marriages in terms of the Marriage Act (25 of 1961), Civil Unions Act (17 of 2006) and Recognition of Customary Marriages Act (120 of 1998). This is supported by Nel Van der Merwe & Smalman

Inc. (2018) stating that the marriages referred to in the Maintenance of Survival Spouse Act include marriages, civil unions and customary unions.

From the abovementioned discussion it is clear that the concern raised by FISA (2015:7) will only occur when the tax on a bequest to the surviving spouse creates a situation where the maintenance needs of the surviving spouse is not catered for by the inheritance that the spouse received from the first-dying spouse together with the surviving spouse's own means while the estate of the deceased spouse however has sufficient means to support these needs. This view is supported by Lamprecht (2016) stating that a surviving spouse can lodge a claim against the estate of the predeceased spouse if the surviving spouse's assets and inheritance is insufficient to support his/her maintenance needs. Lamprecht (2016) adds that the Maintenance of Surviving Spouse Act claim will not be relevant to the surviving spouse's estate when the entire estate of the deceased spouse was bequeathed to the survivor spouse, but might have a major impact on the remaining value of the estate of the deceased spouse in instances where only a portion of the deceased spouse's estate was bequeathed to the surviving spouse.

4.2.2 Recommendations made in the final report

As mentioned in chapter 1, the DTC considered the commentary received from various professional bodies and tax professionals before issuing the final report on Estate Duty in 2016.

This report contained various different recommendations regarding inter-spousal transactions. These recommendations will be discussed below.

4.2.2.1 Estate Duty

The DTC (2016:14) recommended in the final report, similar to the first interim report, on Estate Duty that the inter-spousal exemption in section 4(q) and the portable primary abatement in section 4A(2) must be removed from the Estate Duty Act. The reasons stated by the DTC (2016:13) are also similar to the reasons provided by the first interim report namely that the exemption allowed by section 4(q) results in the Estate Duty system being inequitable. This is due to the fact that it results in married persons paying less Estate Duty than the following types of households:

- a) Families with divorced single parents;
- b) Families with single parents who never married;
- c) Families where the household is supported by grandparents;
- d) Families where children support the household; and

e) Families that are supported by relatives or households.

In chapter 2, it was discussed that the impact of the DTC's recommendation will differ according to the type of spousal relationship and matrimonial regime that exists between the spouses. It was furthermore shown in chapter 2 that currently all types of spousal relationships, irrespective of the type of matrimonial property regime that exists between the spouses, will bear the same tax liability.

The impact of this recommendation is shown below. The illustration will be based on a R20 million combined estate value for the two spouses. This is due to the fact that DTC (2016:16) shows that most of the estates collected in the 2014/2015 year was below R10 million. It is also assumed that the after-tax estate value of the first-dying spouse will remain unchanged in the estate of the surviving spouse.

4.2.2.1.1 Marriage in community of property

As discussed in chapter 2, all assets and liabilities are jointly owned by both spouses married in community of property, resulting in the total estate value of R20 million being shared equally (R10 million each) by the spouses upon the death of the first-dying spouse. The total Estate Duty liability of the spouses are illustrated below:

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

4.2.2.1.2 Marriage out of community of property without the accrual system

In chapter 2, it was discussed that marriage out of community of property without the accrual system means that the separate assets of the spouses will remain the property of the specific spouse and that each spouse will remain responsible for his/her own liabilities. This therefore means that the Estate Duty liability of each spouse will be determined on the spouse's separate net value.

According to Statistics South Africa's (2018:74) Quarterly Labour Force Survey, there are currently more than 2.5 million homemakers in South Africa who are not currently economically active. This is supported by Anon (2018) stating that men earn about 27% more than their women counterparts. SAIT (2015:11) also states that the income and property of men are usually significantly larger than those of females. Since the one spouse might therefore have a significantly higher estate, the order of deaths of the different spouses might, in the absence of section 4(q), impact the Estate Duty liability of the spouses. This is illustrated in the calculation below.

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)

From the calculation above it is clear that, even though the total combined estate values of all the scenarios are equal, the total Estate Duty payable will differ according to the composition of the estates of the different spouses and the timing of death of the spouses. Chapter 3 highlighted the requirement of horizontal equity in the tax system whereby it is required that equal taxpayers should bear equal tax liabilities. If the taxpayers above can be seen as *equal taxpayers*, as discussed in chapter 3, the difference in tax liability will therefore not comply with the canon of equity as described by Smith (1776). The canon of certainty as described by Smith (1776) may also be seen as infringed on as the tax liability of the taxpayers will be different depending on the timing of the death of the spouse who owns the most assets, thereby creating uncertainty regarding the Estate Duty liability of the spouses.

