

# THE IMPLICATIONS OF WEALTH TRANSFER TAXATION IN THE ABSENCE OF ESTATE DUTY

by

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# **A REVIEW OF WEALTH TRANSFER TAXES IN SOUTH AFRICA WITH PARTICULAR EMPHASIS ON THE FUTURE OF ESTATE DUTY**

## **1 INTRODUCTION**

### **1.1 BACKGROUND**

After the introduction of Capital Gains tax (CGT) on 1 October 2001 many key role players argued that the “wealth transfer taxes” or “death duties” as they are referred to in other countries now gave rise to double taxation. This was confirmed in the budget speech of 2002 where National Treasury appeared to have recognised this problem and there was an attempt to come to a compromise to some degree. Tax experts initially expected that the 2002 Budget decrease in the estate duty rate from 25% to 20%, with an abatement increase from R 1000 000 to R 1500 000 would be followed by further decreases and eventual repeal of the Estate Duty Act. This was however not the case, as in the 2012 Budget speech the CGT rate was again increased to a staggering 33,3% for individuals, while there was no decrease in the rate of estate duty.

The practical and economical solution would be to abolish estate duty all together, but according to Mazansky, E who is the head of taxation at law firm Werksmans states that it would be difficult politically to do away with estate duty. It was noted in former Finance Minister Pravin Gordhan’s 2010 Budget speech that the imposition of both estate duty and capital gains tax (CGT) at the death of an individual gives rise to double taxation. Minister Gordhan also conceded that estate duty raised minimal revenue and was cumbersome to administer. Moreover, estate duty’s efficiency is questionable as many wealthy Individuals escape the liability of estate duty through the use of trusts and other estate planning techniques.

Capital gains tax (“CGT”) was introduced in South Africa with effect from 1 October 2001 by the insertion of section 26A as well as the Eighth Schedule into the Income Tax Act 58 of 1962 (“The Income Tax Act”), by the Taxation Laws Amendment Act 5 of 2001, which

was promulgated on 20 June 2001. Although there were many reasons which led to the introduction of CGT, “vertical equity” as described in the “Comprehensive Guide to Capital Gains Tax Issue 4” issued by SARS might just be the most important.

Vertical equity connotes that taxpayers with greater ability to pay taxes should bear a greater burden of taxation. Furthermore, international experience indicates that the biggest share of CGT revenues can be attributed to the wealthiest individuals. Therefore including CGT in taxable income contributes to the progressivity of the income tax system, while enabling government to pursue other tax policy objectives, premised on widening tax bases and reducing standard tax rates.

Given the skewed distribution of wealth in South Africa the introduction of CGT markedly improved the vertical equity of the income tax system in South Africa. CGT has been introduced as an integral part of the Income Tax Act and the levying, collection and administration thereof will accordingly take place in terms of the provisions of the Income Tax Act according to Williams (2005).

In a comprehensive report issued by the Katz Commission (1997) which dealt with tax reform, many arguments were raised in favour of and against the introduction of a CGT. The commission ultimately concluded that having regard to especially the problems of tax administration in South Africa and the low potential yield of CGT, that it should not be introduced. Among various arguments which were raised in favour of the introduction of CGT was that it would limit tax arbitrage, i.e. that it would reduce the incentive for taxpayers to avoid tax by switching income into capital gains, it would bring about tax equity, result in a comprehensive income taxation and protect the income tax base.

Disregarding these recommendations by the Katz commission, the introduction of CGT was announced by the former Minister of Finance, Mr. Trevor Manuel in his budget speech on 23 February 2000. Although the new tax was originally planned to be implemented on the 1<sup>st</sup> of April 2001, the introduction was deferred for a further six months and only took effect on 1 October 2001 (Explanatory memorandum on the Taxation Laws Amendment Bill, 2001).

## **1.2 PROBLEM STATEMENT**

National treasury is currently considering the abolishment of estate duty in South Africa and the main purpose of this study is to analyse the best possible solution with regard to the future of estate duty.

Tax experts have long been calling for the repeal of estate duty. The reasons are among others:

- The perceived double taxation on death when capital gains tax is considered;
- Although estate duty falls under the classification of a “wealth tax”, the wealthy are more likely to avoid these taxes by setting up trusts and paying for elaborate estate planning advice than anyone else.
- There are inconsistencies and very little compatibility between wealth taxes in South Africa;

## **1.3 RESEARCH OBJECTIVES**

The main research objective is to establish whether the abolishment of estate duty is a realistic consideration in light of lessons learned from countries such as Canada and Australia.

If not, what possible alternatives are available to the policy makers with regard to international trends? Should South Africa move to a recipient based system such as the system used in Ireland, or adapt the current estate duty to such a degree that it is aligned with the system used in the UK?

In order to achieve the stated research objectives the following points need to be addressed:

- To determine why similar death taxes have continued to survive in specific countries;

- To determine the reasons behind similar death taxes being abolished in other countries;
- To determine what alternatives are available to South Africa in light of lessons learned from specific countries.

#### **1.4 IMPORTANCE AND BENEFITS OF THE STUDY**

Taking into consideration the 2010 and 2011 Budget speeches where former Finance Minister Pravin Gordhan announced the review of taxes upon death, and the very recent appointment of a separate committee within the Davis commission to review estate duty, the analysis done in this study with regard to wealth transfer taxes may be relevant.

Parties who might find the study relevant and could benefit from it are:

- National Treasury and the South African Revenue Service (SARS) could find the comparisons with international countries enlightening, and these could assist in identifying possible alternatives to estate duty or ways to amend but still retain estate duty;
- Individual taxpayers, tax professionals as well as lawyers and others involved in the process of estate planning.

#### **1.5 DELIMITATIONS**

The study will focus primarily on estate duty and similar wealth transfer taxes, or death taxes in Australia, the United Kingdom and Ireland. The study does not aim to give conclusive solutions to the problems identified with estate duty, but rather to provide suggestions which are substantiated by the lessons learned from the three international countries reviewed.

#### **1.6 DEFINITION OF KEY TERMS AND ABBREVIATIONS**

<b>Abbreviation</b>	<b>Meaning</b>
CGT	Capital Gains Tax
OECD	The Organisation for Economic Co-Operation and Development

SA	South Africa
STT	Security Transfer Tax
UK	United Kingdom
<b>Terms</b>	<b>Meaning</b>
Horizontal equity	A theory stating that people in the same income bracket should be taxed at the same rate
Progressive tax rate	High income earners are taxed at a higher percentage than low income earners
' <i>situs</i> '	The treatment of property in a certain location for legal purposes
Vertical Equity	A method of collecting taxes. If the income increases so does the taxes paid

## 1.7 RESEARCH DESIGN AND METHODOLOGY

A literature review is to be conducted on secondary literature in order to obtain a theoretical point of view for the study and to establish a basic understanding of estate duty in South Africa.

This includes a review and comparison between death duties in four international countries with estate duty in South Africa. The research reviewed both local and international literature with regard to this topic. The reason these countries were chosen was down to two reasons, namely analysing the history of these countries to establish the processes and difficulties these countries went through in abolishing their death duties, and secondly to establish what alternatives there are in the event of South Africa abolishing its estate duty.

## 1.8 LIMITATIONS OF THE STUDY

It must be noted that the study does not include an in depth analysis of donations tax, securities transfer tax or transfer duties.

## 1.9 SUMMARY

The first chapter starts with an introduction which puts certain concepts pertaining to estate duty and CGT into perspective. It also discusses the relevance and importance of

the study to National Treasury and SARS, taxpayers and estate planning professionals. The key abbreviations and terms used in the study are defined and documented, and the research design and methodologies are explained in order to provide an outline for the chapters that follow. Lastly the limitations of the study were noted.

Chapter two discusses the history and current situation in South Africa with regard to taxes which are relevant to the study. It also reviews the discrepancies and effectiveness of estate duty. Later chapters compare and discuss alternatives to estate duty, and pose suggestions in light of the tax practices followed in other countries with regard to death duties.

## **2 SOUTH AFRICAN TAXES WHICH ARE RELEVANT TO THE STUDY – A SHORT OVERVIEW**

Taxes which will be relevant in conducting the study are dealt with in this section. There are usually two main groups i.e. “tax groups” that Estate Duty belongs to (Muller, 2010). These groups are

- Wealth transfer taxes; and
- Taxes on property.

Wealth transfer taxes usually target the taxation of wealth transfers made by individuals and include amongst others:

- estate duty,
- donations tax and
- capital gains tax (CGT).

Taxes on property target the taxation of property transfers made and includes amongst others:

- estate duty,
- donations tax,
- security transfer tax (STT) and
- transfer duties.

### **2.1 THE HISTORICAL DEVELOPMENT OF WEALTH TRANSFER TAXATION IN SOUTH AFRICA**

The following paragraphs will focus on the historical development of wealth transfer taxation in South Africa and will include a brief overview of the development of income taxation in South Africa.

#### **2.1.1 INCOME TAXATION**

Muller [2010: 19-20] documented that income taxes (whether source-based or accretion-based) are usually structured on either a global or a scheduler basis. Muller explained that

global income tax income consists of all types of income, whether capital or revenue in nature or from whence it is derived (source). All deductions are also allowed irrespective of the type income in respect of which they were incurred. This will produce a taxable amount to which a tax rate is applied. In terms of a scheduler system, the system provides for various categories of income which are taxed at different rates in terms of different rules. Muller stated that it is also common for income systems to contain elements of both global and scheduler systems.

Muller [2010:19-20] in addition also stated that in South Africa 60 percent of national revenue is currently derived from a direct income tax, currently levied in terms of the Income Tax Act of 1962. Looking back at history the first income tax enacted in South Africa was in 1914 and was based on the Land and Income Tax Assessment Act of 1895 from New South Wales (Australia), the New South Wales Act was in turn based English income tax legislation. In other words, the South African concept of income was formulated on the English source-based concept of income.

Under the current act, “gross income” is derived from receipts and accruals of a revenue nature excluding receipts and accruals of a capital nature. Even though the current system used in South Africa may be classified as a global income tax, certain provisions have made it a hybrid system with regard to also implementing scheduler taxation (such as the provision for the separate taxation of capital gains within the income tax system).[Muller (2010: 19-20)]

### **2.1.2 WEALTH TRANSFER TAXATION**

The historical development of wealth transfer taxes was researched by Muller [2010; 86-94] who documented it as follows: Wealth transfer tax first made its appearance in South Africa in the Cape of Good Hope colony during 1864 by way of a recipient-based succession duty. In 1899 the old Zuid-Afrikaanse Republiek introduced a transfer-based duty, while the colonials Natal and the Free State introduced a similar succession duty to the Cape of Good Hope in 1905, by way of colonial legislation.

The first national wealth transfer tax to be nationally promulgated was the Death Duty Act 29 of 1922 and, with its promulgation all previous provisional legislation was repealed. This Act was repealed in 1955 when it was replaced by estate duty.

### **2.1.3 ESTATE DUTY**

The following background to estate duty was mainly derived from the SARS “Quick guide to estate duty”, which was based on legislation as at 1 March 2007. Any amendments which were effected before and since then have been noted as per Muller’s [2010] historical development review findings and the current legislation.

Estate Duty is a wealth transfer tax/duty which has been levied on deceased estates since 1 April 1955. At the time of replacement of the Death Duties Act with the Estate Duty Act on 1 April 1955, its general structure was based on the part of the Death Duties Act which levied estate duty on the deceased estate. Although many of the characteristics of succession duty were retained in the form of relief for the surviving spouse and children, as well as progressive tax rates, the provisions thereto were not retained. As a result thereof the Estate Duty Act levies a transferor-based estate tax on the deceased’s estate, and not on the inheritance acquired by the heir.

