



**COLLEGE OF LAW AND MANAGEMENT STUDIES
SCHOOL OF LAW
UNIT OF TAX LAW**

**THE INTERFACE BETWEEN CAPITAL GAINS TAX AND ESTATE
DUTY AND THE DOUBLE TAX IMPLICATIONS THEREOF**

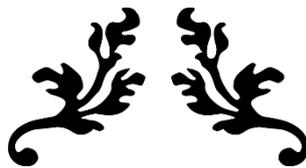
VARSHANI RAMSON

STUDENT NUMBER: 209523742

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SUPERVISOR: MR C. SCHEMBRI

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IMPLICATIONS THEREOF



Varshani Ramson
December 2014

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To my supervisor, Mr C. Schembri:

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Terms and Abbreviations

The following is a list of abbreviations used in the course of this dissertation:

CGT – Capital Gains Tax

IHTA 1984 – Inheritance Tax Act 1984

ITAA 97 – Income Tax Assessment Act (Cth) 1997

PETs – Potentially Exempt Transfers

SAICA – South African Institute of Chartered Accountants

SAIT – South African Institute of Tax Professionals

SARS – South African Revenue Services

TCGA 1992 – Taxation of Chargeable Gains Act 1992

UK – United Kingdom

Abstract

This study, called, “*The Interface between Capital Gains Tax (CGT) and Estate Duty and the Double Tax Implications thereof*” examined the interface between CGT and Estate Duty in South Africa, the double tax implications thereof, and whether these were mitigated by legislation in any manner, and, where it had not been addressed by legislation, to suggest ways in which it could be mitigated. The study emerged from a concern that the current legislation does not function optimally to provide sufficient relief or remedies to a taxpayer affected by double taxation, or where one asset is subject to tax twice.

CGT, which is governed by the Eighth Schedule of the Income Tax Act, forms part of Income tax and is levied on all capital losses and capital gains by individuals, trusts and companies unless specifically exempt. Estate Duty is a separate tax governed by the Estate Duty Act and is levied and collected from the estate of every person who dies after the date of enactment. It is submitted that the operation of CGT has a similar purpose to that of the operation of Estate Duty or Donations Tax, and thus there is an avenue for double taxation. The interface between these taxes appears to occur at death of an individual. This is because death constitutes a disposal for CGT purposes, and estate duty is also levied on the deceased estate. The death of a person triggers a deemed disposal for capital gains tax purposes and therefore it impacts the liquidity of the deceased estate, together with the estate duty.

Therefore, this dissertation undertakes an exploration of the effect of levying both taxes on death. The following key question is asked: Are there any double tax implications in the interface between CGT and estate duty; and if so, how does legislation mitigate these implications? The following sub-questions emanating from the key question are: How does CGT operate? How does Estate Duty operate? Are there any overlaps in the operation of these two taxes? Are these overlaps in the legislation cause for double tax? Does the legislation mitigate these overlaps? If not, how can these implications be mitigated?

Alternate taxation models of the United Kingdom and Australia are examined for their viability for South Africa. It is suggested that the phenomenon of double taxation in South Africa remains a fundamental unfairness to the taxpayer. It is proposed that Estate Duty should be abolished and other possible tax collection alternatives, like increasing the CGT rate, should be adopted, with continued reformation of the CGT system thereafter. While the necessity of greater planning and more time is acknowledged, it is submitted that the challenges South Africa may face in attaining an equitable system in the short term, will be outweighed by the benefits to both the fiscus and taxpayers alike, in the long run.

Chapter One

The Context

1.1 Introduction

This study, which examined the interface between Capital gains tax (CGT) and Estate Duty in South Africa, emerged from a concern that the current legislation does not function optimally to provide sufficient relief or remedies to a taxpayer affected by double taxation, or where one asset is subject to tax twice. CGT, which is governed by the Eighth Schedule of the Income Tax Act, forms part of Income tax and is levied on all capital losses and capital gains by individuals, trusts and companies unless specifically exempt. Estate Duty is a separate tax governed by the Estate Duty Act and is levied and collected from the estate of every person who dies after the date of enactment. It is submitted that the operation of CGT has a similar purpose to that of the operation of Estate Duty or Donations Tax, and thus there is an avenue for double taxation. The interface between these taxes appears to occur at death of an individual. This is because death constitutes a disposal for CGT purposes, and estate duty is also levied on the deceased estate. The death of a person triggers a deemed disposal for capital gains tax purposes and therefore it impacts the liquidity of the deceased estate, together with the estate duty.

In this chapter the purpose and rationale for my study is described, the research questions are delineated, and the conceptual/theoretical framework and research methodology is outlined.

1.2 Purpose of this study

The purpose of this study was to examine the interface between CGT and Estate Duty, specifically the effect of levying both taxes on death, the double tax implications thereof, whether these have been mitigated by legislation in any manner and, where it has not been addressed by legislation, to suggest ways in which it can be mitigated.

1.3 Rationale for the Study

CGT affects all capital assets and transactions of a capital nature. Estate Duty affects the estate of a deceased person and therefore this study is relevant to all taxpayers in South Africa. The rationale for this study is motivated by three imperatives, which I describe below:

The Research Imperative – As alluded to in my introduction, double tax implication arises in certain circumstances, yet there has not been much academic analysis on the subject matter, and does not appear have been tested or commented on by the courts or academic commentators. A concern arose that the current legislation does not function optimally to provide sufficient relief or remedies to a taxpayer who is affected by double tax, or where one asset is subject to tax twice. A review of the literature indicated a dearth of knowledge in this area of double taxation as described above. It is suggested that this study augments the understanding of this double taxation and contribute to the current body of academic knowledge thereof.

The Contextual Imperative – It is essential that a legal system function at its optimum and in a manner that is equitable for its legal subjects. South Africa only implemented a tax on capital assets in 2001. It is therefore a relatively new concept and considering its implication on estate duty and, ergo, the taxpayers, policy needs to be informed in order to achieve the most efficient and equitable method of taxation. Given the continuous debates around taxes, I submit that my study enhances debates around taxation by interrogating ways and suggestions about mitigation of the double tax implication, which will contribute to informing policy.

My Personal Imperative – The personal imperative driving this study involves a personal interest in taxation as an undergraduate, and is motivated by a social justice perspective of equity in law. The possibility of double tax is not immediately apparent in the literature or legislation and therefore many taxpayers would possibly be unaware that they are double taxed. Therefore, I wished to investigate these particular contentions of law.

1.4 Key questions

The research was driven by the following key questions:

1.4.1 Are there any double tax implications in the interface between CGT and estate duty; and, if so, how does legislation mitigate these implications?

To answer this question, an analysis of how the current legislation mitigates double taxation was undertaken. Arising from the key question were several sub-questions. These questions are described below, as well as a synopsis of the attempt how each question was answered, is presented.

1.4.2 How does CGT operate?

In Chapter Two, how CGT operates, how it was developed, the reasons for its implementation and what the effects of it are on a taxpayer, and that on a deceased estate, are discussed

1.4.3 How does Estate Duty operate?

In Chapter Three, how Estate Duty operates, how it was developed, the reasons for its implementation and what the effects of it are on a taxpayer, and that on a deceased estate are discussed, as well as its relationship to CGT, are discussed.

1.4.4 Are there any overlaps in the operation of these two taxes?

In Chapter Four the different transactions where CGT and Estate Duty work, together or individually are highlighted.

1.4.5 Are these overlaps in the legislation cause for double tax?

The following scenarios are also analysed in Chapter Five, viz., the effects of the economic double taxation tax effect on the estate, the CGT rollovers, the separate taxpayers and the effects of the tax on them, the effects of the taxes on a transaction holistically and the possible instances where a beneficiary incurs double taxation

1.4.6 Does the legislation mitigate these overlaps?

This question required an in depth interrogation of the current legislation and in Chapter Six, the applicable statutes to show how the legislation addresses and mitigates the double taxation effect, is examined.

1.4.7 If not, how can these implications be mitigated?

In Chapter Seven, where it has not been addressed adequately by the current legislation, an analysis of other forms of tax, eg. Donations Tax, an attempt to use those principles to mitigate the implications, is undertaken.

In Chapter Eight, a few foreign jurisdictions where both CGT and Estate Duty are in effect are examined, to understand how they deal with their legislation, and its possible double tax implications, and the possible adoption of those methods. In this chapter, the best way to achieve a mitigation or eradication of the double tax implications created by the interface between CGT and Estate Duty, is examined.

The dissertation concludes in Chapter Nine with a discussion on suggestions on applying International Tax Principles in South Africa and my closing Statements.

1.5 Conceptual/Theoretical Framework

The conceptual paradigm used to analyse data, and within which the study has been situated is 'Legal Positivism'. According to this theory, law is a matter of what has already been decided in legislature, precedent and so forth. The theory does not concern itself with the merits of the law, but merely the fact that a legal structure exists. This theory would be most suitable when looking at the field of tax because in this subject area we undertake an investigation of statute, beginning with the assumption that the law, as promulgated by the legislature, exists and therefore that the relevant tax structures are in place.

1.6 Research Methodology

The research methodology for this study is purely qualitative. It is a desktop-based research paper, examining written works only. There is no case law on the subject matter but the relevant statute (Income Tax Act and Estate Duty Act) will be referred to.

Chapter Two

How does CGT Operate

2.1 Introduction and basics of CGT

CGT forms part of Income tax and is levied on all capital losses and capital gains, unless specifically exempt.¹ It is governed by the Eighth Schedule of the Income Tax Act² (the Act) and was introduced in South Africa, with effect on 1 October 2001, and concerns the disposal of an asset on or after this date. Section 26A of the Act³ provides that a taxable capital gain must be included in your taxable income. The rate of taxation is lower than normal tax rates, and is applicable to individuals, trusts and companies. The portion of an individual's taxable capital gain that is subject to tax for the 2013 year of assessment is 33,3% of the net capital gain.⁴

2.2 History and development of CGT

CGT was first proposed, in a limited form, by the Franzsen Commission in 1969⁵, while the Margo Commission in 1986 proposed that a capital gains tax system should not be implemented.⁶ The Katz Commission in its fourth report⁷, considered the tax system holistically and after analysing South African and international tax trends, specifically with regard to capital transfer taxes, supported the notion of implementing CGT. It is to be noted however, that the same

¹South African Revenue Services (or SARS) *Capital Gains Tax* available at <http://www.sars.gov.za/TaxTypes/CGT/Pages/default.aspx>, accessed on 5 March 2014.

²Act 58 of 1962.

³ibid

⁴South African Revenue Services (or SARS) *ABC of Capital Gains Tax for Individuals* available at <http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-CGT-G02%20-%20The%20ABC%20of%20Capital%20Gains%20Tax%20for%20Individuals%20-%20External%20Guide.pdf>, accessed on 2 March 2014, at 5.