4.2.2.1.3 Marriage out of community of property including the accrual system

Chapter 2 showed that a marriage out of community of property that includes the accrual system means that the growth in the combined estate value of the spouses after marriage will be shared equally between the spouses. In the illustrations, the impact of the different scenarios based on the accrual between the spouses is shown below:

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
* Accrual claim of Homemaker			
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)

From the calculation above, it is clear that the concepts of equity and certainty, as described by Smith (1776) are not adhered to as the tax consequences will differ depending on the composition of the estates of the spouses and the order of death relevant to the spouses.

The calculations above also show that, even though the combined estate value of the spouses is equal, the tax treatment of the various matrimonial property regimes will differ. Even though the recommendation of DTC (2016:14) regarding the repeal of section 4(q) of the Estate Duty Act might contribute to the tax system being equitable towards single parent households, the recommendation will lead to unequal tax liabilities being borne by equal taxpayers, depending on the type of matrimonial property regime, composition of the combined estates of the spouses and order of death of the spouses. This will result in non-compliance to the canon of equity.

Furthermore, the recommendation leads to uncertainty of tax liabilities for spouses as the tax liability will differ as a result of the order in which the spouses die and therefore does not adhere to the canon of certainty.

4.2.2.2 Donations Tax

The DTC (2016:14) also considered the inter-spousal exemptions for Donations Tax purposes in terms of section 56(1) (a) and section 56(1) (b) of the Income Tax Act (58 of 1962). The DTC recommended that the Donations Tax exemption be amended to exclude any donations that will represent disposals for CGT purposes. According to DTC (2016:14) this will therefore still exempt transfers of cash, motor vehicles and personal assets from Donations Tax. The exemption must further be amended not to be relevant to any donation in anticipation of death (*donatio mortis causa*).

The reason for the proposed amendment is due to the fact that, according to DTC (2016:14), these provisions may result in a threat to the Estate Duty system. This reason was discussed above and it was found that the transfer of a significant portion of assets before the death of the first-dying spouse will result in a significant reduction in the taxation liability for the spouses.

The DTC (2016:14) further recommended that the exemption must be limited to a certain amount in order to prevent excessive wealth being transferred to the spouse through personal-use assets and cash.

The DTC (2016:15) concedes that the abovementioned recommendation might result in the difficulties associated with divorce proceedings being aggravated as the absence of relief will result in both Capital Gains Tax and Donations Tax being charged upon divorce between spouses. To mitigate this the DTC (2016:14) recommended that an exemption, similar to the death benefit for Estate Duty and Capital Gains Tax purposes must be implemented, provided that the amount of this exemption that was allowed must be deducted from any subsequent death benefit abatements and divorce abatements.

4.2.2.3 Capital Gains Tax

The DTC (2016:20) further recommended that paragraph 67 of the Eighth Schedule to the Income Tax Act (58 of 1962), which allows for rollover relief when assets are transferred between spouses, be repealed if the Estate Duty and Donations Tax recommendations are implemented.

The DTC (2016:19) however state that charging both Capital Gains Tax and Estate Duty on the same transaction is viewed as double taxation by various critics. The DTC (2016:20) however disagrees with this view as Estate Duty can, in the committee's opinion, be regarded as a type of wealth tax while Capital Gains Tax can be regarded as a type of income tax.

Bruwer (2016:43) however argued that double taxation will occur where a transaction is subject to more than one tax imposed by the same revenue authority, during the same period of taxation and the objectives of the taxation partially or fully overlaps. Bruwer (2016:43) further argued that the Estate Duty and Capital Gains Tax may be imposed on the estate of the same taxpayer and since Capital Gains Tax can be regarded as an indirect taxation of wealth, the objective of the tax in many cases also overlap. The levying of Estate Duty and Capital Gains Tax can therefore, according to Bruwer (2016:43), already be viewed as a form of double taxation. It can therefore be reasoned that levying both Capital Gains Tax and Estate Duty on inter-spousal transactions can already be regarded as double taxation. It was also discussed above that a form of double taxation can occur where the same assets are taxed in the estate of the first-dying and surviving spouse if the recommendations of the DTC are implemented.