Estate duty is levied in terms of the Estate Duty Act, 1955, Act 45 of 1955. In terms of current legislation it is levied on the dutiable amount of the estate which exceeds R3500 000, at a rate of 20%.

Up until 1988 Estate Duty was levied at a progressive rate and subsequently amended to a flat rate of 15% in 1988. In 1996 the rate was increased to 25%, but to alleviate potential excessive taxation as a result of the introduction of CGT in 2001, the rate was reduced to 20% of the dutiable amount less the abatement of R3,5million (effective 1 March 2007). If in terms of the Estate Duty Act the deceased bequeathed the entire estate to the surviving spouse, the surviving spouse is entitled to utilise double the abatement available, to an individual, which amounts to R7 million on the date of the surviving spouse’s death less any part of the R 3.5 million abatement used up in the first dying spouse’s estate. Where

the deceased was married in community of property, only half of the estate is deemed to form part of the property of the first dying spouse (with some exceptions).

The dutiable amount includes all property and deemed property which pertains to the estate and includes:

- All immovable or movable, corporeal or incorporeal assets of the deceased;
- Any right in or to the property, for example usufruct or fiduciary interest;
- Any right to an annuity;
- If deceased was ordinarily resident in SA, his/her foreign property is included subject to certain deductions;
- Proceeds of life insurance policies on the life of the deceased, irrespective of whether such proceeds are paid out to the estate or to a beneficiary;
- The right to a claim under the accrual system in terms of the Matrimonial Property Act, 1984;
- Any property which the deceased was competent to dispose of immediately prior to death.

The deceased estate is entitled to certain general deductions which include:

- All property which accrues to the surviving spouse;
- Debts of the deceased as at date of death;
- Funeral, tombstone and death bed expenses;
- Administration costs of winding up the estate;
- Any accrual claim against the estate; and
- Bequests to public benefit organisations.

The executor is liable to pay the estate duty on behalf of the estate. Estate duty is payable at the earlier of 30 days from the date of assessment, or within one year of date of death.

#### **2.1.4 DONATIONS TAX**

Donations tax is levied in terms of the Income Tax Act 58 of 1962 (ITA)(sections 54 to 64).

Donations tax was introduced in 1955 by means of an amendment to the then existing income tax legislation. The purpose of its introduction was aimed at inhibiting the avoidance of income tax and estate duty, and was never intended to raise revenue. The tax was made payable on the cumulative value of donations made by a taxpayer after 23 March 1955. Having donations tax drafted into the income tax legislation was presumably a convenient way to apply many of the definitions and administrative provisions in the ITA to the new tax. It is a way of collecting a tax on wealth during the lifetime of the donor.

### **2.1.5 CAPITAL GAINS TAX**

Capital gains tax (CGT) was introduced in South Africa (South Africa) with effect from 1 October 2001. CGT was introduced as an integral part of the ITA, by inserting section 26A and an Eighth Schedule into the Act in accordance with The Taxation Laws Amendment Act 5 of 2001. The levying, collection, and administration of CGT was from that date accordingly conducted in terms of the provisions of the ITA.

At the time that CGT was introduced, the rates for both estate duty and donations tax were reduced to 20%. This was due to the fact that CGT was triggered at death which meant that a person would pay CGT as well as estate duty which would create potential problems with double taxation. CGT is also levied when a donation is made giving rise to CGT and donations tax.

CGT is triggered when a person disposes of an asset which meets the criteria for 'disposal' and 'asset' under these definitions in part I of the Eighth Schedule. In addition certain events such as death, trigger deemed disposals. A capital gain is calculated by subtracting the base cost of the asset from the proceeds received upon disposal of that asset. The base cost refers to the initial purchase price of the asset or the market value at 1 October 2001, calculated in terms of part V of the Eighth Schedule.

Certain assets are specifically excluded, or excluded to a certain extent from CGT. These include personal use assets, a person's primary residence up to an amount of R 2 million, assets which are bequeathed to the surviving spouse upon death of a person, assets bequeathed to Public Benefit Organisations, the proceeds from life-insurance policies and any interest in a pension-, provident- or retirement-annuity fund.

CGT will form part of any natural or juristic person's taxable income in a year of assessment when a capital gain is realised, and is included in the person's taxable income at a rate of 33.3% for natural persons (and special trusts) and at a rate of 66.6% for juristic persons including *inter vivos* and *mortis causa* trusts. As mentioned above CGT is included in a person's taxable income at the respective inclusion rates, therefore it is linked to the person's marginal tax rate; for example a natural person paying income tax at 40% multiplied by the 33.3% inclusion rate results in an effective rate of 13.3%. CGT levied on a juristic person is also linked to the income tax rate payable by that juristic person or trust, for example 28% and 40% respectively, multiplied by the inclusion rate of 66.6% results in an effective rate of 18.6% for juristic persons other than trusts and 26.6% for trusts which are not special trusts.

#### **2.1.6 LEGISLATION DEALING WITH CGT AT DEATH**

According to Paragraph 40(1) of the Eighth Schedule to the ITA a deceased person must be treated as having disposed of his or her assets, other than –

- (a) Assets transferred to the surviving spouse of that deceased person as contemplated in Paragraph 67(2)(a);
- (b) ...
- (c) A long-term insurance policy of the deceased which, if the proceeds of the policy had been received by or accrued to the deceased, the capital gain or capital loss determined in respect of that disposal would be disregarded in terms of paragraph 55; or
- (d) An interest in pension, provident or retirement annuity fund in the Republic which provides benefits similar to a pension, provident or retirement annuity fund which, if the proceeds thereof had been received by or accrued to the deceased, the capital gain or loss, determined in respect of the disposal of the interest would have been disregarded in terms of paragraph 54,

to his or her estate for an amount equal to the market value of those assets at the date of that person's death, and the deceased estate must be treated as having acquired those assets at a cost equal to that market value, which cost must be treated as an

amount of expenditure actually incurred and paid for the purposes of paragraph 20(1)(a).

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

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

### **3 TAXES UPON DEATH UNDER REVIEW**

#### **3.1 REASONS FOR SARS REVIEWING TAXES UPON DEATH**

The reasons for SARS reviewing taxes upon death were discussed in the Budget of 2010/2011 presented by former Minister of Finance Pravin Gordhan and may be summarised as follows:

- The efficiency of estate duty avoidance through the use of trusts versus estate duty;
- Minimal revenue generated by estate duty compared to the burdensome administration involved;
- The perceived double taxation when estate duty and CGT are levied upon death of an individual.

##### **3.1.1 THE EFFICIENCY OF ESTATE DUTY AVOIDANCE THROUGH THE USE OF TRUSTS OR OTHER LEGAL MECHANISMS VERSUS ESTATE DUTY**

Estate planning in essence is built on the principle of minimising taxes upon death by transferring assets to an entity such as a trust in order to ensure that the growth of the assets remain in the trust and not in the individual's estate, as well as transferring control over the assets to the trustees.

An *inter vivos* trust is the most common vehicle used for estate planning. A donor or founder establishes the trust while he is still alive and transfers all his/her assets to the trust. The control over the assets is then passed on to the trustees who own and manage them according to the provisions of the trust deed. This is done in order to avoid the section 3(3)(d) provision contained within the Estate Duty Act.

Section 3(3)(d) of the Estate Duty Act states that any property that the deceased was competent to dispose of for his own benefit or for the benefit of his estate immediately prior to his death needs to be included as deemed property in the estate.

Evidence of the potential dangers of this section can be found in various court cases. An interesting example was found in a court case which ended up in the Supreme Court of Appeal (“SCA”). A short summary of *Badenhorst v Badenhorst* [2006] JOL 16168 (SCA) was found on the Jardim Bekker Inc. website and Jaco Bekker was quoted as stating:

“While Mr. & Ms Badenhorst (the Respondent and Appellant respectively) were married (out of community of property) the Respondent acquired a farm from his father. The farm was registered in the name of a trust of which the Respondent was the sole controller. The parties discussed it at the time and the Respondent advised the Appellant that the purpose was to protect them against creditors and to avoid Estate Duty. Later the Respondent also registered the names of other businesses and properties which he acquired in the name of the trust.

When the parties divorced, the question before the court was whether the *inter vivos* trust should be taken into account for the purpose of a redistribution order in terms of section 7(3) of the Divorce Act 70 of 1979 (‘the Act’).

The Supreme Court of Appeal held that:

- The trust assets vest in the trustees. The mere fact that the assets vested in the trustees and did not form part of the respondent husband's estate did not per se exclude them from consideration when determining what must be taken into account for redistribution. But to succeed in a claim that trust assets be included in the estate of one of the parties there needs to be evidence that such party controlled the trust and but for the trust would have acquired and owned the assets in his own name. The control must be *de facto* (in reality or fact) and not necessarily *de iure* (according to law).
- To determine whether a party has such control it is necessary to first have regard to the terms of the trust deed, and secondly to consider the evidence of how the affairs of the trust were conducted during the marriage. In the present case the Respondent had full control of the assets of the trust and used the trust as a vehicle for his business activities. The extent of his control is evident from the provisions of the trust deed. From the evidence of the Appellant it is clear that in his conduct of the affairs of the trust the Respondent seldom consulted or sought the approval of

his co-trustee and he paid scant regard to the difference between trust assets and his own assets. It is evident that, but for the trust, ownership in all the assets would have vested in the respondent.

- Therefore the *inter vivos* trust should be taken into account for the purpose of a redistribution order in terms of section 7(3) of the Act.”

Based on the evidence placed before the court, Mr Badenhorst did not cede control of his assets to the trustees and the court held that ownership in all the assets would have vested in Mr Badenhorst. This means that the assets and their control falls directly into the ambit of section 3(3)(d) of the Estate Duty Act. It would have been interesting to see whether SARS would have included the trust assets in order to determine the value of Mr. Badenhorst’s estate for estate duty purposes, should he have passed away and not got divorced.

Section 3(3)(d) deals with control of assets and creating a trust means that the ownership and control of one’s assets are handed over to trustees. This can be difficult for people who are used to managing their own affairs and mistrustful of their trustees’ ability to manage the assets. A founder treating the trustees as puppets, getting them to do his or her bidding without using their own discretion and running the affairs of the trust as if the assets were still his or her own, can run into legal trouble when SARS or creditors come after the assets.

According to a recent article by Tina Weavind published on 18 February 2013 called “Trusts are a pricey way to dodge taxes”, Ernest Mazansky was quoted as stating: “if a court finds that a trust planner or founder has not ceded control of the trust’s assets to the trustees, the existence of the trust can effectively be set aside and the assets treated as though they still belong to the planner in his or her own personal capacity. This could mean that the assets become liable for estate duty or that the creditors are able to access them.”

It is well known that estate planning can be very costly and that wealthy individuals spend fortunes on experts in order to protect their assets against wealth or transfer taxes. Referring to the same article by Tina Weavind, Henry van Deventer who is a financial

planner at financial services group Acsis, is quoted as saying “trusts incur fees of about 1% of the value of the assets each year on average. Although they might protect against estate duty and creditors, they are subject to a host of other taxes and costs”.

A tax that a trust does not protect against is capital gains tax. When a person dies, their personally held assets are legally deemed to have been sold at market value and capital gains tax is triggered at an effective rate of 13,3% of the gain, after any exclusions have been applied. As with an individual or a company, trusts must also pay income tax. The rate for a trust is set at 40%.

If the trust makes any gain from the sale of an asset, for example, capital gains tax will be triggered. Trusts have an inclusion rate of 66.6% and a tax rate of 40%, which means capital gains tax for a trust will effectively be 26.64%.