⁵South African Revenue Services (or SARS) *A Comprehensive Guide to Capital Gains Tax* available at <http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-CGT-G01%20-%20Comprehensive%20Guide%20to%20Capital%20Gains%20Tax%20-%20External%20Guide.pdf>, accessed on 2 March 2014, at 3.

⁶ibid.

⁷M M Katz *Commission of Enquiry into Capital Transfer Tax: Fourth Report*(1997) available at <http://www.treasury.gov.za/publications/other/katz/4.pdf>, accessed on 5 March 2014.

Commission, in its third report, declined to make recommendations, mainly because the administration of CGT was complex.

It was in 2000 that the Minister of Finance announced in his Budget Speech⁸ that CGT was to be introduced with effect from April 2001, later extended to October 2001.

Succeeding this announcement, there was:⁹

1. A guide on the key principles of CGT issued in February 2000, upon which public comment was invited;
2. A first draft in December 2000 where changes were made to the proposals, and a Bill was prepared and published for comments and submissions;
3. A second draft in March 2001 where after further public debate and submissions were considered, an amended draft Bill was released for comment; and
4. The Taxation Laws Amendment Bill was tabled, passed, and approved by the President on June 2001 and the Act was promulgated on 20 June 2001.

Subsequently, there have been numerous amendments to the Eighth Schedule of the Act.¹⁰ In 2010, a portable R 3,5 million deduction between spouses was implemented.¹¹ The rationale behind this roll-over relief was to prevent the need of spouses to effect complex and costly trust mechanisms to preserve their assets.¹² One of the latest developments has been the increase in CGT rates in 2012. The rationale behind the increase was to enhance the equity, integrity and the progressive nature of the South African tax system.¹³ The result of the change was that the inclusionary rate for individuals and special trusts increased from

⁸TA Manuel, 'Budget Speech' (23 February 2000), available at http://www.treasury.gov.za/comm_media/speeches/2000/speech.pdf, accessed on 24 July 2014.

⁹see footnote 5 above; 3-6.

¹⁰58 of 1962

¹¹'Budget 2009/2010 Tax Proposals', available at <http://www.treasury.gov.za/documents/national%20budget/2009/guides/Budget%20Proposals%202009.pdf>, accessed on 17 July 2014, at 23.

¹²ibid.

¹³N Paulsen, 'Increase in capital gains tax rates' (23 February 2012) available at <http://www.polity.org.za/article/increase-in-capital-gains-tax-rates-2012-02-23>, accessed on 18 July 2014.

25% to 33.3%, and from 50% to 66.6% for companies and trusts, which, taking into account the rates of income tax, increased the effective rate of CGT for individuals to 13.3%.¹⁴

2.3 Rationale for implementation of CGT

Tax policy and reform are informed by principles of equity, efficiency and simplicity.¹⁵ CGT was effected, inter alia, for the purposes of¹⁶:

- a) International benchmarking – several of South Africa’s trading partners effected CGT many years ago, as well as other countries on the African continent. These jurisdictions accept the 'comprehensive income' concept as the ideal tax base, which entails that the total sum of all revenue should be included in income tax, and this includes capital gains;¹⁷
- b) horizontal equity – all taxpayers should assume similar tax burdens regardless of what form their income takes, and this consideration of fairness provides a compelling reason for taxing capital gains;
- c) vertical equity – this concept refers to equity between taxpayers in different income categories¹⁸. Taxpayers with greater capability to pay taxes should shoulder a greater responsibility of taxation and since CGT can be attributed to the wealthiest individuals, the introduction thereof promotes vertical equity and supports the progressivity of the income tax system;¹⁹
- d) the shift from income to capital – when capital gains were not taxed, many people re-characterised their income as capital so as to avoid the tax

¹⁴ibid.

¹⁵'Capital Gains Tax in South Africa' (24 January 2001) available at <http://www.ftomasek.com/NationalTreasury.pdf>, accessed on 24 March 2014, at 10.

¹⁶South African Revenue Services (or SARS) *A Comprehensive Guide to Capital Gains Tax* available at <http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-CGT-G01%20-%20Comprehensive%20Guide%20to%20Capital%20Gains%20Tax%20-%20External%20Guide.pdf>, accessed on 2 March 2014, at 1-3; N Brooks, 'Taxing Capital Gains is Good for the Tax System, the Economy and Tax Administration' (26 January 2001), available at <http://www.ftomasek.com/NeilBrooksRevised.pdf>, accessed on 24 March 2014.

¹⁷see note 15 above; 4.

¹⁸N Brooks, 'Taxing Capital Gains is Good for the Tax System, the Economy and Tax Administration' (26 January 2001), available at <http://www.ftomasek.com/NeilBrooksRevised.pdf>, accessed on 24 March 2014, at 4.

¹⁹see note 15 above; 11.

implications and therefore the introduction of CGT bears down on this type of avoidance;

- e) economic efficiency – excluding capital gains from the income tax base leads to tax avoidance and inequity in the economy because capital will flow to the sectors where tax-free capital gains can be realised, thereby reducing a taxpayer's total tax burden.²⁰ Consequently, more capital will be invested in assets that provide returns in the form of capital gains instead of income-producing assets;²¹
- f) simplicity - a tax system should not be administratively arduous, and although CGT is a complex tax, careful design of CGT can avoid the inherent complexities. One method of doing this, and thereby fulfilling the principles of a good tax system, is to not tax capital gains at preferential rates; and
- g) tax base broadening – more individuals will be brought into the net of taxpayers'.

2.4 Effects of CGT on a taxpayer

Income tax is a tax on income earned.²² According to the South African Revenue Services (SARS), CGT is not a separate tax but forms part of income tax and a capital gain arises when an asset is disposed of for an amount greater than its base cost.²³ The Eighth Schedule of the Income Tax Act (the Act)²⁴ gives effect to provisions relating to CGT. Moneyweb's TAX BREAKS discusses CGT in an article entitled 'CGT Demystified'.²⁵ In essence, section 26A of the Act states that

²⁰Brooks (note 18; 11).

²¹ibid.

²²'Introduction to Capital Gains Tax' available at <http://www.grose.co.za/files/2012/12/Intro-to-Capital-Gains-Tax.pdf>, accessed on 25 March 2014.

²³'Capital Gains Tax' <http://www.sars.gov.za/TaxTypes/CGT/Pages/default.aspx>, accessed on 5 March 2014. Other authors, such as P Haupt *Notes on South African Income Tax* 32 ed (2013); A Koekemoer 'Capital Gains Tax (CGT)' in M Stiglingh...et al (ed) *Silke: South African Income Tax* (2013); and M Stein *Capital Gains Tax* LexisNexis (last updated 2011) available at [http://butterworths.ukzn.ac.za.ezproxy.ukzn.ac.za:2048/nxt/gateway.dll/7b/5d/e6?f=templates\\$fn=default.htm\\$vid=myInb:10.1048/enu](http://butterworths.ukzn.ac.za.ezproxy.ukzn.ac.za:2048/nxt/gateway.dll/7b/5d/e6?f=templates$fn=default.htm$vid=myInb:10.1048/enu), accessed on 18 February 2014, discuss Capital Gains Tax in the same manner reviewed in this paper. The basic operation of CGT is mentioned, as well as how it applies to different transactions.

²⁴58 of 1962.

²⁵S Jones 'CGT Demystified' available at http://search.sabinet.co.za.ezproxy.ukzn.ac.za:2048/WebZ/images/ejour/montb/montb_n336_a4.pdf:sessionid=0:bad=http://search.sabinet.co.za.ezproxy.ukzn.ac.za:2048/ejour/ejour_badsearch.html:portal=ejournal, accessed on 17 February 2014.

the capital gain as calculated by the Eighth Schedule must be added to a taxpayer's taxable income. CGT is not triggered by the earning of income, but rather by the disposal or deemed disposal of an asset. 'Disposal' in paragraph 1 of the Eighth Schedule of the Act means "an event, act, forbearance or operation of law envisaged in paragraph 11 or an event, act, forbearance or operation of law which is in terms of this Schedule treated as the disposal of an asset". Events that trigger CGT, and which are regarded as disposals, include a donation of an asset, the sale of an asset or death. A deceased person is treated as having disposed of his or her assets, unless these assets: are transferred to the surviving spouse; is a long-term insurance policy of the deceased; or is an interest in a pension fund, and that these assets are disposed of for an amount received or accrued equal to the market value of those assets at the date of death.²⁶ The SARS guide 'The ABC of Capital Gains Tax for Individuals'²⁷ confirms the discussion in Moneyweb's TAX BREAKS and states that an individual's taxable capital gain for the 2013 year of assessment is 33.3%. The capital gain is calculated by subtracting the base cost from the proceeds of sale. The net capital gain is then calculated by subtracting the annual exclusion (normally R 30 000 a year but R 300 000 in the year of death) from the capital gain. Applying the inclusion rate to this amount will give you the taxable capital gain,²⁸ which is then added to gross income, as per section 26A and the section 1 definition of 'gross income' in the Act.

2.5 Conclusion

In summary, CGT was implemented in 2001 and is levied on all capital gains or capital losses, unless specifically exempt. CGT is not a separate tax but is part of income tax and a capital gain results when an asset is disposed of for an amount greater than its base cost. Events such as the donation of an asset, sale of an asset, or death, trigger CGT, as these events constitute a deemed disposal. Since death is a trigger event and that a deceased person is considered as having disposed of his or her assets, it follows that CGT is levied at death.

²⁶Paragraph 40 of the Eighth Schedule.

²⁷SARS (note 4 above).

²⁸SARS (note 4 above; 8).

In the next chapter, Estate duty, which is the primary avenue for collecting tax at death, is further elaborated.

Chapter Three

How does Estate Duty Operate

3.1 Introduction and basics of Estate Duty

Estate Duty was introduced in South Africa on 1 April 1955. It is a separate tax governed by the Estate Duty Act²⁹ and is levied and collected from the estate of every person who dies after the date of enactment. It is levied on the dutiable amount of the estate³⁰ at the current rate of 20%.³¹

3.2 History and development of Estate Duty

Death duties were first imposed in 1864 when the Succession Duty Act³² was promulgated into legislation. At the time, there were two types of death duties levied:

1. estate duty - a tax levied on the entire estate; and
2. succession duty - this was levied only on the parts of the estate that were transferred to the heirs.³³

There was no consistency of application between the two types of death duties in South Africa with some provinces applying Estate Duty, and others applying Succession Duty. To address this, the Death Duties Act³⁴ was enacted, which dealt with death duties in South Africa in its entirety.