The recommendations made by the DTC regarding inter-spousal transactions may therefore unreasonably burden taxpayers. The calculation below illustrates the total tax charged on an asset that is bequeathed to the surviving spouse. It is assumed that the net value of a taxpayer's assets are R10 million with a base cost of R5 million, the value of the asset did not increase after the death of the first spouse and that the taxpayer is taxed at the marginal income tax rate (45%).

Tax consequences of recommendations		
	Current	DTC recommendations
Spouse A		
Capital Gains Tax		
Proceeds (Paragraph 35 of the Eighth Schedule)	R 10,000,000.00	R 10,000,000.00
Base Cost (Paragraph 20 of the Eighth Schedule)	R -5,000,000.00	R -5,000,000.00
	R 5,000,000.00	R 5,000,000.00
Inter-spousal exemption	R -5,000,000.00	R -
Min: Primary exclusion (Paragraph 5(2) of the Eighth Schedule)	R -	R -300,000.00
Taxable Amount	R -	R 4,700,000.00
Inclusion Rate of 40% (Paragraph 10(a) of the Eighth Schedule)	R -	R 1,880,000.00
Income tax at marginal rate - 45% (Section 5 of the ITA)	R -	R 846,000.00
Estate Duty		
Property of Estate (Section 3 of the EDA)	R 10,000,000.00	R 9,154,000.00
Exemption for inter-spousal bequests (Section 4(q) of the EDA)	R -10,000,000.00	R -
Net Value of Estate (Section 4 of the EDA)	R -	R 9,154,000.00
Min Primary Abatement	R -	R -3,500,000.00
Dutiable Amount	R -	R 5,654,000.00
Tax Payable at 20%	R -	R 1,130,800.00
Spouse B		
Capital Gains Tax		
Proceeds (Paragraph 35 of the Eighth Schedule)	R 10,000,000.00	R 8,023,200.00
Base Cost (Paragraph 20 of the Eighth Schedule)	R -5,000,000.00	R -10,000,000.00
	R 5,000,000.00	R -1,976,800.00
Min: Primary exclusion (Paragraph 5(2) of the Eighth Schedule)	R -300,000.00	R -
Taxable Amount	R 4,700,000.00	R -
Inclusion Rate of 40% (Paragraph 10(a) of the Eighth Schedule)	R 1,880,000.00	R -
Income tax at marginal rate - 45% (Section 5 of the ITA)	R 846,000.00	R -
Estate Duty		
Net Value	R 10,000,000.00	R 8,023,200.00
Min Primary Abatement (Section 4A of the EDA)	R -3,500,000.00	R -3,500,000.00
Min Primary Abatement of spouse (Section 4A(2) of the EDA)	R -3,500,000.00	R -
Dutiable Amount	R 3,000,000.00	R 4,523,200.00
Tax Payable at 20%	R 600,000.00	R 904,640.00
Total Tax Paid	R 1,446,000.00	R 2,881,440.00
Effective tax rate	14.46%	28.81%

Table 4-5: Capital Gains Tax implication of recommendations

From the calculation above, it can be noted that the tax liability of the spouses significantly increased as a result of the recommendations. It can also be seen that the spouses will be liable to pay Capital Gains Tax and Estate Duty on unrealised assets if the recommendations are implemented.

4.3 Recommendations to mitigate the impact

The DTC (2016:16) recommended that the primary abatement (the abatement allowed by section 4A) should be increased from R3.5 million to R15 million. Furthermore, the DTC (2016:16) states that about R556 million in Estate Duty revenue will be sacrificed, but the repeal of the inter-spousal abatements will compensate for this loss of revenue. DTC (2016:17) also further argues that the R15 million will allow for an average middle class family not to be subject to Estate Duty as it allows for a home and personal assets of R5 million and investments and cash of R10 million (which will be sufficient to provide a family with about R30 000 to R40 000 of pre-tax monthly income) to be exempt for Estate Duty purposes. The DTC (2016:17) states that this recommendation will result in only High Net Worth Individuals (HNWI) being subject to Estate Duty. Based on the Estate Duty collections of 2014/2015, this recommendation will also result in only 135 as opposed to 1445 estates being subject to Estate Duty annually.

Furthermore, the DTC (2016:16) reasoned that, to mitigate the impact of the repeal of the inter-spousal Capital Gains Tax rollover relief granted by the paragraph 67 of the Eighth Schedule to the Income Tax Act (58 of 1962), the primary exclusion must be increased from R300 000 to R1 million upon a taxpayer's death.