There are however ways to get around the high effective rate of capital gains tax by ceding the gain to a beneficiary of the trust and effectively reducing the gain to 13.3%. this is in terms of the attribution rules set out in the Eighth Schedule to the Act.

The other question however is how to transfer the assets into the trust without incurring an excessive amount of tax consequences. The founder will have to decide whether to transfer the assets via a sale, a loan or via donation.

If the asset is sold the founder will have to pay 13.3% capital gains tax, which might be problematic because there is no new cash in the trust’s bank account to use as there would be if the asset was sold to a third party. Founders might be able to get around this by selling an asset to the trust on loan account, as discussed below.

If the assets are donated, donations tax of 20% on the value of the assets will be payable (a donation of cash will automatically attract a 20% tax rate). This would be after the annual exemption of R 100 000 has been applied to the donation value. To make matters worse, if the assets donated are worth more than their original cost to the founder, capital gains tax will be triggered on the excess amount.

To avoid donations tax, founders often tend to sell their assets at purchase price to the trust. However Ernest Mazansky also stated in the same article, as referred to above, that this way of transferal will only protect the growth in the value of the assets. The reason for this is that when the founder dies, estate duty still applies to the outstanding balance on the loan account to the founder. The first R 3.5 million will still be tax free according to the exclusion set out in the Estate Duty Act. In this situation it only makes sense to set up the trust when the founder is relatively young, in order to get the maximum benefit from having the growth of his assets in the trust and allowing time for the trust to pay off the loan owing to the founder.

There are however other reasons for creating a trust, other than protecting one's assets from tax erosion. The first of which is to protect the assets from creditors in case the beneficiary, possibly the founder, becomes insolvent. Another might be to allow for the efficient management of a person's affairs after they die. According to Mazansky any assets which are held personally, are frozen in value when the owner dies and remain that way until the executors get a chance to wind up the estate. A trust on the other hand carries on its business unaffected by the founder's death. It is also a very beneficial vehicle when it comes to taking care of a surviving spouse, under-age or special-needs children, or beneficiaries who squander or otherwise dispose of assets in a way which the founder would not approve of.

This section introduces the next common question, why are death taxes so unpopular, avoided to such a degree, and deemed without worth?

### **3.1.2 THE RAISING OF LIMITED REVENUE COMPARED TO THE ADMINISTRATIVE BURDEN**

SARS and National Treasury annually release tax statistics to the public. The subsequent analysis of these statistics proved to be very beneficial in understanding the challenge faced by National Treasury with regard to the title of this section. These aggregated statistics are compiled annually from SARS's register of taxpayers and tax returns.

Estate duty, transfer duty, securities transfer duty and donations tax are all grouped together in the table below under “taxes on property”.

As illustrated below in Figure 1, a figure from the Tax Statistics 2014: Table A1.3.1: Tax revenue by main category, 2009/10 – 2013/14: Taxes on property merely contributes 1.2% (2012/13: 1.1%) of the total tax revenue received by Treasury. This amounts to R 10 487 million (2012/13: R 8 645 million) in 2013/14, a 21.3% increase on the previous year. Although this is a significant increase, revenue generated from taxes on property only increased by 0.1% when taking into account the total tax revenue received. This figure is brought into perspective when comparing it to tax on income and profits contributing 56.4%: R 507 759 million for 2013/14 (2012/13: 56.2%: R457 314 million).

**Figure 1: Table A1.3.1: Tax revenue by main category, 2009/10 – 2013/14**

R million	Taxes on income and profits	Taxes on payroll and workforce	Taxes on property <sup>1</sup>	Domestic taxes on goods and services	Taxes on international trade and transactions	Stamp duties and fees & state miscellaneous revenue <sup>2</sup>	Total tax revenue
2009/10	359 045	7 805	8 826	203 667	19 319	44	<b>598 705</b>
2010/11	379 941	8 652	9 102	249 490	26 977	20	<b>674 183</b>
2011/12	426 584	10 173	7 817	263 950	34 121	5	<b>742 650</b>
2012/13	457 314	11 378	8 645	296 921	39 549	18	<b>813 826</b>
2013/14	507 759	12 476	10 487	324 548	44 732	13	<b>900 015</b>
<b>Percentage of total</b>							
2009/10	60.0%	1.3%	1.5%	34.0%	3.2%	0.0%	<b>100.0%</b>
2010/11	56.4%	1.3%	1.4%	37.0%	4.0%	0.0%	<b>100.0%</b>
2011/12	57.4%	1.4%	1.1%	35.5%	4.6%	0.0%	<b>100.0%</b>
2012/13	56.2%	1.4%	1.1%	36.5%	4.9%	0.0%	<b>100.0%</b>
2013/14	56.4%	1.4%	1.2%	36.1%	5.0%	0.0%	<b>100.0%</b>
<b>Percentage change year-on-year</b>							
2009/10	6.4%	6.5%	6.9%	1.1%	15.5%	92.0%	<b>4.2%</b>
2010/11	5.8%	10.9%	3.1%	22.5%	39.6%	54.8%	<b>12.6%</b>
2011/12	12.3%	17.6%	14.1%	5.8%	26.5%	77.2%	<b>10.2%</b>
2011/12	7.2%	11.8%	10.6%	12.5%	15.9%	292.5%	<b>9.6%</b>
2013/14	11.0%	9.6%	21.3%	9.3%	13.1%	29.0%	<b>10.6%</b>

1. Includes Transfer duties, Securities Transfer Tax (STT), Donations tax and Estate duty.

2. Stamp duty was abolished with effect from 1 April 2009. State miscellaneous revenue received by SARS which could not be allocated to specific revenue types.

It is also clearly illustrated in Figure 2, that estate duty does not contribute significantly to the category, as it only contributed 10.5% (2012/13: 11.7%), amounting to R 1 102 million (2012/13: R 1 013 million) in the 2013/14 fiscal year. The smallest contributor was donations tax 1.1% amounting to R 113 million, with the biggest contributors being STT R 3 784 million (36.1%) and transfer duties R 5 489 million (52.3%).

Over the past six years the highest estate duty contribution was collected in 2011/12 with 13.4% of the category “tax on property”).

**Figure 2: Table A1.5.1: Taxes on property, 2009/10 – 2013/14**

R million	Donations tax	Estate duty	Securities Transfer Tax (STT)	Transfer duties	Total
2009/10	60	759	3 324	4 683	<b>8 826</b>
2010/11	65	782	2 933	5 322	<b>9 102</b>
2011/12	53	1 045	2 886	3 834	<b>7 817</b>
2012/13	82	1 013	3 272	4 278	<b>8 645</b>
2013/14	113	1 102	3 784	5 489	<b>10 487</b>
<b>Percentage of total</b>					
2009/10	0.7%	8.6%	37.7%	53.1%	<b>100.0%</b>
2010/11	0.7%	8.6%	32.2%	58.5%	<b>100.0%</b>
2011/12	0.7%	13.4%	36.9%	49.0%	<b>100.0%</b>
2012/13	0.9%	11.7%	37.8%	49.5%	<b>100.0%</b>
2013/14	1.1%	10.5%	36.1%	52.3%	<b>100.0%</b>
<b>Percentage year-on-year growth</b>					
2010/11	7.5%	3.0%	11.8%	13.7%	<b>3.1%</b>
2011/12	18.5%	33.6%	1.6%	28.0%	<b>14.1%</b>
2012/13	55.9%	3.1%	13.4%	11.6%	<b>10.6%</b>
2013/14	37.3%	8.7%	15.7%	28.3%	<b>21.3%</b>

The table below reflects the total contribution of estate duty compared to the total administered revenue received by SARS, as obtained from its annual report for the year ending 31 March 2014.

<b>Figure 3: Total Estate Duty as a percentage of Total Revenue</b>			
Year	Total Estate duty	Total revenue	Percentage
2012/13	R 1 012,978 million	R 813,825,814 Million	0.1245%
2013/14	R 1 101,505 million	R 900,014,720 million	0.1224%

It is clear from the above that Estate duty contributes very little to the total *fiscus* per year in South Africa. Although an official figure could not be obtained, SARS spent 0.97% of total tax revenue collected in order to administer and collect the various taxes in 2013/14. SARS indicated in 2010 that the reason for a review of death taxes was due in part as a result of the administrative burden in collecting these taxes. One must also bear in mind that part of the administration or processing of an estate's liquidation and distribution account is not fully administered by SARS. The liquidation and distribution account is sent by the executor of the estate to the Master of the High Court and in order for SARS to assess and review the estate it has to communicate with the Master of the High Court in order to have access to this information.

Although it has been clearly observed that estate duty raises limited revenue as set out in the tables above, an article by E Law (1994) "Purposes of Wealth Taxes" posed an interesting remark. The author reviewed the Western Australian State taxes, and remarked that among the OECD countries which administered wealth taxes, there was very little consensus as to the purpose of these taxes. The most common reasons countries administer wealth taxes are among others raising revenue and taxing according to the ability to pay. Others stated that the reason was horizontal equity, which deals with the concept of fairness in relation to economics and taxation (meaning that individuals in the same income earning bracket are taxed the same).

The article further discussed the historical reasons for adopting wealth taxes in Great Britain and the United States (US) as follows. Estate duty was first adopted by Great Britain in 1894 as a means for raising revenue. This was also the case in the United States between 1797 and 1902, where there were three separate occasions where death taxes were introduced to supplement government finance for the impending or actual war. Immediately after averting each crisis caused by the various wars, the tax was repealed and in the present, it would be difficult to argue that this is the primary reason for death taxes to exist in any jurisdiction.

The article concluded that in Australia, where estate duty has been abolished, wealth taxes in the form of taxes upon death have proven to be politically untenable and extremely unpopular. Whether the government's justification is raising revenue or

achieving a more equitable society, the overriding unpopularity of these taxes will prevent them from being reinstated in the foreseeable future.

The last and likely the most debated reason for SARS deciding to review estate duty has been the possible double taxation effect with regard to estate duty and capital gains tax on death. This question seems to be of greater relevance to the reason for possible abolition than merely accepting that death taxes are imposed to generate revenue, or provide for economic equality; while being regarded as unpopular and politically incorrect.

Taking the above into consideration, a few important questions have come to light with regard to these statements. They are:

- What are the definitive factors that still drive countries to enforce death taxes or similar alternatives on the transfer of wealth?
- How important are political and economic views in determining whether death taxes continue to be enforced?
- Although “taxes on property”, and especially estate duty, have proven to be minimal contributors to annual fiscal revenue, how have other countries bridged the loss of revenue after these taxes were abolished?
- To what extent does/did the double taxation argument with regard to estate duty and capital gains tax influence revenue authorities to abolish death taxes? And was it not simpler to rather exempt one or the other where both were applicable?

Chapter 4 discusses Canadian wealth taxes.

## **4 THE ABOLITION OF WEALTH TRANSFER TAXES IN CANADA**

### **4.1 BACKGROUND TO WEALTH TRANSFER TAXES IN CANADA**

The specific events leading up to the abolition of wealth transfer taxes in Canada began somewhat innocuously in 1962 with the appointment of the Royal Commission On Taxation (The Carter Commission), unfolded on a federal level between 1967 and 1971 in response to the Report of the Carter Commission and continued to unfold at a provincial level for a further fourteen years. This chapter briefly describes the historical events as they unfolded according to David G Duff (2005).