When the Estate Duty Act was enacted in 1955, rates of estate duty ranged from 10% on the first R 50 000 to 35% of the portion in excess of R 400 000 of the

²⁹Act 45 of 1955.

³⁰Section 2 of the Estate Duty Act.

³¹First Schedule of the Estate Duty Act.

³²Act 5 of 1864.

³³Estate Duty Notes' *SA Tax Guide* available at <http://www.sataxguide.co.za/chapter-4-estate-duty/>, accessed on 2 March 2014.

³⁴Act 29 of 1922.

dutiable estate.³⁵ Coupled with the rates of taxation, there were also abatements available to alleviate estate duty liability, and there were personal abatements available to the surviving spouse and/or children.³⁶ These rates and abatements fluctuated until 1988 when all personal abatements were abolished and replaced with a single abatement of R 1 million, and estate duty was levied at a flat rate of 15%.³⁷ In 1996, the rate of estate duty was drastically increased to 25% with the rebate remaining the same. In 2001, due to the advent of CGT, the rate was reduced to 20% and the abatement was increased to R 1,5 million. This reduction in the estate duty rate occurred to 'counter any perceived double taxation on the assets', due to CGT applying on death.³⁸ In 2006 the abatement was again increased to R 2,5 million. However, since 2007 section 4A of the Estate Duty Act stipulates the abatement amount as R 3,5 million. This is still the position.

3.3 Rationale for implementation of Estate Duty

I submit that, due to the nature of estate duty, and specifically the purpose behind estate duty to tax the transfer of wealth from the deceased estate to the beneficiaries, estate duty was introduced for purposes of equity, efficiency and simplicity,³⁹ as was the case with CGT in 2001 (see chapter 2). This entails the notion that persons in similar economic circumstances should accept a similar tax burden, and also that taxpayers with greater ability to pay taxes should accept a greater burden of taxation.⁴⁰ That is, a taxpayer should be liable to pay tax on capital, irrespective of the form it takes. The intention behind the introduction of estate duty can be said to be to tax wealthier individuals, but the effectiveness of this is questioned, owed to the fact that wealthier individuals have estate-planning

³⁵C Bornman *The Impact of Estate Duty and Capital Gains Tax on Offshore Assets* (M Com SA and International Taxation thesis, North West University, 2010), available at http://dspace.nwu.ac.za/bitstream/handle/10394/4569/Bornman_C.pdf?sequence=2, accessed on 19 March 2014, at 11.

³⁶ibid.

³⁷ibid.

³⁸T A Manuel 'Budget Speech' (21 February 2001) available at <http://www.treasury.gov.za/documents/national%20budget/2001/speech/speech.pdf>, accessed on 24 March 2014.

³⁹see note 15 above; 10.

⁴⁰Brooks (note 18; 4).

structures in place for the sole purpose of minimising their estate duty liability.⁴¹ The question of effectiveness can further be entrenched now that there has been granted roll-over relief between spouses, as it is likely that more individuals will bequeath all their assets to their surviving spouse, who will then have a R 7 million abatement at their time of death. That is, their own abatement of R 3,5 million and the added unused abatement of R 3,5 million from their spouse.

3.4 Effects of Estate Duty on a taxpayer

Estate Duty is a form of capital transfer tax which refers, effectively, to a tax on wealth.⁴² It is levied on the estate of a person who is ordinarily resident in South Africa as at the date of death.⁴³ As per section 4(2)(2) of the Estate Duty Act, estate duty shall be charged upon the dutiable amount of the estate. To determine net value, allowable deductions as per section 4 must also be deducted from the value of the property and deemed property in section 3. Further there must be deducted an amount of R 3,5 million from the net value of the estate, as determined in accordance with section 4A. As from January 2010, the portion of the abatement amount that is unutilized by the first-dying spouse will be rolled-over to the surviving spouse. Effectively, this could mean that the surviving spouse has a abatement of R 7 million available to him or her at death.⁴⁴ Thus, a dutiable estate comprises all the property of the deceased as at the date of death, plus all deemed property as of the date of death, less allowable deductions and less the abatement amount. It is generally the executor of the estate that is liable for the estate duty, as a representative of the deceased estate. Further, the income received by the executor of a deceased estate will be taxed either in the hands of the heirs or legatees or in the estate.⁴⁵ The estate is taxed on income unless the heirs or legatees are ascertained.⁴⁶ Section 25 of the Act only deals with amounts

⁴¹B Ger 'Time for Estate Duty to go?' (2012) *De Rebus*, available at http://www.myvirtualpaper.com/doc/derebus/de_rebus_may_2012/2012041801/61.html#60, accessed on 27 February 2014, at 59-60.

⁴²Katz (note 7 above).

⁴³Section 2 of the Estate Duty Act.

⁴⁴Section 4A(2) of the Estate Duty Act.

⁴⁵Section 25 of the Income Tax Act.

⁴⁶P Haupt *Notes on South African Income Tax* 32 ed (2013) 792.

received by or accrued to the executor of the deceased estate, not with those paid directly to the beneficiary.⁴⁷

3.5 Conclusion

Before the current legislation, South Africa had a series of death duties imposed on individuals, in the form of succession duties, death duties and inheritance duties. Estate duty was then enacted in 1955 to create consistency and to form an all-encompassing tax at the time of death. It was introduced seemingly for the purposes of equity and fairness. It is levied upon the dutiable amount of the estate, at a rate of 20%. One of the latest developments is the roll-over relief granted between spouses. This, coupled with estate-planning mechanisms, questions the effectiveness of this tax.

Further, following the discussion in chapters 2 and 3 above, it is seen that estate duty operates together with CGT at death, creating an avenue for double taxation. This phenomenon will be explored in more detail in the succeeding chapters.

⁴⁷ibid 793.

Chapter Four

The Overlaps in the Operation of CGT and Estate Duty

4.1 Introduction

CGT is not a separate tax, but rather forms part of income tax. It is governed by the Eighth Schedule of the Income Tax Act.⁴⁸ The inclusion rate in determining the taxable capital gain is 33.3%.⁴⁹ The liability for CGT arises once there has been a disposal or a deemed disposal. For emphasis, and clarity, the definition of 'disposal' is repeated here. Paragraph 1 of the Eighth Schedule defines the term 'disposal' as "an event, act, forbearance or operation of law envisaged in paragraph 11 or an event, act, forbearance or operation of law which is in terms of this Schedule treated as the disposal of an asset". Events that trigger CGT, and which are regarded as disposals, include a donation of an asset, the sale of an asset or death. Therefore, CGT is payable on the death of an individual (see Chapter Two for detailed discussion of CGT).

Estate Duty is a separate tax governed by the Estate Duty Act⁵⁰ and is levied and collected from the estate of every person who dies after the date of enactment. It is levied on the dutiable amount of the estate⁵¹ at the current rate of 20%⁵² (see Chapter Three for detailed discussion of Estate Duty).

The interface between these taxes appears to occur at death. This is because death constitutes a disposal for CGT purposes,⁵³ and estate duty is also levied on the deceased estate. The death of a person triggers a deemed disposal for CGT purposes and therefore it impacts the liquidity of the deceased estate, together with the estate duty.⁵⁴ Although CGT is imposed on the appreciation in the value of

⁴⁸58 of 1962

⁴⁹SARS (note 4 above; 5).

⁵⁰Act 45 of 1955.

⁵¹s 2 of the Estate Duty Act.

⁵²First Schedule of the Estate Duty Act.

⁵³Paragraph 40 of the Eighth Schedule.

⁵⁴D M Davis, C Beneke & R D Jooste *Estate Planning* available at [http://butterworths.ukzn.ac.za.ezproxy.ukzn.ac.za:2048/nxt/gateway.dll/xjxj/4e/bga/hga/r0fe?f=templates\\$fn=default.htm\\$vid=myInb:10.1048/enu](http://butterworths.ukzn.ac.za.ezproxy.ukzn.ac.za:2048/nxt/gateway.dll/xjxj/4e/bga/hga/r0fe?f=templates$fn=default.htm$vid=myInb:10.1048/enu), accessed on 17 February 2014.

the assets, whereas estate duty taxes the transfer of wealth, there is still double taxation on some portion of the same assets.⁵⁵

4.2 Transactions where CGT operates

The Eighth Schedule deals with capital gains and losses on disposal of an asset, but there is no specific section that indicates whether the gain is capital or revenue in nature.⁵⁶ It must therefore first be ascertained, using normal tax principles, whether the disposal is revenue in nature. If it is then the gain or loss will be subject to normal tax and not CGT.⁵⁷

As per paragraph 2 of the Eighth Schedule, the capital gains that are taxed are those derived from assets that are disposed of on or after 1 October 2001. In order to calculate a capital gain or loss, four requirements must be met:⁵⁸

1. There must be an asset;
2. There must be a disposal;
3. There must be an ascertained base cost; and
4. The proceeds on disposal must be determined.

The following illustrates the method of determining the taxable capital gain to be included in taxable income.⁵⁹

The Eighth Schedule

- Proceeds *less* Base Cost *equals* Capital Gain/Loss;
- Capital Gain/Loss *less* Annual Exclusion *equals* Aggregate Capital Gain/Loss

⁵⁵Ger (note 41 above; 59-60).

⁵⁶A Koekemoer 'Capital Gains Tax (CGT)' in Stiglingh, M...et al (15 ed) *Silke: South African Income Tax* (2013) 872.

⁵⁷ibid.

⁵⁸ibid 874.

⁵⁹Adapted from A Koekemoer 'Capital Gains Tax (CGT)' in Stiglingh, M...et al (16ed) *Silke: South African Income Tax* (2014) 875.

- Aggregate Capital Gain/Loss *less* Previous Assessed Loss *equals* Net Capital Gain
- Net Capital Gain *multiplied by* Inclusion Rate *equals* Taxable Capital Gain.

The Income Tax Act

- Gross Income *less* Exempt Income *equals* Income
- Income *less* Deductions *plus* Taxable Capital Gain *less* Section 18 & 18A Deductions *equals* Taxable Income
- Taxable Income *multiplied by* Rates of Tax *less* rebates *equals* Normal Tax Payable

Therefore, there will be a CGT liability, and an application of the Eighth Schedule, in any circumstance where the four requirements as mentioned above, are fulfilled and where the disposal is not revenue in nature.

I draw on several examples here below to illustrate how a CGT liability arises.

Example 1 below is derived from various scenarios described in the literature.