The recommendation above will therefore have the impact of only wealthy persons being subject to Estate Duty. This will therefore contribute to the achievement of the redistribution of wealth and resources objective of taxation as discussed in chapter 3. Furthermore, the recommendation meets the canons of vertical equity and economy in collection as established by Smith (1776).

Hasson (2010: 33) however examined the impact that taxation on wealth has on economic growth, by analysing 20 OECD countries, and found support that taxes on wealth might damper economic growth.

4.4 Conclusion

In this chapter, the recommendations of the DTC's first interim and final report on Estate Duty were discussed. The reasons provided by the DTC in the abovementioned reports were assessed based on various criticisms against these recommendations and the canons of a good tax system (as discussed in chapter 2). The impacts of these recommendations were also illustrated by calculations.

This chapter noted that some of the recommendations made by the DTC will not adhere to the canons of a good wealth system as described by Smith (1776). It was however found that the recommendations may in some instances promote the achievement of the primary objective of taxation, namely the raising of revenue, and that the recommendations in totality may also promote the achievement of one of the secondary objectives of taxation, namely the redistribution of wealth and resources, but that it must be borne in mind that the increase in taxation liability of wealthy taxpayers may result in a decrease in economic growth.

CHAPTER 5 SUMMARY AND CONCLUSION

5.1 Introduction

In chapter 1, the fact that the DTC made recommendations on the tax treatment of inter-spousal transactions for Donations Tax, Capital Gains Tax and Estate Duty purposes in the first interim and final report on Estate Duty, which was issued to the Minister of Finance in 2015 and 2016 respectively, were discussed. The mandate of the Davis Tax Committee was, according to DTC (2015:5) to investigate the progressivity of the tax system and the role of the Estate Duty in the reaching of the objective of a more equitable and progressive tax system. It was further noted that the proposals were criticised by various professional bodies and other tax professionals.

This study aimed to discuss the reasonability of the recommendations on inter-spousal transactions by measuring them against the requirements of a successful wealth transfer tax system while also taking into account the reasons provided for these recommendations by the DTC as opposed to the criticism raised by the various professional bodies and other tax professionals.

This chapter will summarize the findings and conclusions reached in this study. The extent to which the primary objectives of the study were achieved will be discussed.

5.2 Primary and secondary objectives

The primary objective of this study was to determine whether, based on the requirements of a good tax system, the recommendations of the Davis Tax Committee regarding the taxation of inter-spousal transactions, as contained in the committee's first interim and final report on Estate Duty, can be regarded as reasonable.

In order to achieve this objective, the study however firstly discussed, in chapter 2, the definition of a 'spouse' in order to determine the relationship types that will be influenced by these recommendations. Furthermore, chapter 2 illustrated the current tax treatment of the inter-spousal transactions. From this chapter it was found that any type of relationship, whether heterosexual or homosexual, will qualify for the inter-spousal abatements, provided that the commissioner is satisfied that these relationship types are intended to be permanent. It was shown that the amount of tax will currently be equal for all types of properties, irrespective of the type of matrimonial property regime that exists between the spouses.

Chapter 3 discussed the requirements of a successful wealth transfer tax system. The chapter found that the canons of a good tax system as established by Adam Smith are also relevant to

wealth transfer tax. Furthermore, the chapter showed that the reasons for the repeal of wealth transfer tax in various other countries were due to the tax not complying with these canons. It was lastly found in this chapter that the most countries surveyed by EY (2014) reasoned that favourable inter-spousal provisions were implemented in the Wealth Transfer Tax systems of the countries due to the principle of the need of most citizens to care for their dependants even after their death and the fact that most countries view spousal relationships as single tax units.

In chapter 4, the recommendations in the Davis Tax Committee's first interim and final report on Estate Duty were discussed. The figures below highlight the impact of the recommendations made by the DTC in aggregate. For the first figure, it will be assumed that the total net value of the total household will be R15 million (as reasoned by the DTC to be an estate that will be sufficient to provide for an average family), including a primary residence of R2 million (with base cost of R0), cash of R3 million and other assets of R10 million. The second table will however assume that the combined asset value of the household is R30 million, including a primary residence of R2 million (with base cost of R0) and cash of R10 million. It is also assumed that the base cost of all assets were R5 million in both scenarios and that this R5 million is the value of the assets for accrual basis purposes at the marriage date. For the current tax treatment calculation, it will be assumed that the spouses are married in community of property, however the total current tax liability resulting from inter-spousal transfers will not differ as a result of the matrimonial property regime that exists between the spouses.