#### **4.1.1 The Carter Commission 1962 – 1967**

In the opening speech of his 1962 election campaign, Progressive-Conservative Prime Minister John Diefenbaker stated that an independent commission had long been favoured by tax professionals and business leaders as a vehicle to reduce progressive rates, simplify administration and enforcement, and address technical anomalies in the income tax. After the election in 1962, the Progressive-Conservative Party formed a minority government and Diefenbaker announced the appointment of a Royal Commission comprised of mainly professionals and businesspersons, with the chair being Toronto accountant Kenneth Carter. The Carter Commission's mandate was extremely broad and involved a review of all aspects of federal taxation including "income, sales and excise taxes and estate duties". [Duff (2005:26)].

This type of Commission was very similar to South Africa's Margo- and Katz Commissions of 1980 and 1990 respectively. More recently (2013), the previous Finance Minister of South Africa, Mr Pravin Gordhan announced the establishment of a new commission called the "Davis Tax Commission". The Commission's chair was to be Judge Dennis Davis of Tax Court. Its mandate and objectives are broadly similar to that of the Carter Commission of 1962. A brief description of the Davis Tax Commission is contained in chapter 8.

Given the Carter Commission's origins and its membership, it was not surprising to note that the Commission would affirm the prevailing problems of the same business and

professional commentators who pushed for its establishment. Formal submissions included among others, that taxes were too high, indirect or value-added taxes should be considered as alternatives to high income taxes, and that the wealth transfer taxes were causing Canadian family businesses to be sold to foreigners. [Duff (2005:26-27)].

According to the Shoe Manufacturers' Association of Canada, for example, "[t]he unreasonably high level of succession duties has been the largest single factor both in encouraging the sell-out of Canadian enterprises to foreign interests and in eliminating from the economic scene continuing independent family businesses." The Canadian Bar Association decried the "excessive amount of property" that was tied up for long periods of time in trusts to avoid wealth transfer taxes, concluding that these arrangements "frequently restrict the company's proper development and expansion and may add to production costs." As well as accepting submissions from various commentators, the Commission embarked on its own research programme which lasted four years and cost approximately \$ 4 million. Among 27 research studies conducted, one found no evidence that the estate tax was a major factor in the sale of small businesses. [Duff (2005:27)].

After much delay, and two intervening elections resulting in Liberal minority governments, the Commission's six-volume report was finally released in February 1967. Among the many recommendations made by the Commission, the main recommendation came forth in its conclusion which stated that "taxes should be allocated according to the changes in the economic power of individuals and families." Emphasizing that "[t]he first and most essential purpose of taxation is to share the burden of the state fairly among all individuals and families", the majority of the Commission rejected any distinction between different sources of changes to a taxpayer's economic power, and proposed a "comprehensive tax base". According to the proposal "all the net gains of each tax unit should be subject to tax on an annual basis." [Duff (2005:28-29)]

The implications of this approach resulted in gifts and inheritances to be included in the comprehensive tax base for the year in which they were received. The Commission recommended therefore that separate wealth transfer taxes be repealed, since gifts and inheritances were now to be included in the recipient's income. The approach also meant that capital gains tax would be fully recognised on an accrual basis irrespective of any

sale. To alleviate administration difficulties the Commission later distanced themselves from the accrual treatment for capital gains and losses and rather recommended that these gains and losses be recognised on a realisation basis, as well as instances where property was to be transferred as a gift or upon death. This is a similar method to what South Africa is currently using. [Duff (2005:29)]

Other important recommendations included the introduction of a family tax unit (including dependent children), a reduction in the top marginal rate from 80 percent to 50 percent, and a dramatic reduction in tax concessions for income from mineral and petroleum extraction.

#### **4.1.2 Federal Reform: 1967-1971**

While the Commission's Report was classified by leading tax academics as "a landmark in the annals of taxation" (Harberger (1968)), affluent individuals including professional and business interests who pushed for the Commission's formation expressed their immense disapproval of the paper. These commentators felt that although a reduction in the top marginal rate and repeal of the wealth transfer taxes would provide some benefit for affluent individuals, it would be more than offset by the full taxation of capital gains and the inclusion of gifts and inheritances in income. [Duff (2005:30)]

The Report initially estimated that about 64% of taxpayers would reap the benefits of lower taxes under its proposals. It so happened that only about 5% benefitted from the proposals contained in the report, and were generally limited to taxpayers with incomes of less than \$35,000 in 1964. In contrast 27000 taxpayers with incomes higher than \$35,000 would have expected to pay an additional \$1,000 on average, while an estimated 633 individuals with incomes in excess of \$300,000 would have expected to pay an average of \$67,000 in additional taxes. [Duff (2005:30)]

Although the then Finance Minister Mitchell Sharp publicly responded to various complaints and commentators strongly disapproving of the Report in April of 1967, and setting out a timetable to deal with the report, as well as inviting comments on the major recommendations by September of 1967, the Government's first official response to the

report came on November 30 1967 when the Minister of Finance tabled the federal budget. [Duff (2005:29-31)]

Sharp confirmed that there were common concerns contained in the submissions that he had received regarding the uncertain impact of such far-reaching reforms contained in the Report and the need to attract foreign capital. Sharp announced that whichever proposals the Government would “place before parliament and the public in the form of a White Paper and ultimately in the draft legislation” would “undoubtedly be influenced” by the Report of the Commission, but “will be more in the nature of reforms to the existing tax structure rather than the adoption of a radically different approach” in other words the Government was aiming to adopt a more politically correct or conservative approach to tax reform, rather than the comprehensive framework suggested by the Commission’s Report. [Duff (2005:31-32)]

The Government was however thrown into disarray as a result of the then Prime Minister Lester Pearson announcing his intention to resign. A leadership race and federal election intervened before any more specific proposals could be formulated. Under a new Liberal Government headed by Prime Minister Pierre Trudeau, the promised White paper was predictably delayed. In April of 1968 however the new Finance Minister Edgar Benson announced a change in the government’s tax reform schedule, he explained that major tax reforms would not be presented until sometime in 1969. [Duff (2005:32)]

In the interim, government signalled its disapproval of the Commission’s comprehensive tax base by introducing major revisions to the federal gift and estate taxes in October 1968 federal budget. These changes included: exempting inter-spousal transfers, integrating these taxes in the form of a cumulative progressive tax, and increasing rates on estates valued at less than \$5 million. The Finance Minister also defended the continued existence of a separate gift and estate tax by explaining that he respected “the intellectual coherence and elegance” of the Commission’s recommendation, but that “the overwhelming weight of Canadian opinion is against it now, and many Canadian practices and institutions would be seriously disrupted if we embraced this proposal”. [Duff (2005:32:33)]

As a result of the increased impact on small to medium sized estates, it was no surprise that the amendments to the gift and estate tax generated considerable political opposition, in particular from owners of small businesses and farms who had played a relatively small role in opposing the Royal Commission's Report. In western Canada where farming interests were particularly strong, the provincial governments of Alberta and Saskatchewan succumbed to this sector by refunding the provincial share of the federal estate tax to estates from which it had been collected. Consequently estate taxes were effectively reduced by 75 percent in these provinces. [Duff (2005:33)]

As a result of these adopted methods by Alberta and Saskatchewan the long awaited White Paper was finally released on November 7, 1969. Although strongly rejecting the Commission's comprehensive tax base suggestion, as well as various other proposals such as family taxation and the elimination of all resource tax incentives, the White Paper agreed with the Commission's Report that capital gains should be fully taxable at ordinary rates, as a general rule. [Duff (2005:33)]

In order to alleviate the potential application of capital gains tax and estate duty on death, the White Paper instead suggested that capital gains should be recognised when property is transferred at death. It further recommended that "the person who inherits the assets be treated as if he had purchased them at their cost to the deceased" plus "part of the death taxes paid on the assets in question – the part that relates to the capital gain." This method is broadly similar to countries such as Ireland and the United Kingdom which are discussed in chapter six and seven respectively. [Duff (2005:34)]

With regard to gifts however, the White Paper recommended that capital gains be taxable in the year the gift was given, and that the person receiving the property be treated "as if he had purchased the asset for its fair market value." Lastly the White Paper recommended that shareholders in widely-held Canadian corporations be required to recognise accrued gains and losses every five years – though only half of these gains and losses would be recognised for tax purposes. There are broadly similar provisions in the Income Tax Act of South Africa i.e. section 9C which deals with circumstances in which certain amounts accrued from disposal of shares are deemed to be of a capital nature. [Duff (2005:34)]

The White Paper contained a statement by the Minister of Finance who welcomed “public discussion of the proposals ... before parliament is asked to approve a bill to implement tax reform. At the height of the campaign for public proposals and comments, the Government was reported to be receiving protest letters at a rate of 7,000 each day. [Duff (2005:36-37)]

After a long and tedious process of taking all proposals into account and formulating a response, Government substantially revised its proposals in light of the parliamentary committee’s reports. It released its final tax reform package in the form of draft legislation accompanying the federal budget on June 8 1971. The draft legislation adopted a one-half inclusion rate for all capital gains and losses accruing after a designated valuation day, dropped the White Paper proposal to tax accrued gains on widely traded shares every five years, and accepted the Carter Commission’s original proposal to tax accrued gains when property is transferred on death as well as by gift. [Duff (2005:37)]

Following the recommendations and proposals of its various committees, Government decided to abandon the estate and gift tax field and decided to hand over the enforcement of these taxes to the provinces. The reasons for government’s decision were expressed in four short paragraphs in its *Summary of 1971 Tax Reform Legislation*:

- Firstly it explained that the combination of capital gains tax and estate tax at death “could in some instances result in substantial tax impact arising on the death of the taxpayer.”
- Secondly, “a reduction in federal estate taxes to the extent suggested by the Committees would result in a revenue loss of about \$55 million now received by the federal government from this source”, after payment of the provincial share to provincial governments.
- Thirdly it expressed that “two provinces now return their entire share of estate taxes to estates and it is no longer possible to establish a uniform national system of death duties through federal legislation.
- Lastly, it concluded, “in these circumstances, it has been decided that the federal government will vacate the estate and gift tax field on December 31, 1971.”

It would seem therefore that the introduction of capital gains tax at death, a low revenue yield for the federal government and the ineffective joint occupancy of estate duty by both the federal and provincial governments eventually led to the demise of federal wealth transfer taxes in 1972. Unstated of course was the organised opposition to capital gains and wealth transfer taxes, reflected in public campaigns and submissions to the parliamentary committees. [Duff (2005:38-39)]

In some ways it is a very similar situation to the one faced currently by South Africa. As mentioned by former Minister of Finance Mr Pravin Gordhan in his 2010/2011 budget speech, the reasons for SARS and National Treasury reviewing the field of estate duty comes down to limited revenue generated by the tax, the ever increasing administration costs associated with it as well as the perceived double taxation implications when both estate duty and CGT are applied at death.