Example 1:

Cappelo realises a capital gain of R 80 000 on the sale of his holiday beach home, and a loss of R 20 000 on an investment portfolio of shares. During the same year of assessment his cumulative taxable income amounts to R 250 000. Cappelo further has an assessed capital loss of R 5000 from the previous year of assessment. Using the method illustrated above, his taxable capital gain and taxable income is as follows:

| | |
|--|------------------|
| <i>Taxable Capital Gain</i> | |
| Capital gain on the sale of holiday home..... | R 80 000 |
| Capital loss on shares..... | R (20 000) |
| Sum of capital gains and losses..... | R 60 000 |
| Less: Annual Exclusion..... | R (30 000) |
| Aggregate capital gain..... | R 30 000 |
| Less: Assessed capital loss (previous year)..... | R (5 000) |
| Net Capital Gain..... | R 25 000 |
| | |
| Taxable capital gain (@ 33.3%)..... | <u>R 8 325</u> |
| <i>Taxable income</i> | |
| Other taxable income..... | R 250 000 |
| Taxable capital gain..... | R 8 325 |
| Taxable Income..... | <u>R 258 325</u> |

4.3 Transactions where Estate Duty operates

Estate Duty is levied on the estate of the deceased person to tax the transfer of wealth from the deceased estate to the beneficiaries.⁶⁰ Estate duty is payable at a rate of 20% of the dutiable amount of the estate, and only if the net value of the estate exceeds R 3,5 million, as an abatement equal to this amount may be deducted from the net value when determining the dutiable amount.⁶¹

The steps to be taken in calculating whether estate duty is payable are the following:⁶²

- Determine the gross value of the estate which includes all property owned by the deceased at the date of his death, and all property deemed to be property.⁶³
- Deduct amounts allowed as deductions from the gross value of the estate in terms of section 4 of the Estate Duty Act. This will be the net value.

⁶⁰R Oosthuizen 'Estate Duty' in Stiglingh, M...et al (16 ed) *Silke: South African Income Tax* (2014) 1002.

⁶¹Section 4A of the Estate Duty Act.

⁶²Oosthuizen (note 60 above; 1003).

⁶³Section 3 of the Estate Duty Act.

- Deduct the R 3,5 million abatement from the net value.⁶⁴ This amount can be up to R 7 million, considering the roll-over provision in the section. The amount arrived at is the dutiable amount of the estate.
- Apply the rate of 20% to the dutiable amount to calculate estate duty payable.⁶⁵
- Allowable rebates may then be subtracted from the estate duty payable amount.

The Financial Planning Institute of Southern Africa (2012)⁶⁶ provides the following example illustrating how Estate Duty is calculated.

| | |
|---|------------------|
| Example 2: | |
| Princess passed away two years after Prince. Prince, on his death bequeathed R500 000 to his son and the residue to his spouse, Princess. The gross value of Prince's estate was R5 000 000. Princess's assets when she passed away was R7 500 000. Calculate the estate duty of both the respective estates. In applying the method described above: | |
| <i>Prince's Estate</i> | |
| Gross value of the estate..... | R 5 000 000 |
| Allowable deductions (s 4(q) - amounts to spouses)..... | R 4 500 000 |
| Net estate..... | R 500 000 |
| Section 4A abatement..... | R 500 000 |
| Dutiable estate..... | R 0 |
| Estate Duty payable..... | <u>R 0</u> |
| <i>Princess's Estate</i> | |
| Gross value of the estate..... | R 7 500 000 |
| Allowable deductions..... | R 0 |
| Net estate..... | R 7 500 000 |
| Section 4A abatement..... | R 6 500 000* |
| *(Roll-over relief section 4A(2)) | |
| Dutiable estate..... | R 1 000 000 |
| Estate duty @ 20%..... | <u>R 200 000</u> |

⁶⁴Section 4A of the Estate Duty Act.

⁶⁵Section 2(2) and the First Schedule to the Estate Duty Act.

⁶⁶'Changing Mindsets' (June 2012) *Financial Planning Institute of Southern Africa* available at http://www.mcatv.co.za/files/Download/Estate%20Planning_Errol%20Meyer.pdf, accessed on 23 November 2014.

4.4 Illustration of where both taxes operate in one transaction

Estate duty overlaps in many ways with CGT. In terms of the current legislation, both CGT and estate duty are levied at death. Since the implementation of CGT in October 2001, assets that an individual owns are deemed to have been disposed of at their market value and CGT may be imposed on the gain made by this deemed disposal.⁶⁷ Estate duty is then also levied on the transfer of wealth. It can be argued that the CGT liability would decrease the dutiable amount of the estate as a debt owing by the deceased but this does not in itself detract from the fact that there is still double taxation on at least some portion of the same assets.

The following examples are an illustration of the double taxation:

Example 3 below is extracted from Ger (2012).

Example 3:

X has an asset with a market value of R 1 million on the date of his death. He bought this asset for R 600 000. Let us assume the abatement and the annual exclusions have been exhausted and that X is taxed at the maximum marginal rate.

CGT liability

| | |
|-------------------------------------|-----------------|
| Proceeds..... | R 1 000 000 |
| Less: base cost..... | R 600 000 |
| Net capital gain..... | R 400 000 |
| CGT @ effective rate of 13.33%..... | <u>R 53 320</u> |

Estate Duty liability

| | |
|-------------------------|------------------|
| Dutiable amount..... | R 1 000 000 |
| Estate duty at 20%..... | <u>R 200 000</u> |

The total tax on the asset is R 253 320.

⁶⁷Ger (note 41 above; 59-60).

Example 4:

A, a widower with no children or liabilities, dies after 1 October 2001. His personal marginal income tax rate for the year of his demise is 40%. His assets consisted of the house in which he resided during his lifetime, valued at R750 000; a motorcar valued at R200 000; personal assets valued at R650 000; and a seaside property valued at date of death at R4 500 000 and which had been purchased for R1 000 000.

His CGT and Estate Duty liabilities would be as follows:

The primary residence, motorcar and other personal use items are excluded

CGT liability

| | |
|--|------------------|
| Proceeds..... | R 4 500 000 |
| Less base cost..... | R 1 000 000 |
| Capital gain..... | R 3 500 000 |
| Less annual exclusion (year of death)..... | R 300 000 |
| Net capital gain..... | R 3 200 000 |
| CGT at effective rate of 13.33%..... | <u>R 416 000</u> |

Estate duty liability

| | |
|----------------------------|------------------|
| Gross value of estate..... | R 6 100 000 |
| Less CGT(s 4)..... | R 416 000 |
| Net estate..... | R 5 684 000 |
| Less abatement..... | R 3 500 000 |
| Dutiable amount..... | R 2 184 000 |
| Estate duty @ 20%..... | <u>R 436 800</u> |

The total tax on the assets is R 852 800.

The above illustrations depict the individual being taxed twice on the increase in the value of the asset, that is, the appreciation of the value of the asset and the seaside property, respectively.

4.5 Conclusion

In light of the above examples and explanations on the calculations of CGT and Estate Duty, it is apparent that the overlap between the two taxes occurs at death and, specifically, on the appreciation of the value of an asset. The effect of this on the taxpayer will be explored in more detail in the succeeding chapters.

Chapter Five

The Resultant Double Tax Effect of the Overlap Between CGT and Estate Duty

5.1 Introduction

As alluded to in the preceding chapter, the overlap between CGT and Estate Duty appears to occur at death. This is because death constitutes a deemed disposal for CGT purposes,⁶⁸ and estate duty is also levied on the deceased estate. Although CGT is imposed on the appreciation in the value of the assets, and whereas estate duty taxes the transfer of wealth, there is, as shown in chapter four, still double taxation on certain parts of the same assets.⁶⁹ This chapter seeks to explore the effect of this double taxation on the taxpayer.

5.2 Analysis of double tax effect on the estate

There are certain assets in a deceased estate that are excluded from CGT. These include:

- Personal-use assets;⁷⁰
- Assets accruing to the surviving spouse;⁷¹
- Assets bequeathed to approved public benefit organisations;⁷²
- Proceeds from life insurance policies;⁷³
- Interests in pension, provident or retirement annuity funds;⁷⁴
- The first R 2 million on a primary residence;⁷⁵
- Currency, except gold or platinum coins.⁷⁶

⁶⁸Paragraph 40 of the Eighth Schedule.

⁶⁹Ger (note 41 above; 59-60).

⁷⁰Paragraph 53 of the Eighth Schedule.

⁷¹Paragraph 67 of the Eighth Schedule.

⁷²Paragraph 62 of the Eighth Schedule.

⁷³Paragraph 55 of the Eighth Schedule.

⁷⁴Paragraph 54 of the Eighth Schedule.

⁷⁵Paragraph 45(1)(b) of the Eighth Schedule.

⁷⁶The definition of 'asset' in paragraph 1 of the Eighth Schedule.

At death, CGT is activated through a deemed disposal. The deceased is deemed to have disposed of all his assets to the estate at a cost equal to market value at the time of death.⁷⁷ Paragraph 40(1A)(a) states that if any asset of a deceased person is transferred directly to the estate, the estate is treated as having acquired the asset from the deceased at a cost equal to market value of that asset as at the date of death of the deceased. This amount is treated as the expenditure, or base cost, and may be increased by further expenditure incurred by the executor. The estate has nil CGT liability because in terms of par 40(2), the proceeds are deemed to be equal to the base cost if distributed to an heir or legatee, and the base cost, according to par 40(1A)(a), is the market value upon death. This results in a taxable capital gain of zero. Further, assets to spouses are specifically excluded from disposal upon death, as per par 40(1). There is therefore only estate duty payable and there is no double tax effect here.

However, there are liabilities of the deceased that must be settled by the executor. These liabilities include CGT that may become payable on his death. It is also imperative to avoid liquidity problems on the death of the deceased. The planner should estimate liability for CGT and estate duty and prepare accordingly so that assets do not have to be sold to settle these debts.⁷⁸

5.3 Analysis of double tax effect on the beneficiaries

According to paragraph 40(1A)(b), if an asset of a deceased person is transferred directly to an heir or legatee of the deceased, the heir or legatee is treated as having acquired the asset from the deceased at a cost equal to market value of that asset at the date of death of the deceased. Paragraph 40(2) deals with the CGT treatment of assets disposed of by the executor to an heir or legatee (other than the surviving spouse). In essence, it is provided that the estate is treated as having disposed of the assets for proceeds equal to the base cost (market value as at the date of death), and the heir or legatee will be deemed to have acquired the asset at a cost equal to the base cost to the estate. In the hands of the heir or legatee, this amount must be treated as expenditure actually incurred in order to

⁷⁷ Paragraph 40 of the Eighth Schedule.

⁷⁸ R de Swardt 'Estate Planning' in M Stiglingh...et al *Silke: South African Income Tax* 16 ed (2014) 1029.

ascertain the base cost. When the beneficiary eventually disposes of the asset they will pay CGT on the portion of growth from the time of death to the time of eventual disposal, that is with the valuation of the deemed base cost. However, even though the CGT liability will be less, there is still double tax on the portion of the asset that grew as it would have been subject to estate duty in the estate.