Tax consequences of recommendations - R15 million combined assets								
Spouse A								
Capital Gains Tax	Current	Marriage in community of property	DTC recommendations					
	Current treatment		Marriage out of community of property (Excluding the accrual system)			Marriage in community of property (Including the accrual system)		
			Equal Estates and primary residence is jointly owned	Homemaker as first-dying spouse	Homemaker as surviving spouse	Equal Accrual, equal estates and jointly owned	Homemaker as first-dying spouse	Homemaker as surviving spouse
Assets for CGT purposes	R 6 000 000	R 6 000 000	R 6 000 000	R -	R 12 000 000	R 6 000 000	R -	R 12 000 000
Primary Residence	R 1 000 000	R 1 000 000	R 1 000 000	R -	R 2 000 000	R 1 000 000	R -	R 2 000 000
Cash	R -	R -	R -	R -	R -	R -	R -	R -
Other Assets	R 5 000 000	R 5 000 000	R 5 000 000	R -	R 10 000 000	R 5 000 000	R -	R 10 000 000
Proceeds (Paragraph 35 of the Eighth Schedule)	R 6 000 000	R 6 000 000	R 6 000 000	R -	R 12 000 000	R 6 000 000	R -	R 12 000 000
Base Cost (Paragraph 20 of the Eighth Schedule)	R -2 500 000	R -2 500 000	R -2 500 000	R -	R -5 000 000	R -2 500 000	R -	R -5 000 000
	R 3 500 000	R 3 500 000	R 3 500 000	R -	R 7 000 000	R 3 500 000	R -	R 7 000 000
Inter-spousal exemption (Paragraph 67 of the Eighth Schedule)	R -3 500 000	R -	R -	R -	R -	R -	R -	R -
Less: Primary Residence exclusion (Paragraph 5(2))	R -1 000 000	R -1 000 000	R -1 000 000	R -	R -2 000 000	R -1 000 000	R -	R -2 000 000
Less: Primary exclusion (Paragraph 5(2) of the Eighth Schedule)	R -	R -1 000 000	R -1 000 000	R -	R -1 000 000	R -1 000 000	R -	R -1 000 000
Taxable Amount	R -1 000 000	R 1 500 000	R 1 500 000	R -	R 4 000 000	R 1 500 000	R -	R 4 000 000
Inclusion Rate of 40% (Paragraph 10(a) of the Eighth Schedule)	R -	R 600 000	R 600 000	R -	R 1 600 000	R 600 000	R -	R 1 600 000
Income tax at marginal rate - 45% (Section 5 of the ITA)	R -	R 270 000	R 270 000	R -	R 720 000	R 270 000	R -	R 720 000
Estate Duty								
Assets for Estate Duty Purposes	R 7 500 000	R 7 230 000	R 7 230 000	R -	R 14 280 000	R 7 230 000	R 5 000 000	R 14 280 000
Primary residence	R 1 000 000	R 1 000 000	R 1 000 000	R -	R 2 000 000	R 1 000 000	R -	R 2 000 000
Cash	R 1 500 000	R 1 230 000	R 1 230 000	R -	R 2 280 000	R 1 230 000	R -	R 2 280 000
Other Assets	R 5 000 000	R 5 000 000	R 5 000 000	R -	R 10 000 000	R 5 000 000	R -	R 10 000 000
Deemed property: Accrual claim against spouse (Section 4(3) of EDA)	R -	R -	R -	R -	R -	R -	R 5 000 000	R -
Less Accrual claim for surviving spouse (Section 4(IA))	R -	R -	R -	R -	R -	R -	R -	R -4 640 000
Exemption for inter-spousal bequests (Section 4(q) of the EDA)	R -7 500 000	R -	R -	R -	R -	R -	R -	R -
Net Value of Estate (Section 4 of the EDA)	R -	R 7 230 000	R 7 230 000	R -	R 14 280 000	R 7 230 000	R 5 000 000	R 9 640 000
Less: Primary Abatement	R -	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000
Dutiable Amount	R -	R -7 770 000	R -7 770 000	R -15 000 000	R -720 000	R -7 770 000	R -10 000 000	R -5 360 000
Tax Payable at 20%	R -	R -	R -	R -	R -	R -	R -	R -
Spouse B								
Capital Gains Tax								
	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000
Proceeds (Paragraph 35 of the Eighth Schedule)	R 6 000 000	R 6 000 000	R 6 000 000	R 12 000 000	R -	R 6 000 000	R 12 000 000	R -
Value of own assets	R 6 000 000	R 6 000 000	R 6 000 000	R -	R 12 000 000	R 6 000 000	R -	R 12 000 000
Value of spouses assets	R -5 000 000	R -8 500 000	R -8 500 000	R -5 000 000	R -12 000 000	R -8 500 000	R -5 000 000	R -12 000 000
Base Cost (Paragraph 20 of the Eighth Schedule)	R -2 500 000	R -2 500 000	R -2 500 000	R -5 000 000	R -	R -2 500 000	R -5 000 000	R -
Base Cost of own assets	R -2 500 000	R -6 000 000	R -6 000 000	R -	R -12 000 000	R -6 000 000	R -	R -12 000 000
Base Cost of spouse assets	R 7 000 000	R 3 500 000	R 3 500 000	R 7 000 000	R -	R 3 500 000	R 7 000 000	R -
Less: Primary Residence exclusion (Paragraph 5(2))	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000
Less: Primary exclusion (Paragraph 5(2) of the Eighth Schedule)	R -300 000	R -1 000 000	R -1 000 000	R -1 000 000	R -1 000 000	R -1 000 000	R -1 000 000	R -1 000 000
Taxable Amount	R 4 700 000	R 500 000	R 500 000	R 4 000 000	R -3 000 000	R 500 000	R 4 000 000	R -3 000 000
Inclusion Rate of 40% (Paragraph 10(a) of the Eighth Schedule)	R 1 880 000	R 200 000	R 200 000	R 1 600 000	R -	R 200 000	R 1 600 000	R -
Income tax at marginal rate - 45% (Section 5 of the ITA)	R 846 000	R 90 000	R 90 000	R 720 000	R -	R 90 000	R 720 000	R -
Estate Duty								
Net Value	R 14 154 000	R 14 640 000	R 14 640 000	R 14 280 000	R 14 280 000	R 14 640 000	R 14 280 000	R 14 280 000
Assets for CGT	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000	R 12 000 000
Cash	R 2 154 000	R 2 640 000	R 2 640 000	R 2 280 000	R 2 280 000	R 2 640 000	R 2 280 000	R 2 280 000
Less: Primary Abatement (Section 4A of the EDA)	R -3 500 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000
Less: Primary Abatement of spouse (Section 4A(2) of the EDA)	R -3 500 000	R -	R -	R -	R -	R -	R -	R -
Dutiable Amount	R 7 154 000	R -360 000	R -360 000	R -720 000	R -720 000	R -360 000	R -720 000	R -720 000
Tax Payable at 20%	R 1 430 800	R -	R -	R -	R -	R -	R -	R -
Total Tax Paid	R 2 276 800	R 360 000	R 360 000	R 720 000	R 720 000	R 360 000	R 720 000	R 720 000
Effective tax rate	15.18%	2.40%	2.40%	4.80%	4.80%	2.40%	4.80%	4.80%