## **4.2 RECENT DEVELOPMENTS AND CURRENT SITUATION IN CANADA**

In a recent article published in the Huffington Post, Brian Sweigman who is an associate Lawyer at Goldstein, Rosen & Rassos LLP, explained what taxes might be applicable to a Canadian resident in the event of death. [Sweigman(2012:1)]

### **4.2.1 Estate Administration Tax**

The first tax which will be applicable at death would be that of Estate Administration Tax. This tax entails that the person appointed to carry out the terms of the will must first submit an application for a Certificate of Appointment of Estate Trustee, issued by the Ontario Superior Court of Justice, before distributing the deceased's estate. Before issuing that certificate, the court will levy an Estate Administration Tax ("EAT"), set in section 2(6) of the Estate Administration Tax Act, 1998. [Sweigman(2012:2)]

Contrary to popular belief, the EAT, or Probate Tax, is not particularly high. It is only 0.5 per cent of the Estate's first \$50,000, amounting to \$250 total, and 1.5 per cent thereafter, totalling \$15 to each additional \$1,000 of value in the Estate. While this tax is not as intimidating as it appears, it must still be accounted for, as EAT is \$7,000 on an estate

worth \$500,000, \$14,500 on an estate worth \$1,000,000 or \$74,500 on an estate worth \$5,000,000. Including all the property and assets in an individual's possession, many individuals do not realize how high their estate is valued, which can leave a large EAT bill for their estate. [Sweigman(2012:2)]

#### **4.2.2 Income Tax**

Similar to the legislation in South Africa, a new taxpayer is created upon death. The estate of the deceased is created and becomes liable to pay any income tax owed by the deceased individual. The deceased estate will be taxed according to the tables in the Federal Income Tax Act, and is similar to the treatment of a deceased estate in South Africa. [Sweigman(2012:2)]

According to section 70 of the Federal Income Tax Act ("ITA"), income tax is immediately payable upon death and any monetary interest of a taxpayer, employment and business income as well as investment income, where tax was not paid before death, is deemed to have accrued in daily amounts up to and including the day of death. [Sweigman(2012:2)]

The taxpayer is deemed to have disposed of all capital assets immediately prior to death at its fair market value. The assets are treated as if the deceased had sold their real estate, jewellery, assets and all other capital property immediately before death and received its fair market value in return. This in turn means that capital gains tax will be triggered. The deceased estate will be liable to pay capital gains tax on the amount of growth the assets showed over the period of ownership. This is similar to South Africa's capital gains tax provisions pertaining to deemed disposals at death. [Sweigman(2012:2)]

In addition to the above taxes, the law treats it as though the deceased has withdrawn all funds from their registered retirement plans such as "Registered Retirement Savings Plans" (RRSPs), "Registered Retirement Income Funds" (RRIFs), etc. immediately before death. Since the money in such funds are tax-deferred, taxes on such retirement funds are due upon death. [Sweigman(2012:2-3)]

The treatment of a Canadian taxpayer's deceased estate for purposes of CGT is very similar to the South African CGT provisions applicable at death. There is however a significant distinction, Canada abolished their inheritance tax after the introduction of CGT, South Africa only reduced estate duty payable from 25% to 20% and currently provides for an estate duty abatement of R 3.5 million. In other words, if the deceased's estate is R 3.5 million or less, no estate duty will be payable.[Muller(2010)]

Everything over and above the R 3.5 million will be subject to estate duty at 20%. The Estate Duty Act 45 of 1955 was only recently amended to the effect that in the event of the deceased bequeathing all his assets to the surviving spouse, i.e. utilising the section 4(q) deduction provided for by the Estate Duty Act 45 of 1955, the R 3.5 million abatement will be transferred to the surviving spouse, thereby increasing the threshold at her death to R 7 million.

Chapter four has illustrated what happened in Canada before and after the abolishment of death taxes or estate duty. It is interesting to notice that the treatment of a deceased's estate in Canada is very similar to that of a deceased estate in South Africa, with the exception being that no estate duty is levied on death. By abolishing estate duty, Canada has alleviated all the debates and questions of equality, double taxation and limited revenue generation of estate duty at death. Australia found themselves in a similar situation as Canada and also abolished their death duties in the late seventies, after a long political and public campaign which eventually led to capital gains tax being introduced in 1985. Chapter five discusses the history of pre- and post- abolishment of estate duty in Australia.

## **5 THE ABOLITION OF WEALTH TRANSFER TAXES IN AUSTRALIA**

### **5.1 BACKGROUND TO WEALTH TRANSFER TAXES IN AUSTRALIA**

David G Duff (2005), reviewed the lessons learned from the abolition of wealth transfer taxes in Australia, Canada and New Zealand. Duff stated that the events which led up to the repeal of federal and provincial wealth transfer taxes in Canada were very different from those in Australia. Unlike in Canada where the process of abolition began by appointing a royal commission, the abolition of wealth transfer taxes in Australia originated in a popular protest movement initiated by a skilled carpenter and building contractor from Western Australia named Sydney Negus.

Negus first learned about estate duty when he discovered that it could have a substantial impact on relatively modest amounts left to his wife. After launching a successful petition campaign calling for its abolition he ran for public office and was elected into the Federal Senate. Not more than a decade later wealth transfer taxes completely disappeared from Australian tax legislation.

Duff (2005: 47-54) highlighted three important factors which contributed to the demise of estate duty in the 1970's, particularly among farmers and small business owners. The first of these were that exemptions were not updated to take inflation into account, which meant that relatively modest estates were subjected to Commonwealth and State taxes. To put this into perspective, at the time Commonwealth estate duty at the federal level contained exemptions of only AU\$10,000 for estates passing to a spouse, child or grandchild and AU\$5,000 for all other estates. Consequently the Taxation Review Committee (Asprey Committee) reported that over 55 percent of taxable estates in 1972-73 were valued at less than AU\$40,000 and almost 83 percent were valued at less than AU\$80,000.

At State level exemptions were generally lower, resulting in a larger number of taxable estates. Influential leaders in the farming community were of the opinion that farms had to be sold to pay the estate duties, although evidence was scarce and mostly anecdotal. Not surprisingly therefore it was political leaders with rural political support who pushed the abolition agenda.

Duff also stated that in addition to the inability of government to adjust estate duties for inflation, the second factor which contributed to the unpopularity of these taxes was the failure to integrate state and commonwealth duties. Although the existence of this “duplicative” system of wealth transfer taxes were increasing compliance costs for all taxable estates, the burden was slightly more for small or medium sized estates. Despite several attempts and recommendations by the Asprey Committee to reallocate these revenue sources solely to either the State or Commonwealth government, they stayed in force until the eventual repeal of these taxes halted proceedings.

The third and final factor which contributed to the demise of wealth taxes were the relative ease with which these taxes could be avoided. In a way which is still used today, discretionary trusts could transfer wealth from generation to generation without any tax consequences. At the federal level for instance, gift taxes were not integrated with estate duty and gifts themselves were only aggregated over 18 month periods. These and other deficiencies contributed to the ease with which these taxes could be avoided by the most affluent and sophisticated taxpayers, shifting the primary burden again on the small and medium sized estates. As a result of this, as Duff explains “the extent of tax avoidance created public cynicism about the taxes”.

As the unpopularity of these taxes increased in the public domain these taxes were generating declining amounts of revenue as time passed. In 1973, the Commonwealth government collected AU\$75 million from its gift and estate duties, which represented 0.7 percent of total revenue collected for 1973, a lower percentage than any other time in history. Compared to the Commonwealth government, States collected approximately AU\$185 million from their wealth transfer taxes in the same year. Although it was twice the figure generated by Commonwealth, it only amounted to 9 percent of total revenue generated by the states. This in turn was also the lowest for the States than at any time after the Second World War.

In hindsight one has a clear view of what was to follow, as a result of the inability of the Commonwealth and the States to adjust the wealth taxes for inflation, an increasing number of small estates became taxable, which meant that the administrative burden was

increasing exponentially compared to the relatively small amounts of revenue which were collected from the increasing number of small estates. In 1972-73 for example, 55.7 percent of estates subjected to estate duty, contributed only 3.9 percent of total revenue collected.

Joint occupancy by the Commonwealth and State governments contributed substantially to the ever increasing administration costs as both levels of government were required to maintain the organisational apparatus to enforce and collect these taxes.

The first legislative victory for the abolition movement came in Queensland which was as the Brisbane Courier Mail put it, a “hotbed of agrarian resentment against death duties”. The paper had run a series of articles which highlighted the hardships caused by death duties and the ever growing campaign for abolition. The conservative Liberal-Country Party coalition government embraced complete abolition in 1976, after exempting inter-spousal transfers from estate and gift duties a year earlier, and repealed the taxes all together effective January 1977. [Duff (2005:51)]

Although the coalition’s Liberal Party Treasurer Sir Gordon Chalk expressed some concern over the budgetary consequences of the abolition, which would reduce State coffers by between \$25- to \$30 million per annum, Country Party Premier Joh Bjelke-Peterson apparently argued that the loss in revenue would be offset by the stream of internal migrants who wanted the warm climate adjacent to the tax-free bequests within Queensland. [Duff (2005:51)]

No sooner than Premier Joh Bjelke-Peterson’s words had gone cold, and even before the repeal had come into effect, the Gold Coast Visitor’s Bureau had prepared a pamphlet entitled “Legal information on the Abolition of Death Duties in Queensland”. It contained examples of the duty payable in other states on an estate of AU\$ 100 000, and gave detailed ways in which to avoid these duties via investment and domicile in Queensland. Not surprisingly other States were subjected to increasing pressure by the public to either amend or abolish their own gift and death duties. [Duff (2005:52)]

This consequently happened in in 1976 where all inter-spousal transfers became exempt in New South Wales and South Australia, while Victoria enacted legislation exempting estates which passed to spouses, children and grandchildren from any duties in the period between 1976 and 1981. This created an acceleration of these types of amendments in other states. Over the next three years Tasmania first introduced exemptions for inter-spousal transfers and later all transfers. Western and South Australia both abolished estate duties in 1980 with New South Wales doing so in 1981. As a result Duff stated that by the 1980's, the momentum against death duties in Queensland carried all other death duties to the grave. [Duff (2005:52)]

At Commonwealth level interstate rivalry was not an issue however the overwhelming political momentum gained by the estate duty abolition movement quickly spilled over to Commonwealth level. Shortly after Mr Negus from Queensland was elected but before the abolishment of wealth transfer duties in that state, a Senate Committee was assembled with the task of reviewing the subject of wealth transfer taxes. The Committee recommended that the Commonwealth vacate the field and leaving the negotiations on a uniform base and rates up to States. Three out of the eight members of the Committee gave dissenting reports which recommended that the Commonwealth repeal its gift and estate duties, and having the States reduce their duties in the short term with the objective of eventual abolition. [Duff (2005:53)]

The Asprey Committee also released a report in January of 1975 recommending that an integrated national gift and estate duty be introduced in order to reduce administration and compliance costs which would in turn minimize the opportunity to avoid these taxes. In the election that followed the Australian constitutional crisis later in 1975, former Labor Prime Minister Gough Whitlam promised to abolish Commonwealth estate and gift duty if he was to be re-elected after the Liberal-Country coalition received a majority vote on 10 December 1977 the Government introduced legislation which would effectively repeal these taxes from 1 July 1979. [Duff (2005:54)]

## 5.2 RECENT DEVELOPMENTS AND CURRENT SITUATION

As mentioned in section 5.1 death taxes were abolished by the Federal government in 1979. Capital gains tax was subsequently introduced in Australia with effect from 20 September 1985, and according to the Australian Tax Office Guide to Deceased Estates, CGT will only apply to capital assets purchased on or after that date, also referred to as “post CGT assets”. The capital gains tax provisions are contained in sections 100-1 to 152-425 of the Income Tax Assessment Act 1997 (referred to as the “ITAA”).

Section 104-5 of the ITAA sets out a total of 52 different events which will trigger capital gains tax, with the most common events being the disposal of an asset, as set out in subsection A1. A capital gain will arise in the event that the asset is disposed of and the proceeds exceed the cost base of the asset (acquisition cost). A capital loss on the other hand will arise when the proceeds from the disposition does not exceed the cost base.

As a general rule the Australian Tax Office guide to deceased estates and capital gains tax states that capital gains tax will be levied in the event of any change of ownership of a post-CGT asset subject to various exceptions. One in particular is classified as being a special rule that will apply when a deceased passes on an asset to another person. The rule states that a capital gain or loss made on a post-CGT asset will be disregarded in the event that such asset, which was owned by the deceased, is passed on directly to the deceased’s legal representative or to a beneficiary, or in the event of such asset being passed on from a legal personal representative to a beneficiary.