5.4 Analysis of CGT effect on the spouse ("roll-over relief")

Paragraph 67 provides a form of 'roll-over relief' in respect of disposals between spouses. Any capital gain or loss in respect of the disposal of an asset to the spouse must be disregarded. In terms of par 67(1), the surviving spouse is treated as having acquired the asset on the same date as the deceased and for an amount equal to the base cost expenditure of the deceased prior to disposal. Therefore, any capital gain or loss that is made by the surviving spouse on the subsequent disposal of the assets must be determined in accordance with the deceased's base cost. The higher the growth of the asset, the higher the CGT liability. This means therefore that although there was roll-over relief at the time of death of the transferor, when the transferee disposes of the asset he or she will be liable for CGT on the growth of the asset as at the date it was acquired by the transferor, and at that base cost. However, in respect of the double tax effect on these assets, there is only a double taxation if the assets are disposed of due to the subsequent death of the transferee. It is at this point that there will be CGT and estate duty on those assets. If, however, the transferee disposes of the asset by sale or donation, he or she will only be liable for CGT, not for estate duty.

5.5 Analysis of double tax effect on a transaction holistically

When analysing the breakdown of CGT and estate duty on the different parties and entities as seen above, there appears to be little avenue for double taxation. However, let us look at the transaction holistically.

As noted in chapter five, estate duty overlaps in many ways with CGT. In terms of the current legislation, both CGT and estate duty are levied at death. Since the implementation of CGT in October 2001, assets that an individual owns are

deemed to have been disposed of at their market value and CGT may be imposed on the gain made by this deemed disposal.⁷⁹ Estate duty is then also levied on the transfer of wealth from the deceased to the deceased estate, heirs or legatees. It can be argued that the CGT liability would decrease the dutiable amount of the estate as a debt owing by the deceased but this does not in itself detract from the fact that there is still double taxation on at least some portion of the same assets.

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

5.6 Conclusion

As seen in the above discussion, certain transactions incur double tax while others do not, based on the interpretation and implementation of the Income Tax Act and the Estate Duty Act. Spouses may escape liability for both taxes, but this is incumbent on the way they deal with assets left to them by the first-dying spouse. In other instances, as with beneficiaries, or with the transaction as a whole, it is not possible to escape the double tax net. The next chapter explores the means by which current legislation, if at all, mitigates the double tax effect.

⁷⁹Ger (note 41 above; 59-60).

Chapter Six

The Current Means of Mitigating the Double Tax Effect

6.1 Introduction

It has been illustrated in the preceding chapters that there is an avenue for double taxation on at least some portion of the same assets. Having established this, it is important to then ascertain how, and to what extent, the legislation addresses this issue of double taxation. This is the focal point of this chapter.

6.2 Examination of the Current Statutory Provisions

6.2.1 Increase in the abatement amount

From 1955, with the promulgation of the Estate Duty Act,⁸⁰ there have been abatements granted to the deceased estate of an individual, in order to alleviate the estate duty liability. From 1988, prior to the implementation of CGT, the abatement amount was R 1 million.⁸¹ When CGT came into operation in 2001, this abatement amount was increased to R 1.5 million.⁸² In 2006, this amount was again increased to R 2.5 million.⁸³ Finally in 2007, and as is the current position, the abatement is R 3.5 million as per section 4A of the Estate Duty Act.

6.2.2 Decrease in estate duty rate

The rates of estate duty fluctuated for many years after its implementation. When, in 1988, the personal abatements were abolished in favour of a single abatement as mentioned in 5.2.1 above, the rate at which estate duty was levied stabilised to 15%. In 1996 this rate was drastically increased to 25% and subsequently

⁸⁰45 of 1955.

⁸¹Bornman (note 35; 11).

⁸²ibid.

⁸³ibid.

decreased to 20% with the promulgation of CGT in 2001.⁸⁴ The rate at which estate duty is levied is still 20%.⁸⁵

6.2.3 Increase in CGT rate

At its inception, CGT was effected at an inclusionary rate of 25%. This means that 25% of the capital gain or loss was included in the taxable income. This, in turn, meant that an individual who was taxed at the maximum bracket for income tax purposes (40%), would be liable for an effective rate of 10% on the taxable capital gain. For companies, the inclusionary rate was 50%. In 2012, the inclusionary rate for individuals and special trusts increased from 25% to 33.3%, thereby increasing the effective rate to 13,33%. For companies the inclusionary rate was increased to 66.67%.

6.2.4 Roll-over relief

As from January 2010, the portion of the abatement amount that is unutilized by the first-dying spouse will be rolled-over to the surviving spouse. Effectively, this could mean that the surviving spouse has an abatement of R 7 million available to him or her at death.⁸⁶ Further, any assets left to the surviving spouse by the first-dying spouse is exempt from estate duty⁸⁷ and CGT.⁸⁸

6.2.5 Increase in annual exclusion

In each year of assessment there is an annual amount of the total capital gains and losses for the year that is excluded from CGT.⁸⁹ In the first few years of its implementation the annual exclusion amount was R 10 000. From 2007 until 2012

⁸⁴ibid.

⁸⁵First Schedule of the Estate Duty Act.

⁸⁶Section 4A(2) of the Estate Duty Act.

⁸⁷Section 4(q) of the Estate Duty Act.

⁸⁸Paragraph 67(1) of the Eighth Schedule to the Income Tax Act 58 of 1962.

⁸⁹SARS (note 4 above; 4).

this amount increased annually until it stood at R 20 000 in 2012.⁹⁰ This amount was then finally increased to R 30 000 in 2013, and currently stands as same.⁹¹

6.2.6 Increase in annual exclusion in year of death

The amount mentioned in 6.2.5 above is increased in the year of death. From 2001 to 2006, the exclusion amount in the year of death was R 50 000. This was increased to R 100 000 in 2007 and then again increased to R 120 000 from the year 2008 to 2011. In 2012 the annual exclusion in the year of death stood at R 200 000.⁹² In 2013, the amount was finally increased to R 300 000.⁹³ This is the current position.

6.3 The Mitigating Effect of the Legislation

Now that the statutory provisions have been outlined in 6.2 above, we will examine whether these provisions mitigate the effect of the double tax, and to what extent. In order to illustrate the effect of the double tax, we will make use of a scenario and apply the different rates and abatements to the scenario. This will show us comparatively, whether the taxpayers are disadvantaged now with the application of both CGT and estate duty, or whether the changes in fiscal policies have lessened and mitigated the double tax burden sufficiently.

The scenario is as follows:

X dies. In his estate he leaves only a holiday beach flat in Ballito to a close family friend. X purchased the flat in 1980 for R 500 000. It is now realised at a value of R 4,5 million. For practical purposes, it must be assumed in each case that the rates are operational at the current date and value of the flat.

We will apply and compare the following rates:

⁹⁰ibid.

⁹¹Paragraph 5(1) of the Eighth Schedule.

⁹²SARS (note 4 above; 4).

⁹³Paragraph 5(2) of the Eighth Schedule.

1. When Estate Duty operated on its own, before the implementation of CGT. There are two periods to examine.

1.1) 1988 - 1996: The abatement was R 1 million and the rate of estate duty was 15%;

1.2) 1996 - 2001: The abatement was R 1 million and the rate of estate duty was 25%.

2. When CGT came into effect and operated together with Estate Duty. There are, here, also two periods to examine.

2.1) 2001: CGT rate is 10%, annual exclusion in year of death is R 50 000, abatement is R 1 million, and estate duty rate is 20%;

2.2) 2014: CGT rate is 13.3%, annual exclusion in year of death is R 300 000, abatement is R 3,5 million, and estate duty rate is 20%.

Calculations:

1.1.

Estate Duty payable:

4 500 000 (total estate) - 1 000 000 (abatement) = 3 500 000

3 500 000 x 15% (rate) = 525 000

Total tax payable is R 525 000.

1.2.

Estate Duty payable:

4 500 000 - 1 000 000 = 3 500 000

3 500 000 x 25% (rate) = 875 000

Total tax payable is R 875 000.

2.1.

CGT payable:

4 500 000 (proceeds) - 500 000 (base cost) = 4 000 000

4 000 000 - 50 000 (annual exclusion) = 3 950 000

3 950 000 x 10% (rate) = 395 000

Estate Duty payable:

4 500 000 (total estate) - 1 000 000 (abatement) = 3 500 000

3 500 000 x 20% (rate) = 700 000

Total tax payable is 395 000 + 700 000 = R 1 095 000

2.2.

CGT payable:

4 500 000 (proceeds) - 500 000 (base cost) = 4 000 000

4 000 000 - 300 000 (annual exclusion) = 3 700 000

3 700 000 x 13.33% (rate) = 493 210

Estate Duty payable:

4 500 000 - 3 500 000 (abatement) = 1 000 000

1 000 000 x 20% (rate) = 200 000

Total tax payable is 493 210 + 200 000 = R 693 210

Although the scenario above is a fundamental one, the above calculations show us that the lowest tax burden on the taxpayer existed between 1988 and 1996 when only estate duty was due on a deceased estate. This held true even though the abatement for determining the dutiable value of the estate was R 2,5 million less than it is currently. Increasing the estate duty rate in 1996 to 25% caused an increase of R 350 000 in estate duty liability. However, even this sharp increase in liability did not compare to the taxes owed in 2001. The implementation of CGT, even coupled with the decrease in the estate duty rate and the CGT annual exclusion, caused a further R 220 000 increase in tax liability on a deceased estate.

Currently, the tax liability would be R 693 210. Although this has drastically been reduced since the implementation of CGT in 2001, it still includes a portion of double taxation, and the taxpayer bears a higher tax burden. In explanation, if only

CGT were to be paid, the liability would be R 493 210; and if only estate duty were to be paid, the liability would be a mere R 200 000. Although the amount is higher as a CGT liability than as an estate duty liability, it is still significantly lower than when only estate duty was payable, at its lowest rate of 15%.

It can be argued that this may not always hold true in different circumstances. One such example would be that between spouses. This is because of provisions such as section 4(q) of the Estate Duty Act, which deems bequests between spouses to be exempt from estate duty; as well as section 4A(2) of the same act, which allows for the unused portion of the abatement of the first-dying spouse to be added to the R 3,5 million abatement of the surviving spouse. This latter provision therefore allows the second-dying spouse a possible abatement of R 7 million. In many circumstances this would render an estate duty liability of nil and therefore there would be no double tax. However, this does not detract from the fact that estates over R 7 million, and also those where the spouse is not the beneficiary or the sole beneficiary, will be subject to double taxation on the application of both CGT and estate duty.