Table 5-1: Aggregate impact of recommendations – R15 million combined estate

Tax consequences of recommendations - R30 million combined assets								
Spouse A								
Capital Gains Tax	Current	DTC recommendations						
	Current treatment	Marriage in community of property	Marriage out of community of property (Excluding the accrual system)			Marriage in community of property (Including the accrual system)		
			Equal Estates and primary residence is jointly owned	Homemaker as first-dying spouse	Homemaker as surviving spouse	Equal Accrual, equal estates and jointly owned primary residence	Homemaker as first-dying spouse	Homemaker as surviving spouse
Assets for CGT purposes	R 10 000 000	R 10 000 000	R 10 000 000	R -	R 20 000 000	R 10 000 000	R -	R 20 000 000
Primary Residence	R 1 000 000	R 1 000 000	R 1 000 000	R -	R 2 000 000	R 1 000 000	R -	R 2 000 000
Cash	R -	R -	R -	R -	R -	R -	R -	R -
Other Assets	R 9 000 000	R 9 000 000	R 9 000 000	R -	R 18 000 000	R 9 000 000	R -	R 18 000 000
Proceeds (Paragraph 35 of the Eighth Schedule)	R 10 000 000	R 10 000 000	R 10 000 000	R -	R 20 000 000	R 10 000 000	R -	R 20 000 000
Base Cost (Paragraph 20 of the Eighth Schedule)	R -2 500 000	R -2 500 000	R -2 500 000	R -	R -5 000 000	R -2 500 000	R -	R -5 000 000
	R 7 500 000	R 7 500 000	R 7 500 000	R -	R 15 000 000	R 7 500 000	R -	R 15 000 000
Inter-spousal exemption	R -7 500 000	R -	R -	R -	R -	R -	R -	R -
Min: Primary Residence exclusion (Paragraph 5(2))	R -1 000 000	R -1 000 000	R -1 000 000	R -	R -2 000 000	R -1 000 000		R -2 000 000
Min: Primary exclusion (Paragraph 5(2) of the Eighth Schedule)	R -	R -1 000 000	R -1 000 000	R -	R -1 000 000	R -1 000 000		R -1 000 000
Taxable Amount	R -1 000 000	R 5 500 000	R 5 500 000	R -	R 12 000 000	R 5 500 000	R -	R 12 000 000
Inclusion Rate of 40% (Paragraph 10(a) of the Eighth Schedule)	R -	R 2 200 000	R 2 200 000	R -	R 4 800 000	R 2 200 000	R -	R 4 800 000
Income tax at marginal rate - 45% (Section 5 of the ITA)	R -	R 990 000	R 990 000	R -	R 2 160 000	R 990 000	R -	R 2 160 000
Estate Duty								
Assets for Estate Duty Purposes	R 15 000 000	R 14 010 000	R 14 010 000	R -	R 27 840 000	R 14 010 000	R 12 500 000	R 27 840 000
Primary Residence	R 1 000 000	R 1 000 000	R 1 000 000	R -	R 2 000 000	R 1 000 000	R -	R 2 000 000
Cash	R 5 000 000	R 4 010 000	R 4 010 000	R -	R 7 840 000	R 4 010 000	R -	R 7 840 000
Other Assets	R 9 000 000	R 9 000 000	R 9 000 000	R -	R 18 000 000	R 9 000 000	R -	R 18 000 000
Deemed property: Accrual claim against spouse (Section 4(3) of EDA)	R -	R -	R -	R -	R -	R -	R 12 500 000	R -
Minus Accrual claim for surviving spouse (Section 4(1A))	R -	R -	R -	R -	R -	R -	R -	R -11 420 000
Exemption for inter-spousal bequests (Section 4(q) of the EDA)	R -15 000 000	R -	R -	R -	R -	R -	R -	R -