According to Kruger (2015) the event of an Australian taxpayer passing away will cause assets to be passed on directly to a beneficiary (the person or persons named in the will of the deceased) or persons entitled to those assets in terms of the laws of intestacy. It may also pass directly to the deceased’s legal personal representative (usually the appointed executor to the estate), who is responsible for the administration process to wind up the estate, and he will be entitled to dispose of any or all of the assets as well as pass them on to the applicable beneficiaries.

As a result of the above exception there will therefore be no capital gains tax payable on the death of an Australian resident, as long as a taxable asset will eventually be transferred to a beneficiary appointed by the deceased, either in his last will and testament or in terms of the Australian laws of Intestacy. There are however exceptions to this special rule, they will be triggered in the following events:

- where a deceased bequeaths an asset to a tax-advantaged entity such as a charity or the trustee of a complying superannuation fund,
- or to a foreign resident.

If either of these events is satisfied any capital gain or loss made must be taken into account in the deceased's final tax return. In addition to the above mentioned exceptions, Australia also does not levy any wealth transfer tax in the form of a death or estate duty.

The capital gains tax provisions regarding roll-overs to beneficiaries are similar to that of South African provisions. In terms of section 128-15 of the ITAA, beneficiaries are deemed to have acquired a taxable asset, either from the deceased estate or from the legal personal representative, on the date of death, without an increase in the base cost. In other words the beneficiary receives the asset at the same value that the deceased originally purchased the asset for.

There are however important differences. Due to the fact that capital gains tax was not made applicable retrospectively when it was introduced, an asset acquired before 20 September 1985, also referred to as a "pre-CGT asset", will in terms of section 128-15 of the ITAA be deemed to have been disposed of to the beneficiary at market value on the date of the deceased's death. The beneficiary will therefore benefit from a higher base cost, without a corresponding capital gains tax liability for the estate of the deceased. The asset will subsequent to transfer lose its pre-CGT status and will be subject to normal capital gains tax when the beneficiary eventually disposes of it.

One may argue that if an Australian beneficiary is receiving a post-CGT asset and a capital gains tax liability as a result of the base cost staying the same as when the deceased purchased the asset that it does not differ materially from the capital gains tax provisions in South Africa. This is due to the fact that capital gains tax will be paid

eventually when the asset is disposed of. In a perfect world this argument would hold some merit, but it does not take into account the deferral of the capital gains tax liability until the beneficiary eventually decides to sell the asset at some point in the future. If the asset is not disposed of by the time the beneficiary dies, the roll-over will again apply.

### **5.3 SUMMARY**

This section discussed an overview of death taxes and its early abolition in Australia. It is unclear from the articles reviewed as to what taxes were used to make up the deficit in the aftermath of death tax abolishment. It was however mentioned by Duff that Australia's "double wealth" transfer tax system in the states as well as the Commonwealth government was a source of complexity and high compliance and administrative costs.

Although South Africa has not yet gone down the difficult path Australia has, history has taught us that wealth taxes in the guise of death duties have been shown to be politically untenable. Whether their justification is raising revenue or to receive a more equitable society, the overriding unpopularity of such a tax would prevent it from ever being reinstated in Australia.

To conclude, Australia generally does not levy capital gains tax or wealth transfer tax in the form of death or estate duty at the death of a taxpayer. Furthermore a taxable asset acquired before 20 September 1985 will not be subject to capital gains tax if it is disposed of before the death of an Australian taxpayer, unless it is transferred to a beneficiary on date of death. In such an event where the asset is transferred to a beneficiary, the base cost of the asset for the beneficiary receiving the asset will be deemed to be the market value of such asset on the date of death of the deceased, without a corresponding capital gains tax liability for the deceased's estate.

Chapter 6 briefly reviews the situation in Ireland.

## **6 RECIPIENT BASED INHERITANCE TAX IN IRELAND**

### **6.1 BACKGROUND TO DEATH TAXES IN IRELAND**

Muller (2010) reviewed the recipient based capital acquisition tax in her paper titled “A framework for wealth transfer taxation in South Africa”. The following section pertains to the review Muller did with regards to wealth transfer tax in Ireland.

Ireland adopted the British estate duty upon its foundation as a state in 1922 after which it was subsequently replaced by a recipient-based capital acquisition tax (hereafter “CAT”) in 1975. Upon its enactment, Ireland became the first common-law legal system to impose a recipient-based wealth transfer tax.

### **6.2 RECENT DEVELOPMENTS AND CURRENT SITUATION**

Muller documented that an O’Brien Committee reviewed the direct tax system of Ireland in 1982 and the provisions contained in the Capital Acquisitions Tax Act of 1976 and the amending provisions of the annual Finance Acts were consolidated into the Capital Acquisitions Consolidation Act of 2003 which is still in force today. A short lived probate tax, which levied a duty of two percent on a deceased estate introduced in 1993, was abolished in respect of deaths occurring on or after 6 December 2000.

CAT is made up of three taxes, namely an inheritance tax, gift tax and a discretionary trust tax.

#### **6.2.1 INHERITANCE TAX**

In terms of the Capital Acquisitions Tax Consolidation Act of 2003 the following sections regarding inheritance tax are summarised briefly as taken from the Irish Revenue Tax and Customs website below:

- Section 9: Charge of inheritance tax;
- Section 10: Inheritance deemed to be taken;

- Section 11: Taxable inheritance;
- Section 12: Disclaimer;
- Section 13: Surviving joint tenant deemed to take an inheritance, etc.

Inheritance Tax is a tax which can arise where a beneficiary receives an inheritance as a result of someone dying. The beneficiary is responsible for paying the tax. An inheritance can be taken under a will or intestacy - or in some other way such as, for example, where an asset in the joint names of the deceased and another person is taken, on the death of the deceased, by that other person as survivor.

The Inheritance Tax provides relief for a surviving spouse or surviving civil partner receiving an inheritance from their deceased spouse or civil partner. The inheritance will be completely exempt and no matter how valuable, will not be liable to inheritance tax.

When other beneficiaries are considered the taxability of their inheritances will depend on whether the total value of the gifts and inheritances received by the beneficiary from the deceased (or anybody else to whom the same group threshold applies) in the period from 5 December 1991 up to (and including) the date of the inheritance, exceeds a tax-free element called the "tax-free amount"

Up to the "tax-free" threshold amount nil percent of inheritance tax is payable and 33% on the remainder.

For the purpose of gift and inheritance tax, the relationship between the person who provides the gift or inheritance (i.e. the donor) and the person receiving the gift or inheritance (i.e. the beneficiary) determines the maximum tax-free threshold known as the "group threshold". The indexed group thresholds for the 2009, 2010, 2011 and 2012 years of assessment are given in the table below:

<i>Indexed group thresholds</i>							
Group	Relationship to Disponer	Group Threshold from 8/4/2009 to 31/12/2009	Group Threshold from 1/1/2010 to 7/12/2010	Group Threshold from 8/12/2010 to 31/12/2010	Group Threshold from 1/1/2011 to 6/12/2011	Group Threshold from 7/12/2011 to 5/12/2012	Group Threshold from 6/12/2012
A	Son/Daughter	€434,000	€414,799	€332,084	€332,084	€250,000	€225,000
B	Parent*/Brother/Sister/Niece/Nephew/Grandchild	€43,400	€41,481	€33,208	€33,208	€33,500	€30,150
C	Relationship other than Group A or B	€21,700	€20,740	€16,604	€16,604	€16,750	€15,075

\*In certain circumstances a parent taking an inheritance from a child can qualify for Group A threshold.

A number of other important exemptions and reliefs are available, including relief for agricultural and business property and exemptions for certain dwelling houses. An asset is liable for Irish inheritance tax if the asset is located in Ireland, or if the asset is located abroad and the deceased or beneficiary is resident or ordinarily resident in Ireland.

## **6.2.2 GIFT TAX**

In terms of the Capital Acquisitions Tax Consolidation Act of 2003 the following sections regarding gift tax are summarised briefly as on the Irish Revenue Tax and Customs website below:

- Section 4: Charge of gift tax;
- Section 5: A gift which is deemed to be taken;
- Section 6: The meaning of “taxable gift”;
- Section 7: Liability to gift tax in respect of gift taken by joint tenants;
- Section 8: Disponer in certain connected dispositions.

Gift tax is charged on any gratuitous benefit (gift) taken otherwise than on death, on or after 28 February 1974. The tax is charged on the taxable value of the gift or inheritance. The taxable value is established by deducting any permissible debts or incumbrances including any consideration paid by the beneficiary from the market value of the gift.

Once the taxable value has been determined the amount of tax payable will depend on whether the appropriate tax free threshold has been exceeded. The rates of tax are as follows: up to the threshold amount a percentage of nil will be charged with the excess portion being taxed at 33 percent. The rate of 33 percent was introduced on 6 December 2012.

Gifts of Irish property are liable to tax whether or not the disponent is resident or domiciled in Ireland. Foreign property is liable to tax where either the disponent or the beneficiary is resident or ordinarily resident in Ireland at the relevant date.

Various exemptions from gift and inheritance tax have been provided for. For example, the first €3,000 taken as a gift by a beneficiary from a disponent in any one year is exempt from tax as are gifts and inheritances taken by one spouse or civil partner from the other. There are exemptions in favour of certain charities, heritage property, superannuation benefits, and foreign donees of certain Irish government securities. Qualifying insurance policies to the extent that they are utilised in the payment of certain gift tax or inheritance tax are also exempt. A dwelling house taken as a gift or inheritance is exempt in certain circumstances.

### **6.2.3 DISCRETIONARY TRUST TAX**

A once-off inheritance tax applies to property subject to a discretionary trust on 25 January 1984, or becoming subject to a discretionary trust on or after that date. The current rate of tax is 6%. In certain cases the 6% rate can be reduced to 3%.

An annual inheritance tax at the rate of 1% applies to property subject to a discretionary trust on 31 December in each year from 2006 onwards. Prior to 2006, the annual charge applied to property subject to a discretionary trust on 5 April in each year commencing with the year 1986.

## **6.3 SUMMARY**

This section discussed the three types of wealth transfer taxes applicable to taxpayers in Ireland. These taxes differ from South African taxes in that the beneficiary is liable to pay

these taxes in Ireland rather than the transferor as in South Africa. The final section deals with a brief overview of the historical development and current situation regarding death taxes in the United Kingdom.

## **7 REVIEW OF DEATH TAXES IN THE UNITED KINGDOM**

### **7.1 HISTORICAL OVERVIEW OF DEATH TAXES IN THE UK**

In Muller's (2010) review of the historical development of wealth transfer taxes in the modern era, she noted that England originally introduced a probate duty in 1694 on all probates and letters of administration. This duty was largely based on Holland's stamp tax. Subsequent to the probate duty, England introduced four taxes over a period of 100 years:

- I. Legacy duty in 1780;
- II. Succession duty in 1853;
- III. Account duty in 1881;
- IV. Estate duty in 1889.

Legacy duty and succession duty were both duties imposed on beneficiaries of personal property and real estate respectively. Account duty was introduced as an anti-avoidance or probate duty for situations where property is donated shortly before death. Estate duty was brought in as a supplement for the co-existing duties, but was short lived.

The following duties were levied on the transferor:

- Probate duty;
- Account duty; and
- Temporary Estate Duty.

In contrast to transferor-based duties the following were levied on the beneficiary:

- Legacy duty; and
- Succession duty

Muller stated that in 1894 a modern estate duty was introduced, replacing most of the early death duties which had been imposed on the United Kingdom over a period of two hundred years since the original introduction of probate tax in 1694. The Estate duty was levied on property passing from a deceased to his or her estate, as well as on gifts made

in a certain period before death, initially set at one year. There was no tax levied in the case where the person survived the “gifts period” which was amended from time to time.