Another mitigating factor would be the list of assets that are excluded from the CGT net. These items are:

- Personal-use assets;⁹⁴
- Assets accruing to the surviving spouse;⁹⁵
- Assets bequeathed to approved public benefit organisations;⁹⁶
- Proceeds from life insurance policies;⁹⁷
- Interests in pension, provident or retirement annuity funds;⁹⁸
- The first R 2 million on a primary residence;⁹⁹
- Currency, except gold or platinum coins.¹⁰⁰

⁹⁴Paragraph 53 of the Eighth Schedule.

⁹⁵Paragraph 67 of the Eighth Schedule.

⁹⁶Paragraph 62 of the Eighth Schedule.

⁹⁷Paragraph 55 of the Eighth Schedule.

⁹⁸Paragraph 54 of the Eighth Schedule.

⁹⁹Paragraph 45(1)(b) of the Eighth Schedule.

¹⁰⁰The definition of 'asset' in paragraph 1 of the Eighth Schedule.

The effect of the exclusion from CGT is simply a total reduction on the overall taxable capital gain. This assists in lessening the CGT liability, and subsequently, the total liability after estate duty is added.

Looking at all of the above information, there is evidence of mitigating the double tax effect. The extent of the mitigation is, however, incomplete because there still exists situations in which a taxpayer will bear a high burden of taxation, in direct consequence of having both CGT and estate duty operate on a single transaction.

6.4 Conclusion

In summary, what the above data depicts is an inclination toward lessening the tax burden on taxpayers, due to the effects of implementing both CGT and estate duty. However, even though the data shows a move toward mitigation, the avenue leading to double taxation still exists. The next chapter seeks to analyse means of possibly further mitigating the double tax effect. The chapter will explore a few alternatives and will ascertain whether each of those methods will succeed or not.

Chapter Seven

Suggestions to Mitigate or Eradicate the Double Tax Effect

7.1 Introduction

The foregoing chapters have established that an interface exists between CGT and Estate Duty, and the result of this interface is double taxation. Chapter six illustrated the current legislative means available to mitigate the effect of this phenomenon on the taxpayer. It was further established that even though there is mitigation available, the double taxation still exists. This chapter aims to explore other alternatives, with the objective of further mitigating, and possibly eradicating, the double tax effect.

7.2 Abolishing Estate Duty

In the 2010 budget proposal¹⁰¹ it was promised by the Minister of Finance that estate duty would be reviewed. The Minister acknowledged the fact that both Estate Duty and CGT were levied on death, giving rise to the perception that there is a double tax.¹⁰² The Minister, in his proposal, conceded that "estate duty raised limited revenue and was cumbersome to administer".¹⁰³ He further conceded that "its efficacy is questionable", justifying this statement by acknowledging that wealthy individuals escape estate duty liability through tools such as trusts.¹⁰⁴ According to an article in Business Day Live,¹⁰⁵ the South African Revenue Services (SARS) spokesman said that SARS was anticipating collecting R 285.9 billion income tax from individuals and R 167.8 billion profit tax from companies, whereas the estate duties to be collected would amount to a mere R 1.2 billion.

¹⁰¹ 'Budget 2010/2011 Tax Proposals', available at <http://www.treasury.gov.za/documents/national%20budget/2010/guides/Budget%20Tax%20Proposals.pdf>, accessed on 24 July 2014.

¹⁰² *ibid.*

¹⁰³ *ibid* 25.

¹⁰⁴ *ibid.*

¹⁰⁵ A Visser 'The departed 'taxed more than ever before'' (5 February 2013) available at <http://www.bdlive.co.za/business/2013/02/05/the-departed-taxed-more-than-ever-before>, accessed on 17 April 2014.

Limited revenue and cumbersome administration are, however, just a few reasons why experts are calling for the abolishment of Estate Duty.

The South African Institute of Chartered Accountants (SAICA) National Tax Committee has made detailed submissions in relation to Estate Duty in South Africa, with the abolishment of Estate Duty being the preferred approach.¹⁰⁶ It is stated that neither the government nor any of the commissions intended, consciously, to apply to taxes on death. It is further submitted that the Katz Commission¹⁰⁷ and the Margo Commission both debated whether a wealth tax to replace estate duty. The Margo Commission¹⁰⁸ was against the introduction of CGT¹⁰⁹ but when deciding on the retention of Estate Duty, the Commission recommended that a capital transfer tax to replace both Estate Duty and Donations Tax.¹¹⁰ It is noted¹¹¹ that South Africa is the only country that levies both CGT and Estate Duty on death.

The Committee¹¹² submitted numerous reasons why CGT should be retained and estate duty abolished. The following list is not exhaustive:

- CGT is observed internationally;
- It covers a range of events that are treated as disposals and therefore has a wide tax base;
- CGT is relatively easy to collect, as it forms part of income tax;
- CGT does not provide for a deduction of debts thereby increasing the amount to be taxed, unlike Estate Duty;
- CGT is in line with the tax principle of equity, as those with a higher income tax bracket pay a higher effective rate of CGT;

¹⁰⁶The document referred to, and which is the basis for the preceding arguments on the alternatives to estate duty, was compiled by the South African Institute of Chartered Accountants (SAICA) National Tax Committee and is addressed to the National Treasury. It is titled "Submission Proposals: Estate Duty". This is an unpublished document and is therefore not accessible by the public. A copy of this document was emailed to me by a member of SAICA.

¹⁰⁷Katz (note 7 above).

¹⁰⁸CS Margo *Commission of Inquiry into the Tax Structure of the Republic of South Africa*, RP34/1987 (Pretoria: The Government Printer 1987), (Margo Commission).

¹⁰⁹Ibid 224.

¹¹⁰Ibid 322.

¹¹¹Ger (note 41 above; 59-60).

¹¹²SAICA (note 106 above).

- Administratively, double-tax treaties will not need re-negotiating as CGT is already covered therein; and
- Anti-avoidance provisions already exist in the main act.

The arguments expounded above pose as an ideal solution to the double tax issue, but we must also examine and address the obstacles to the abolition of estate duty. One such obstacle will be that the CGT collections on death will not match those previously obtained by Estate Duty. Another argument against abolition of Estate Duty will be that CGT does not tax life insurance, personal-use assets, or currency and therefore there is significant loss of revenue here. SAICA, in their submissions, have pre-empted these arguments for Estate Duty and have responded with suggestions to deal with the obstacles accordingly.

Firstly, in respect of the lower revenue collection at death, one must not forget that CGT operates throughout the duration of an individual's lifetime. That is, CGT is levied upon any capital gain made on any disposal throughout a taxpayer's lifetime, and not just at death. This would include disposals to trusts.

Secondly, in respect of life insurance, the CGT exemption can be removed, included as a disposal on death and treated in the same way as in the Estate Duty Act, where exceptions are made.¹¹³

Thirdly, in respect of personal-use assets, SAICA has proposed an exclusion value, so as to remove the administrative burden of locating and valuing small assets. The exclusion value is proposed at R 50 000, but assets that amount to more than this value will be included in the CGT calculation. The treatment of personal-use assets in this manner ensures that there is no loss of revenue, and minimises the administrative task of valuing small personal-use assets.

Fourthly, in respect of currency, SAICA have not made any affirmative suggestions. Currency is not included in the definition of 'assets' in the Eighth

¹¹³Section 3(a) of the Estate Duty Act 45 of 1955.

Schedule of the Income Tax Act.¹¹⁴ Therefore, when money is transferred from one person to another, the recipient does not pay CGT on the amount. This amount would therefore only be subject to Donations Tax under the current tax regime. However, at death, Estate Duty would be levied on the cash in the possession of the deceased. Therefore, I submit that CGT should operate on currency in the way that Donations Tax does, but, bearing in mind that CGT does not allow for deductions for debts, loans, mortgage bonds and allowable expenses, CGT should not apply to currency at death.

A further suggestion, in correspondence with abolishing Estate Duty, would be to broaden the scope of CGT by increasing the inclusionary rate to 40%, in order to make up for the Estate Duty deficit. This would amount to an effective rate of 16% for the highest income bracket, and 7.2% for the lowest income bracket. This, coupled with the lack of any abatements as was the case with Estate Duty, should satisfy the fiscus and ensure that they are not prejudiced by the abolishment of Estate Duty.

Let us consider this last suggestion by means of a calculation:

X dies and has a holiday flat that he purchased for R 500 000, and which is now worth R 4,5 million.

Current CGT liability:

$$4\,500\,000 - 500\,000 = 4\,000\,000$$

$$4\,000\,000 \times 13.33\% = 533\,200$$

Estate Duty liability:

$$4\,500\,000 - 3\,500\,000 = 1\,000\,000$$

$$1\,000\,000 \times 20\% = 200\,000$$

Total tax liability is R 733 200.

¹¹⁴Paragraph 1.

Proposed CGT liability

4 500 000 - 500 000 = 4 000 000

4 000 000 x 16% = R 640 000

The total tax liability is R 640 000.

By abolishing Estate Duty and increasing the effective rates of CGT: the taxpayers save on the double taxation; the fiscus gains on CGT with an increase in the rate; and the fiscus no longer has to contend with abatements and roll-over abatements, whereby up to R 7 million of the estate could be exempt from taxation as the Eighth Schedule merely provides for a CGT roll-over, or deferral, between spouses.¹¹⁵

Further, as stated by SAICA, Estate Duty is administratively easy to abolish, as it is "a one line item on the Liquidation and Distribution Account". It has already been mentioned that CGT is an easy tax to administer because it forms part of Income Tax and is already embedded in the Act, as the Eighth Schedule to the Act.

7.3 Reducing the Estate Duty rate

In 2001 when CGT was introduced Estate Duty decreased from 25% to 20%. However, in 2012 when CGT was increased, the Estate Duty rate remained the same, causing an imbalance.

It is possible to argue that this imbalance is mitigated by the R 3,5 million abatement, as well as by the spousal roll-over, which can effectively reduce an estate by R 7 million.

However, this R 3,5 million abatement was increased from R 2,5 million in 2007, when the CGT effective rate was 10%, and the estate duty rate was 20%. These rates remained unchanged and in 2010, a portable R 3,5 million deduction

¹¹⁵Paragraph 67 of the Eighth Schedule.

between spouses was implemented.¹¹⁶ The rationale behind this roll-over relief was to prevent the need of spouses to effect complex and costly trust mechanisms to preserve their assets.¹¹⁷ It was only in 2012 that the CGT rate increased again, making the effective rate 13,33% for taxpayers in the highest income tax bracket. The actual inclusion rate increased from 25% to 33,33%. It cannot, therefore, successfully be argued that the portable deduction between spouses in 2010 and the abatement increase in 2007, are a mitigating factor for the CGT increase in 2012. The changes to Estate Duty were implemented first, with the objective of addressing the effects of inflation. I submit, however, that the CGT increase in 2012 has cancelled out, or at least significantly diminished, the effect of the R 1 million increase in the abatement in 2007.