Net Value of Estate (Section 4 of the EDA)	R -	R 14 010 000	R 14 010 000	R -	R 27 840 000	R 14 010 000	R 12 500 000	R 16 420 000
Min Primary Abatement	R -	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000
Dutiable Amount	R -	R -990 000	R -990 000	R -15 000 000	R -15 000 000	R -990 000	R -2 500 000	R 1 420 000
Tax Payable at 20%	R -	R -	R -	R -	R 2 568 000	R -	R -	R 284 000
Spouse B								
Capital Gains Tax								
Proceeds (Paragraph 35 of the Eighth Schedule)	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000
Value of own assets	R 10 000 000	R 10 000 000	R 10 000 000	R 20 000 000	R -	R 10 000 000	R 20 000 000	R -
Value of spouses assets	R 10 000 000	R 10 000 000	R 10 000 000	R -	R 20 000 000	R 10 000 000	R -	R 20 000 000
Base Cost (Paragraph 20 of the Eighth Schedule)	R -5 000 000	R -12 500 000	R -12 500 000	R -5 000 000	R -20 000 000	R -12 500 000	R -5 000 000	R -20 000 000
Base Cost of own assets	R -2 500 000	R -2 500 000	R -2 500 000	R -5 000 000	R -	R -2 500 000	R -5 000 000	R -
Base Cost of spouse assets	R -2 500 000	R -10 000 000	R -10 000 000	R -	R -20 000 000	R -10 000 000	R -	R -20 000 000
	R 15 000 000	R 7 500 000	R 7 500 000	R 15 000 000	R -	R 7 500 000	R 15 000 000	R -
Min: Primary Residence exclusion (Paragraph 5(2))	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000	R -2 000 000
Min: Primary exclusion (Paragraph 5(2) of the Eighth Schedule)	R -300 000	R -1 000 000	R -1 000 000	R -1 000 000	R -1 000 000	R -1 000 000	R -1 000 000	R -1 000 000
Taxable Amount	R 12 700 000	R 4 500 000	R 4 500 000	R 12 000 000	R -3 000 000	R 4 500 000	R 12 000 000	R -3 000 000
Inclusion Rate of 40% (Paragraph 10(a) of the Eighth Schedule)	R 5 080 000	R 1 800 000	R 1 800 000	R 4 800 000	R -	R 1 800 000	R 4 800 000	R -
Income tax at marginal rate - 45% (Section 5 of the ITA)	R 2 286 000	R 810 000	R 810 000	R 2 160 000	R -	R 810 000	R 2 160 000	R -
Estate Duty								
Net Value	R 27 714 000	R 28 200 000	R 28 200 000	R 27 840 000	R 25 272 000	R 28 200 000	R 27 840 000	R 27 556 000
Assets for CGT	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000	R 20 000 000
Cash	R 7 714 000	R 8 200 000	R 8 200 000	R 7 840 000	R 5 272 000	R 8 200 000	R 7 840 000	R 7 556 000
Min Primary Abatement (Section 4A of the EDA)	R -3 500 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000	R -15 000 000
Min Primary Abatement of spouse (Section 4A(2) of the EDA)	R -3 500 000	R -	R -	R -	R -	R -	R -	R -
Dutiable Amount	R 20 714 000	R 13 200 000	R 13 200 000	R 12 840 000	R 10 272 000	R 13 200 000	R 12 840 000	R 12 556 000
Tax Payable at 20%	R 4 142 800	R 2 640 000	R 2 640 000	R 2 568 000	R 2 054 400	R 2 640 000	R 2 568 000	R 2 511 200
Total Tax Paid	R 6 428 800	R 4 440 000	R 4 440 000	R 4 728 000	R 6 782 400	R 4 440 000	R 4 728 000	R 4 955 200
Effective tax rate	21.43%	14.80%	14.80%	15.76%	22.61%	14.80%	15.76%	16.52%