Muller documented that the early development of wealth transfer taxation in England had a dramatic influence on the development of these wealth transfer transactions in a number of international jurisdictions. With the British Empire’s expansion in the eighteenth and nineteenth centuries, former colonies also adopted the English death duties as a result. Estate duty was eventually replaced in 1975 by a capital transfer tax, and was given a new name in 1986 as Inheritance tax.

Her Majesty’s Revenue and Customs website (UK revenue services) states that Inheritance tax is paid by a deceased estate. It is also payable by trusts on gifts made during someone’s lifetime. Most estates don’t have to pay inheritance tax because they’re valued at less than the threshold (£325,000 in 2014 to 2015). The tax is payable at 40% on the amount over this threshold or 36% if the estate qualifies for a reduced rate as a result of a charitable donation.

Since October 2007, married couples and registered civil partners can effectively increase the threshold on their estate when the second partner dies - to as much as £650,000 in 2014/15. Their executors or personal representatives must transfer the first spouse or civil partner’s unused inheritance tax threshold or ‘nil rate band’ to the second spouse or civil partner upon death of the first spouse or civil partner.

It is further noted that Inheritance tax is payable by different people in various situations. The Executor or personal representative will typically pay the tax by using funds from the deceased’s estate. The trustees would be responsible for paying inheritance tax on assets in, or transferred into a trust. Occasionally persons receiving gifts or inheritances from the deceased will be called upon to pay inheritance tax. This is however uncommon.

The website provides guidance to the taxpayer with regard to the taxability of the estate. The first step is to value the estate. This means adding up the value of all the assets in the estate - such as a house, possessions, money and investments - and deducting any debts the deceased may have owed, including household bills and funeral expenses. An estate

also includes the deceased's share of any jointly owned assets and the value of any assets held in trust. Any gifts that the deceased may have made in their lifetime must be reviewed to see if they are exempt, and if they aren't exempt, they must be included in the overall value of the estate (see more below).

In terms of Her Majesty's Revenue and Customs website (UK revenue services, 2014) inheritance tax includes exemptions and reliefs which are summarised as follows:

- **Spouse or civil partner exemption.** An estate usually does not owe inheritance tax on anything which is left to a spouse or civil partner who has their permanent home in the UK - nor on gifts which are made to them in the deceased's lifetime - even if the amount is over the threshold.
- **Charity exemption.** Any gifts made to a 'qualifying' charity - during the deceased's lifetime or in the deceased's will - will be exempt from inheritance tax. A donation to charity in a deceased's will may also reduce the rate of tax.
- **Potentially exempt transfers.** If a person survives for 7 years after making a gift to someone else, the gift is generally exempt from inheritance tax, no matter what the value.
- **Annual exemption.** An amount up to £3,000 may be given away each year, either as a single gift or as several gifts adding up to that amount – a person can also use any unused allowance from the previous year, but that person must use the current year's allowance first.
- **Small gift exemption.** A person can make small gifts of up to £250 to as many individuals as they like tax-free.
- **Wedding and civil partnership gifts.** Gifts to someone getting married or registering a civil partnership are exempt up to a certain amount.
- **Business, Woodland, Heritage and Farm Relief.** If the deceased owned a business, farm, woodland or National Heritage property, some relief from Inheritance Tax may be available.

In most cases inheritance tax will have to be paid within 6 months of the month in which the deceased dies. If the period has passed, interest is charged on the outstanding

amount. In the event where the estate is tied up in immovable property, payment can be spread over a period of ten years.

There is no capital gains tax when someone dies. Even when assets change hands in the event of an inheritance, there will be no capital gains tax. However if the assets are disposed of in order to pass on the money as proceeds to the heir, a gain or loss will have to be determined.

Inheritance tax will be levied on trusts in the following circumstances:

- When assets are transferred or settled into a trust;
- When a trust reaches its ten year anniversary from being founded;
- When assets are transferred out of a trust or if the trust is wound up;
- When someone dies and a trust is involved.

## **7.2 CURRENT SITUATION REGARDING INHERITANCE TAX IN THE UK**

Various articles regarding criticism against Inheritance tax were noted in the following:

In August 2006 an article published in the Daily Telegraph described former Cabinet Minister Stephen Byers calling for the abolition of inheritance tax. This was also noted in a 2008 article where Philip Johnston had a blog post against inheritance tax. He stated that Inheritance tax is a wealth tax which is no longer levied on the wealthy, and while middle classes have found the tax to be increasingly difficult to avoid, it is in fact a voluntary burden on the seriously rich. He argued that these wealthy individuals had the shield over their assets of offshore tax havens beyond the reach of any mere mortal. Byers also claimed that the tax is “a penalty on hard work, thrift and enterprise”. He called it a “tax on death” and called for it to be abolished. He also suggested a rise in green taxes to make up the deficit.

In reply to Byers’s comment a treasury spokesperson said that inheritance tax is not an unfair tax as it only affects the top six percent of all estates. He stated that “anyone who wants to abolish it needs to explain how they would plug the £3.3 billion cost – equivalent

to more than a penny on income tax and twice the amount we are spending on counter-terrorism and security this year.”

In more recent developments in an article by the Guardian on 15 October 2014, Prime Minister David Cameron backs the raising of the inheritance tax threshold. David Cameron said that he would like to ensure that only the “very wealthy” pay inheritance tax as he voiced support for the raising of the threshold at which tax is paid. The Prime Minister expressed that he would like to ease pressure on people who do not regard themselves as “in a way the mega-rich” but whose estates are subject to tax.

The article made reference to George Osborne, who originally suggested the raising of the threshold to £1 million in 2007 when he spoke at the party’s conference. But the pledge was quietly dropped after the 2010 general election in the coalition negotiations as the policy appeared out of place in times of austerity. This means that inheritance tax of 40 percent has to be paid on estates worth more than £325 000 or £650 000 for couples.

Cameron, who was answering questions at Age UK’s London office, said he would like to see progress on raising the threshold. Properties in London valued at the average price of £514,000 are liable for the tax. The average price of a property in the UK is £274,000, according to figures released by the Office for National Statistics.

He said: “To me inheritance tax is a tax that should be paid by the very wealthy. I think you should be able to pass a family home on to your children rather than leave it to the taxman. And further:

“I would like to see that go further because I think even at £650,000, particularly in some parts of the country, you see someone who has worked hard, they have put money into their house, they have done it up to improve it and they want to leave it to their children and they don’t feel that they are in any way the mega-rich, and they feel: ‘I should be able to do that without having 40% of it knocked off’.

### **7.3 SUMMARY**

This section described the historical and recent developments of Wealth Transfer tax in the United Kingdom. It seems as though politics play a major role in death taxes, but the contribution to the *fiscus* appears to be utilised and well justified by government. There are differences compared to South Africa. Although the UK does have capital gains tax, it is only payable on the death of a person in the event where an asset was sold from an estate, and the money received from the sale is then transferred to an heir. This differs from South Africa where a deceased is deemed to have disposed of a capital asset immediately prior to death. This means that there will be capital gains tax even if the asset is transferred to an heir.

## 8 FINAL REMARKS AND SUGGESTIONS

### 8.1 INTRODUCTION

As was stated in the above sections, SARS is investigating the effectiveness of estate duty as a wealth transfer tax in South Africa. The reasons for this investigation were highlighted in the above sections, in particular the fact that SARS is considering abolishment of estate duty all together. In doing so one has to consider what is currently happening in other countries with regard to abolishment and alternative wealth transfer tax options.

It was evident from the discussion that estate duty individually, and when taken into account with other taxes on property contribute an insignificant amount of revenue each year. It is perceived as a tax on the rich and deemed to affect a minimal percentage of the population. With this being said, SARS and Treasury will have to look for an alternative way in which to generate new revenue in order to make up for the hole left in the *fiscus* when estate duty is abolished.

One has to be reminded of the chaos which unfolded in Australia. States and Commonwealth government failed to adjust estate duty legislation according to inflation. This in turn meant that an increasing number of small to medium estates were now becoming taxable, with the administration costs increasing at a much faster rate than the actual revenue which was received at the time.

The question which has to be asked is: “what alternatives are there”, and how are SARS and Treasury going to fill the hole left when estate duty is abolished? Special care should be taken not to replace the loss in revenue with a tax which will cause economic burden on lower or middle income earning classes, for example a fuel levy increase or increasing the VAT rate.

## **8.2 SUMMARY OF LITERATURE REVIEWED**

An overview of the following situations are discussed in order to determine possible options available to Treasury with regard to estate duty, and whether the options would be feasible to implement in the current death tax practice in South Africa:

- Option 1: Estate duty to be abolished (as in Australia);
- Option 2: Estate duty is replaced with a transferor-based inheritance tax (as in Ireland);
- Option 3: Estate duty is retained with an exemption from CGT at death (as in the UK – effectively eliminate the double taxation effect).

### **8.2.1 OPTION 1: ESTATE DUTY TO BE ABOLISHED (AS IN AUSTRALIA and Canada);**

#### **8.2.1.1 GENERAL OBSERVATIONS**

As was observed in chapter five pertaining to the abolition of estate duties in Australia, one commentator argued before the abolishment that in doing so it could potentially increase the direct investment in Queensland tenfold. This was proven to be true in theory in the Hong Kong Bills Committee on Revenue (Abolition of Estate Duty) Bill which was released in 2005. It discussed the effect that abolition of estate duty had on foreign direct investments in New Zealand after the legislation was repealed.

The Bill revealed that the abolition brought about a 103 percent increase in its foreign direct investment in 1993. This figure narrowed to 22 percent in 1994 and remained at the same level through 1995. The committee believed that the increase was as a result of the abolition of estate duty but could not definitively state that it was not as a result of a variety of other factors. Even though the figure narrowed in 1994-95 it still showed the power that this legislation had in deterring potential foreign investment.

After observing the tax treatment of deceased estates and especially capital gains tax in both Australia and Canada, it was interesting to note that currently neither country has a

form of death duty. It is also evident that in Canada for example there will be capital gains tax at death as a result of a deemed disposal immediately prior to death. The biggest lesson one can learn is in the way both of these countries came to the conclusion that estate duty or death taxes were not sustainable, neither politically nor socio economically.

The other issue which came up in both discussions in chapter four and five was the limited revenue generated by an estate duty compared to the administrative burden involved to manage the collection of these taxes. In both cases it was not viable and in Australia in particular, the estate duty rate was not adjusted for inflation, which meant that an increasing number of smaller estates were becoming taxable with limited revenue being generated. The effect of this was an imbalance in the cost effectiveness of the tax, making it impossible for the Australian federal government to ignore the issue.

Although South Africa has provisions in place such as section 4(q) of the Estate Duty Act and the roll-over provisions contained in the eighth schedule to the Income Tax Act, it is still very burdensome to bequeath assets. In Australia for example, when an asset is transferred at death to a beneficiary, the beneficiary is deemed to have received the asset at original base cost, and the liability of capital gains tax will only become apparent once the beneficiary decides to sell the asset, therefore deferring the liability.

In Canada the situation is very similar to South Africa. In fact it is so similar that the only apparent difference is the non-existence of estate duty payable in Canada. It does however create the perception that South Africans are paying double tax at death. One will have to analyse whether the tax rates differ and what exclusions there are in both countries before a conclusion can be reached. The fact is that the lack of estate duty has been a positive recipe of success for Canada and South Africa can definitely learn from their history.