This can be illustrated as follows:

X dies. In his estate is an investment property worth R 6 million, which X purchased for R 2,8 million.

In 2007:

CGT liability

6 000 000 (proceeds) - 2 800 000 (base cost) = 3 200 000 (gain)

3 200 000 - 300 000 (exclusion in year of death) = 2 900 000

2 900 000 x 10% (effective rate) = 290 000

Estate Duty liability

6 000 000 (estate) - 3 500 000 (abatement) = 2 500 000

2 500 000 x 20% = 500 000

Total liability is R 790 000.

In 2014:

CGT liability

6 000 000 (proceeds) - 2 800 000 (base cost) = 3 200 000 (gain)

¹¹⁶'Budget 2009/2010 Tax Proposals', available at <http://www.treasury.gov.za/documents/national%20budget/2009/guides/Budget%20Proposals%202009.pdf>, accessed on 17 July 2014, at 23.

¹¹⁷ibid.

3 200 000 - 300 000 (exclusion in year of death) = 2 900 000

2 900 000 x 13,33% (effective rate) = 386 570

Estate Duty liability

6 000 000 (estate) - 3 500 000 (abatement) = 2 500 000

2 500 000 x 20% = 500 000

Total liability is R 886 570.

This basic calculation simply illustrates that since 2007 there has been an increased tax burden of R 96 570 on the taxpayer. This, in turn, means that the portion of the assets that is subject to double taxation has increased.

The South African Institute of Tax Professionals (SAIT) have come out strongly in support of increasing the abatement.¹¹⁸ They make mention of the fact that since 2007 no changes have been made to Estate Duty to alleviate inflation.¹¹⁹ I submit that even though the purpose behind their proposal is to curb inflation, it will have the dual effect of reducing the double tax burden that has become ingrained in our tax system. This increase in abatement, coupled with a decrease in the Estate Duty flat rate, as suggested by Ernest Mazansky, cited in an article in the *Business Day Live*,¹²⁰ will have the combined effect of only the "super rich" paying both CGT and Estate Duty, which will surely drastically mitigate the double tax problem, compared to the current means. The article suggests that for the balance to be adequately restored the rate of Estate Duty should be reduced to 15% or less.

This can be illustrated as follows, using the same example as above:

Current rates:

CGT liability

6 000 000 (proceeds) - 2 800 000 (base cost) = 3 200 000 (gain)

3 200 000 - 300 000 (exclusion in year of death) = 2 900 000

¹¹⁸Call for Comment on the Fiscal Framework and Revenue Proposals: 2014 Budget' (3 March 2014) *South African Institute of Tax Professionals* available at http://c.ymcdn.com/sites/sait.site-ym.com/resource/resmgr/2014_technical_submissions/2014Budget.pdf, accessed on 2 August 2014, at 9.

¹¹⁹ *ibid.*

¹²⁰Visser (note 105 above).

$$2\,900\,000 \times 13,33\% \text{ (effective rate)} = 386\,570$$

Estate Duty liability

$$6\,000\,000 \text{ (estate)} - 3\,500\,000 \text{ (abatement)} = 2\,500\,000$$

$$2\,500\,000 \times 20\% = 500\,000$$

Total liability is R 886 570

Decrease in Estate Duty rate to 15%:

CGT liability

$$6\,000\,000 \text{ (proceeds)} - 2\,800\,000 \text{ (base cost)} = 3\,200\,000 \text{ (gain)}$$

$$3\,200\,000 - 300\,000 \text{ (exclusion in year of death)} = 2\,900\,000$$

$$2\,900\,000 \times 13,33\% \text{ (effective rate)} = 386\,570$$

Estate Duty liability

$$6\,000\,000 \text{ (estate)} - 3\,500\,000 \text{ (abatement)} = 2\,500\,000$$

$$2\,500\,000 \times 15\% = 375\,000$$

Total liability is R 761 570

At this point, simply reducing the Estate Duty rate by 5% will cancel out the effect of the 2012 CGT increase on an individual, and in fact, provide added relief.

If we are to then increase the abatement by R 1 million, as was done from 2006 to 2007:

CGT liability

$$6\,000\,000 \text{ (proceeds)} - 2\,800\,000 \text{ (base cost)} = 3\,200\,000 \text{ (gain)}$$

$$3\,200\,000 - 300\,000 \text{ (exclusion in year of death)} = 2\,900\,000$$

$$2\,900\,000 \times 13,33\% \text{ (effective rate)} = 386\,570$$

Estate Duty liability

$$6\,000\,000 \text{ (estate)} - 4\,500\,000 \text{ (abatement)} = 1\,500\,000$$

$$1\,500\,000 \times 15\% = 225\,000$$

Total liability is R 611 570

The combination of these relief methods, if implemented, will reduce the tax burden by R 275 000 of an individual with an estate higher than R 4,5 million. This means that only a person with an estate of more than R 4,5 million, excluding other deductions and liabilities, will have both Estate Duty and CGT levied on their estates. This has an effect of eradicating the double tax effect for those whose estate is less than R 4,5 million, and reducing the tax on the portion of assets that are subject to both taxes on death.

Therefore, if Estate Duty cannot be abolished this would be a fair and uncomplicated alternative to eradicate in some cases, and further mitigate in others, the double tax effect.

7.4 Removing death as a trigger event for CGT

A further alternative to abolishing estate duty would be to remove 'death' as a trigger event for CGT purposes so that CGT does not apply at all on death.. Effectually, this would be the best alternative to removing the double tax payable by the estate at the time of death.¹²¹

There are two ways this could occur:

First would be to have roll-over relief of CGT for any beneficiary, in the same way as paragraph 67¹²² provides between spouses. The provision states that any capital gain or loss must be disregarded on disposals between spouses. The transferee receives the asset with a base cost equal to that of the transferor. This means that when the surviving spouse finally disposes of the asset, he or she will pay CGT on the full amount, as if he or she were the transferor. If this were implemented between beneficiaries, CGT would not be payable at the time of death, but rather when the asset is finally disposed of by the beneficiary. The problem with this suggestion is that it does not mitigate or eradicate the double tax effect, as it is merely deferred to when the beneficiary finally disposes of the asset. There will still be double tax because estate duty will be paid on the asset when

¹²¹ SAICA (note 106 above).

¹²² Eighth Schedule to the Income Tax Act 58 of 1962.

the transferor dies, and CGT will still be payable on the growth of the asset from the original base cost to the time of final disposition.

A second method would be where Estate Duty is paid on an asset, and that asset is received by the beneficiary at a cost equal to market value as at the date of death. CGT will therefore not be payable on the growth from the time of original acquisition to the date of death, but rather only from the value at the date of death to when the beneficiary finally disposes of the asset. This will reduce the CGT payable on the asset.

To illustrate: John purchases an asset for R 100 000 and when he dies the asset is worth R 400 000. This asset is received by beneficiary Amanda. Five years later Amanda sells the asset for R 600 000.

With the first method, Amanda will pay CGT on R 500 000 (R 600 000 - R 100 000), whereas with the second method she will only pay CGT on R 200 000. This is a reduction of R 300 000 on her CGT liability and can therefore be regarded as a mitigation of the double tax effect.

As per SAICA, it is not uncommon worldwide to not treat death as an event triggering CGT, and many countries defer the CGT until the heir disposes of the asset. However, both taxes still do apply, although not at the same time, and the only option is to then mitigate the effect, as discussed above. I submit, therefore, that it is not viable to have zero CGT applying on an asset that is transferred to a beneficiary when a transferor dies. Even if death is not a trigger event, the sale or other disposal of the asset causes an eventual CGT liability in the hands of the beneficiary. The asset itself is still subject to both Estate Duty, in the estate, and CGT, when ultimately disposed of.

7.5 Implementing an Inheritance Tax in place of Estate Duty

Presently in South Africa there is no tax payable by the heirs who receive an inheritance, and CGT is also not payable by the recipient of an inheritance.¹²³

Let us consider the implication of replacing Estate Duty with an Inheritance Tax. As discussed, Estate Duty is levied on the dutiable amount of the estate before it is disbursed to the beneficiaries. An Inheritance Tax is where the recipient of the wealth pays the tax.¹²⁴ According to the SAICA National Tax Committee submissions,¹²⁵ the replacement of Estate Duty with an Inheritance Tax will not alleviate the double tax issue because in most cases, the tax payable on the inheritance is often deferred until such time as the beneficiary disposes of the asset. This, therefore, simply shifts the levying of a double tax from Estate Duty to Inheritance Tax.

Further, implementing an entirely new tax regime will be administratively cumbersome and complicated. The solution is not in replacing Estate Duty with another tax, but rather in diminishing its effect, or doing away with it altogether.

The notion of implementing an Inheritance Tax is opposed for practical reasons.

7.6 Conclusion

As illustrated in the preceding chapters, there is a double tax imposed on assets on the death of a person. Although CGT seeks to tax the appreciation of wealth and Estate Duty taxes the transfer of all wealth, it has been shown that there is still double tax on some portion of the same wealth because both these taxes affect the same assets.

South Africa has taken steps to assuage the double tax effect since the implementation of CGT in 2001, by initially decreasing the Estate Duty flat rate,

¹²³ 'Tax and Inheritance' *South African Revenue Services* available at <http://www.sars.gov.za/ClientSegments/Individuals/Tax-Stages/Pages/Tax-and-Inheritance.aspx>, accessed on 2 August.

¹²⁴ *ibid.*

¹²⁵ SAICA (note 106 above).

and successively increasing the abatements and CGT annual exclusions, but it has also been noted that these means of relieving the taxpayer have been significantly diminished by the continuous increase in the rates of the taxes levied, and by inflation. The chapters depict an increasing tax burden on the taxpayer's, and it follows that with an increase in the tax rates, there is a consequent increase in the portion of assets on death that are subject to double tax.

This chapter concludes that abolishing estate duty is the only method of completely eradicating the double tax. However, it is possible to further mitigate the double tax effect, if not eradicate, by reducing the estate duty rate and increasing the abatements, or by removing death as a CGT trigger event. It has further been discovered that implementing an Inheritance Tax Model will confront us with the same issues as the present tax regime.

Having concluded the South African tax system analysis, we will now examine the manner in which the United Kingdom and Australia tax death and capital gains. It is important to look to other jurisdictions in order to ascertain where, if at all, our system can improve.