Table 5-2: Aggregate impact of recommendations – R30 million combined estate

These figures show the aggregate impact that the recommendations will result in. It can be seen that High Net Worth Individuals will be impacted mostly by the recommendations and that the impact will differ according to the type of matrimonial property regime existing between the spouses.

The reasons for the proposals were analysed in order to determine whether the reasons provided will comply with the tax canons and objectives of taxation as discussed in chapter 3. This chapter found that the separate recommendations will, in isolation, mostly not comply with the tax canons discussed in chapter 3, but when the recommendations are viewed in totality, including the recommendation that the primary abatement allowed by section 4A of the Estate Duty Act must be increased from R3.5 million to R15 million, the recommendations will result in only High Net Worth Individuals being subject to Estate Duty. The combined impact of all the recommendations will therefore result in the promotion of the objectives of taxation and the canons of equity and economy in collection. It was however finally also noted that it must be assessed whether the increase in liability imposed on the wealthy persons will result in the decrease in economic growth.

5.3 Further research areas

The scope of this study did not allow for a complete analysis of all relevant factors relating to the recommendations regarding treatment of inter-spousal transactions. During the course of the research further research areas were identified.

In chapter 4, the study discussed the fact that an undue hardship will be placed on the surviving spouse who will be forced to dispose of some of the spouses' assets in order to settle the tax liability of the first-dying spouse if the DTC's recommendations are implemented. A complete analysis of the social and financial impact of these recommendations will therefore shed more light on the hardship imposed on the surviving spouse and the descendants of the deceased.

It was furthermore discussed that the additional tax liability placed on wealthy taxpayers may result in a decline of economic growth. It is therefore submitted that a complete study of the economic impact of the Davis Tax Committee's recommendations, specifically the fact that only High Net Worth Individuals will be subject to Estate Duty, can be conducted. The results of such a study will also provide more information on the reasonability and impact of the Davis Tax Committee's recommendations.

5.4 Conclusion

Even though this study could not definitively conclude on the reasonability of the DTC's recommendations, it was shown that these recommendations are motivated by reasons that were not always considered to be adhering to the canons of a good tax system.

The study however found that the recommendations can be regarded as promoting the canon of equity in the tax system (specifically vertical equity), but that the impact of these recommendations on the economy must be established. It was further shown that the canon of equity (specifically horizontal equity) and certainty might not be achieved due to the inconsistent tax liabilities imposed on taxpayers based on the type of matrimonial property regime, order of death of the spouses and the composition of the estates of the spouses in a spousal relationship.

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