#### **8.2.1.2 Conclusion**

The abolishment of estate duty could be a very lucrative cure for South Africa's current economic situation. According to the Trading Economics website South Africa experienced an actual GDP growth rate of 0.6% in the second quarter of 2014, followed by 1.4% for the third quarter of 2014. According to statistics on the website, GDP figures are expected to

decrease by 0.41% in the first quarter of 2015. This method could be the accelerator South Africa needs to lift its economy and become more competitive in international markets. Politicians would also welcome this as the economy will be stimulated in a positive way and South Africa will be able to pay off its debt quicker. South Africa had a government debt to GDP ratio of 46.1% in 2013 which amounted to US\$ 141 837 million in the second quarter of 2014.

One must also learn from other countries as to how not to handle certain issues, as was apparent by the mass political campaign against estate duty in Australia. One can also suggest similar provisions as Australia, to be implemented in South African legislation, which could alleviate some of the perceived double taxation concerns expressed by professional and public role-players in South Africa. Implementing a similar system to Australia or Canada might have a positive effect for the country, allowing the wealthy to again invest in the country without the fear of estate duty eliminating their wealth for future generations.

## **8.2.2 OPTION 2: ESTATE DUTY IS REPLACED WITH A TRANSFEROR-BASED INHERITANCE TAX (AS IN IRELAND):**

### **8.2.2.1 *General observations***

As was noted in the section on wealth taxes in Ireland, inheritance tax is levied on the recipient of the inheritance and not on the transferor as in South Africa with estate duty. Muller (2010) again documented that in theory a recipient-based wealth transfer tax system has a strong appeal for the following reasons:

- The argument of double taxation is ruled out by the fact that the CGT is paid by the transferor and the inheritance tax is paid by the recipient.
- Receiving unearned benefits increases the recipient's ability to pay.
- Inheritance tax is equally spread between recipients.
- Estate duty is seen as a death tax whereas inheritance tax is seen as a transfer tax.
- Numerous international reform commissions and countries justify the introduction of a recipient-based tax.

- It is a modern and efficient way of levying tax on *inter vivos* transfers as well as transfers on death.
- There is an incentive created to spread wealth to a wider audience of beneficiaries.
- Makes more sense to be taxing the living than the dead.

In contrast with the array of positive factors a recipient-based system holds, it has the disadvantage of being more complex to administer as there are various taxpayers and not only the estate.

### **8.2.2.2 Conclusion**

The recipient-based tax system surely puts up its hand as the strongest contender to replace estate duty in future with its array of positive and encouraging features to look forward to. It has one rather large chink in its armour and that is that it has the potential to increase administration costs. It might be an interesting topic to investigate, whether the increase in administration costs will be offset by the increased revenue generated as a result of the recipient-based tax system. Only time will tell.

## **8.2.3 OPTION 3: ESTATE DUTY RETAINED WITH AN EXEMPTION TO CGT (AS IN UNITED KINGDOM)**

### **8.2.3.1 General observations**

In the event of Treasury approving an exemption of CGT on death in terms of Estate duty, the double taxation element might be eliminated and will be in line with similar legislation in the United Kingdom. It would have been refreshing to see how the Margo Commission and Katz Commission's report would have looked in 1980 and 1990 respectively, if capital gains tax was considered.

Muller (2010) identified various discrepancies within the South African wealth transfer tax system. The first of which was that the Margo- and Katz Commissions recommended the need for the two wealth transfer taxes to be within one statute (these Commissions were

prior to the introduction of CGT). Currently estate duty is levied under the Estate Duty Act and donations tax under the Income Tax Act.

The second discrepancy was that both estate duty and donations tax were primarily levied on a worldwide basis. Additionally for the purposes of estate duty, property which is located, registered or enforceable in South Africa which is owned by a person who is not ordinarily resident on date of death will be liable for estate duty. Therefore estate duty is enforceable on a *situs* basis as well. In contrast, local property donated by a non-resident does not fall within the ambit of donations tax, implying that the jurisdictional basis for donations tax does not extend to a *situs* basis.

Thirdly estate duty is levied with regard to a person being “ordinarily resident” in the Republic, whereas donations tax is levied on a “resident. Furthermore the Estate Duty Act contains special valuation rules for unquoted shares, whereas donations tax does not.

For the purposes of estate duty, usufructuary, fiduciary and other like interests and annuities are valued with reference to the life expectancy of the beneficiary (unless the interest is to be enjoyed for a specific period), whereas for donations tax purposes the donor’s life expectancy is used to value these interests (unless the interest is to be enjoyed for a shorter period).

Some exemptions for example are offered under the donations tax provisions without the same relief applying to similar situations with regard to estate duty. And lastly the general anti-avoidance provisions contained in the Income Tax Act also applies to donations tax, whereas the Estate Duty Act does not have these or similar provisions.

### **8.2.3.2 Conclusion**

As was mentioned in the section pertaining to wealth taxes in the United Kingdom, there is currently no CGT effect when a person dies, unless the assets are disposed of to pass the proceeds on to an heir. In such a situation a capital gain will have to be calculated.

If the discrepancies in the current legislation between donations tax and estate duty are taken into account, there is not a close link between the two. In contrast Muller (2010) showed that gift tax and inheritance tax in the UK seems to have a much stronger link when the two pieces of legislation are reviewed. It would be interesting to review estate duty and donations tax if/and when the discrepancies are resolved, to discover what the effect will be with regard to capital gains tax.

In the meantime one can only speculate. As to the option of exempting certain parts of CGT in terms of estate duty, it could be a viable option. It has worked thus far in the UK and South Africa has a rich history of adopting UK trends when it comes to law or taxation matters. If the exemption is accepted the argument of double taxation will be nullified and the revenue will stay intact with regards to estate Duty. Only time will tell if Treasury are willing to change the legislation in this regard.

### **8.3 GENERAL ARGUMENTS FOR THE REPEAL OF ESTATE DUTY**

#### **8.3.1 FACTORS AGAINST ESTATE DUTY TO BE CONSIDERED**

- The deficit left in revenue received when estate duty is repealed might be offset by the simultaneous deduction in administrations costs for SARS, as their staff will be able to focus on being more efficient at collecting higher revenue-contributing taxes.
- Single taxpayers might feel discriminated against as they are unable to utilise certain provisions in the ITA specifically relating to spouses. For example the roll-over relief for spouses as well as the transfer of abatement.
- The fact that CGT is triggered at death causes the perception of double taxation. Even though this CGT can be deducted as a liability in the estate, it will still be included in the deceased's final income tax calculation for the year in which they passed away.

- Estate duty is also seen as a wealth tax, although the wealthy are most likely to be able to avoid these taxes as they can afford the cost of elaborate estate planning and setting up of trusts.
- Political influence possibly played a significant role in retaining taxes which are meant to be levied on the rich.
- There are inconsistencies and very little compatibility between wealth taxes in South Africa.
- Wealth transfer taxes' decline in OECD countries is greater among countries that use a transferor-based system.

### **8.3.2 OTHER FACTORS TO BE CONSIDERED**

- If Estate Duty is not repealed and kept as present:
  - Treasury and SARS will have to establish the levels to which exemptions will have to be increased to account for rising inflation and asset prices.
  - Consider whether there are other capital gains tax exemptions which can be implemented to protect the middle class and small business owners from paying exorbitant amounts of estate duty as a result of poor estate planning.
- In the event of estate duty being repealed, the Master of The High Court's responsibilities and current regulation of estates will have to be reviewed.
- The abolition of estate duty should make financial and economic sense, without the need for a politically driven campaign against it.
- The Katz Commission recommendations should be reviewed and the effect of CGT on these recommendations should be taken into account.

## **8.4 SUGGESTIONS**

In light of the findings in this study it is imperative for Treasury to do extensive research as to the effect that possible legislation amendments, exemptions with regard to CGT, total abolition of estate duty or the implementation of a new system will have on SARS's

capacity and budget to absorb these potential changes. In the end it comes down to a cost versus benefit situation and estimating the potential contributions compared with the burden of changing an existent system or implementing something new. SARS and Treasury will have to ensure that the current benefits they have, are at least matched by the potential income earning benefits brought about by a change.

The introduction of a new system will bring about a new administration process and should be cost effective and feasible to implement. This requires extensive research and simulation tests to establish if it will indeed be feasible and cost effective.

On 17 July 2013 the former Minister of Finance, Mr Pravin Gordhan, announced the members of the Tax Review Committee (the Committee) as well as the Committee's Terms of Reference. This gave effect to the Minister's previous announcement in February 2013 when he tabled the 2013/14 Budget that government will initiate a tax review this year *"to assess our tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability"*.

It was decided at the inaugural meeting of the Committee on 25 July 2013 that the Committee will be known as The Davis Tax Committee (DTC).

According to the broad mandate of the Davis Tax Committee, the Committee's purpose is to inquire into the role of the tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability. This has become even more significant in light of the economic contraction in the first quarter of 2014.

In less than a year after its establishment, the Davis Tax Committee (DTC) has added three more sub-committees to its existing ones for Small Business, Macro Analysis and Base Erosion and Profit Shifting (BEPS). The new sub-committees to deal with further specifics in the Terms of Reference of the Committee are for Mining, VAT and Estate Duty.

In a media statement released on 3 June 2014, National treasury called for submissions to the Davis Tax Committee with regard to mining, VAT and estate duty. The media

statement contained the following quote regarding the purpose of the estate duty sub-committee:

“The progressivity of the tax system and the role and continued relevance of estate duty to support a more equitable and progressive tax system. In this inquiry, the interaction between capital gains tax and the estate duty should be considered.”

It is therefore evident that Treasury is taking this matter seriously and there is no doubt that with the proper resources to their disposal, the DTC will soon shed light on a possible solution to the inquiry on the interaction between CGT and estate duty.

## 9 CONCLUSION

The main purpose of this study was to establish whether Treasury's review and possible abolishment of estate duty was warranted by what is happening in other countries. This was extensively reviewed in chapter 4 to 6. In subsequent chapters certain similarities were drawn between estate duty and similar taxes in other countries. It may be concluded that Treasury's rationale behind the review and possible abolishment of Estate duty is not a unique concept in global comparisons. Wealth taxes remain unpopular worldwide.

The research objectives were achieved as the reasons for the survival or abolition was considered in comparison to other similar wealth or death taxes in the UK, Ireland and Australia. Possible alternatives for death taxes in South Africa were also discussed in the last chapter to this study.

It was very interesting to observe that in most cases worldwide the determining and influential factor and driving force, either behind or against wealth taxes comes down to political reasoning. This was the telling factor in Australia where one politician decided to start a campaign against death duties in Queensland, which led to it being eventually abolished countrywide in little more than a decade. Politician's own agendas with regard to the taxability of the rich also have to be considered, especially when they rank among the top earners in South Africa.

With the rate at which unemployment and the population is growing in South Africa, it is clear that the current contribution estate duty makes to the *fiscus*, should have a heavy bearing on the factors to be considered before repealing such a tax permanently. It would be impossible to implement a replacement tax which would have to be paid by all South Africans, especially with South Africa's delicate Union situation being close to boiling point.

Another wealth tax will have to be considered, a tax which will be applicable only to the rich, thereby not affecting the middle and lower class earners. This will be a very important consideration to make. As global trends are at the moment, the rich are getting richer and poor are getting poorer. There is no better example of this than in South Africa. Therefore

Treasury will find it very difficult to justify why a “wealth tax” was repealed in favour of a tax which is applicable to all classes of taxpayers.

It seems as though revenue collected from a specific tax would not economically justify the repeal of any tax currently. With politicians striving to increase personal wealth rather than focus on growing the economy, one can only hope that economic welfare will prevail over political agendas

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