Chapter Eight

Application of Estate Duty and CGT in Foreign Jurisdictions

8.1 Introduction

As noted in 2.3 above, our CGT system was introduced for a number of reasons.¹²⁶ One such purpose was for international benchmarking. Many of South Africa's trading partners enacted CGT many years ago and these jurisdictions accept the 'comprehensive income' concept as the ideal tax base, which means that the total sum of all revenue should be included in income tax, and this includes capital gains.¹²⁷ It was therefore felt that South Africa should advance its tax system in keeping with international practice.

Thus the purpose of this chapter is to examine foreign tax systems and how they operate in respect of estate duties and capital gains tax, with the objective of utilising the employed practices, if required, to ensure that the tax system is South Africa progresses along with international standards.

The two jurisdictions that will be examined are Australia and the United Kingdom. I chose these jurisdictions because, as stated by Williams,¹²⁸ the South African provisions dealing with CGT in the Eighth Schedule of the Income Tax Act¹²⁹ are largely influenced by a number of foreign jurisdictions, most especially Australia and the United Kingdom.

¹²⁶South African Revenue Services (or SARS) *A Comprehensive Guide to Capital Gains Tax* available at <http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-CGT-G01%20-%20Comprehensive%20Guide%20to%20Capital%20Gains%20Tax%20-%20External%20Guide.pdf>, accessed on 2 March 2014, at 1-3; N Brooks, 'Taxing Capital Gains is Good for the Tax System, the Economy and Tax Administration' (26 January 2001), available at <http://www.ftomasek.com/NeilBrooksRevised.pdf>, accessed on 24 March 2014.

¹²⁷see note 15 above; 4.

¹²⁸R C Williams *Capital Gains Tax: A Practitioner's Manual* (2005) 1.

¹²⁹58 of 1962.

8.2 The Australian Tax System

8.2.1 Introduction to Australian Tax Law

Currently, Australia does not impose an Inheritance Tax or a Gift Tax.¹³⁰ There is, however, a Capital Gains Tax that operates on the death of an individual, in certain circumstances.¹³¹

As a point of departure, we will discuss the past application of death duties in Australia. As part of our discussion, we will examine its history, the rationale behind its implementation, and the reasons for its subsequent abolishment.

8.2.2 Estate Taxes

The operational Commonwealth estate tax in Australia was simple. The applicable rate was levied on the net value of the deceased's estate, less any statutory exemption, and less the State death taxes payable.¹³²

8.2.3 History and Development of Estate Taxes

The ensuing historical analysis of death duties in Australia is based largely on a text by Michael Gilding.¹³³ Estate duties were first effected between 1851 in New South Wales and 1895 in Western Australia, and are considered to have been the first direct taxes imposed in Australia.¹³⁴ The Estate Duty Assessment Bill was introduced after World War One, and proposed a progressive tax on estates

¹³⁰ 'International Estate and Inheritance Tax Guide' (2013) *Ernst & Young* available at [http://www.ey.com/Publication/vwLUAssets/2013-international-estate-and-inheritance-tax-guide/\\$FILE/2013-international-estate-and-inheritance-tax-guide.pdf](http://www.ey.com/Publication/vwLUAssets/2013-international-estate-and-inheritance-tax-guide/$FILE/2013-international-estate-and-inheritance-tax-guide.pdf), accessed on 28 July 2014.

¹³¹ *ibid.*

¹³² 'Review of Western Australian State Taxes: Chapter 5: Death Duties and Other Wealth Taxes' (1994) 1(4) *Murdoch University Electronic Journal of Law* (MurUEJL), available at <http://www.austlii.edu.au/au/journals/MurUEJL/1994/23.html>, accessed on 14 October 2014, at 2.

¹³³ Professor Michael Gilding is the Executive Dean of the Faculty of Business and Enterprise at the Swinburne University of Technology in Melbourne, Australia. His conference paper titled "The Abolition of Death Duties in Australia: A Comparative Perspective" was presented at 'Social Causes, Private Lives', the Annual Conference of the Australian Sociological Association (TASA 2010), Sydney, Australia, 06-09 December 2010.

¹³⁴ M Gilding 'The Abolition of Death Duties in Australia: A Comparative Perspective' (2010) available at <http://www.tasa.org.au/uploads/2011/01/Gilding-Michael.pdf>, accessed on 14 October 2014, at 5.

ranging from 1 percent on estates of £1000, to 15 percent on those of £70 000 and above.¹³⁵ The Bill also proposed a two-third concession for widows, children and grandchildren.

The two main justifications propounded by government speakers were, firstly, fiscal in that there was a high demand for revenue and secondly, political, as a means of curbing tax avoidance by the rich.¹³⁶ Although there was wide support for the implementation of Estate taxes, the Liberal Opposition expounded upon why the Bill should not be implemented. Among these reasons were: legal issues in that the rates were excessive by international practice; fiscal issues that overall disputed the need for an estate tax at all; and political issues that the government was using the tax in order to confiscate wealth.¹³⁷ Many Opposition members also believed that the implementation of an estate tax would curb any inflow of capital or investment into Australia.¹³⁸ Since its implementation, and until the early 1940s, the operation of the tax was extended. Loopholes in its operation that allowed for tax evasion were closed, the top rate increased to 20 percent and then further to 27,9 percent, and a progressive gift duty was also introduced.¹³⁹ Following the extension of the tax, the exemptions provided for family members were also extended.¹⁴⁰

It is from the late 1960s that cognizance was given to the inefficiency and unfairness of the collection of estate taxes.¹⁴¹ This is where the argument to abolish death duties began.

One substantial detailing of the abolition of estate taxes in Australia is by Willard H Pedrick.¹⁴² The Death Duty Abolition Movement in Australia began in 1969 with the

¹³⁵ *ibid* 6.

¹³⁶ *ibid*.

¹³⁷ *ibid* 7.

¹³⁸ *ibid*.

¹³⁹ *ibid* 8.

¹⁴⁰ *ibid*.

¹⁴¹ *ibid*.

¹⁴² Mr Pedrick was the Founding Dean of the Arizona State University Law School until 1976, and thereafter a Professor of Law until 1983.

death of Oscar Negus, a Justice of the Supreme Court of Western Australia.¹⁴³ Justice Negus' younger brother, Sydney Negus, had the task of handling the estate affairs and then realised the harsh impact probate duties had, even on relatively modest estates, and the unfair effect on the property left to the surviving spouse.¹⁴⁴ With this realisation as a motivating factor, Sydney Negus set out to have death duties on bequests to widows abolished.¹⁴⁵ By March 1970, the campaign to abolish death and gift duties began, as it is the period where thousands of citizens signed the "Petition Against Probate and Death Duties" organised by Sydney Negus. It was his belief that this cause (to abolish death duties) needed a voice in Parliament, and it is for this reason that he entered the election race as an Independent. He was elected a Senator in 1971, and it is this event that is widely believed to have been the catalyst in the abolition of death duties.¹⁴⁶

The State of Queensland formally endorsed the campaign to abolish death duties in 1971, partly due to the concern of farming groups of the impact of death duties on farms.¹⁴⁷ The Premier of Queensland, in 1975, supported the inter-spousal exemption from transfer taxes, and then in 1976 embraced the movement to totally abolish death duties.¹⁴⁸ By 1977, there was a total abolition of estate and gift duties in Queensland, with an estimated loss of revenue to the state standing at \$25 million.¹⁴⁹ The complete abolition of death duties in the State of Queensland spurred many of the other states into action. The other states followed suit by first exempting inter-spousal transfers, and then abolishing death duties entirely, and by 1982 all the states had abolished death duties.¹⁵⁰ At a Federal level, Parliament adopted a measure to abolish death and gift duties in April 1978.¹⁵¹ At this point, the Labor Party proposed a deferment of the abolition of death duties until an

¹⁴³ W H Pedrick 'Oh to Die Down Under! Abolition of Death and Gift Duties in Australia' (1981) *Western Australian Law Review* available at <http://www.austlii.edu.au/au/journals/UWALawRw/1982/6.pdf>, accessed on 14 October 2014, at 438.

¹⁴⁴ *ibid.*

¹⁴⁵ *ibid.*

¹⁴⁶ *ibid* 439-440.

¹⁴⁷ *ibid* 440.

¹⁴⁸ *ibid* 440-441.

¹⁴⁹ *ibid.*

¹⁵⁰ *ibid* 441-442.

¹⁵¹ *ibid* 443.

alternative tax on capital could be promulgated.¹⁵² This plea was defeated and the abolition of Federal death and gift taxes became effective from 1979.

There is a plethora of reasons for abolishing estate taxes in Australia and an examination of the salient reasons leaves us with the following:

- State death levies operated quite harshly, even on modest estates, and inflation intensified this position due to the low exemption rates allowed (as low as \$20 000 in the 1970s in some states). Further, these factors, coupled with the lack of inter-spousal exemptions, impacted heavily on the financial stability of surviving spouses;¹⁵³
- Some data shows that the hardship on farmers was an extremely potent factor in fuelling the debate to abolish estate taxes. The hardship claim propounded by farmers was that there was a low rate of return on farming property, when compared to the high value of farm land, and the estate tax was therefore exceptionally heavy on farmers;¹⁵⁴
- The fact that wealthy individuals had access to estate-planning tools that others did not, was a severe loophole in the pro-estate-tax movement. This meant that persons with the means to seek professional advice could avoid paying estate tax altogether. an example of this would be the use of a discretionary trust through which family wealth could be passed from generation to generation without incurring a death tax liability;¹⁵⁵
- With the increase in inflation and the advent of weaker financial climates, an estate could face paying duties on assets where the value has significantly diminished and, further, the exemptions provided do not take into account the increase in inflation and therefore become quickly outdated and ineffective;¹⁵⁶ and,

¹⁵²ibid.

¹⁵³ibid 446.

¹⁵⁴ibid 448.

¹⁵⁵ibid 449.

¹⁵⁶ibid 551.

- The high administrative costs for the collection of estate taxes does not warrant the actual collection of estate and gift duties, therefore nullifying the effect of the estate tax.¹⁵⁷

Australia no longer has any form of death duties, and when death duties were abolished in 1978, it became the first country in the world to abolish estate taxes.¹⁵⁸

Having dealt with the imposition, and subsequent repeal, of estate taxes and gift duties in Australia, a pertinent question arises of what taxes now apply on the death of an individual. It has already been mentioned that Australia does not have an Inheritance Tax or a Gift Tax,¹⁵⁹ and therefore the next point of departure is to examine the effect of its CGT on death.

8.2.4 Capital Gains Tax

8.2.4.1 History and Development of CGT

The Australian Income Tax system was largely based on the United States example of a global income tax system, and there has never been an all-encompassing definition of 'income'.¹⁶⁰ The tax has been broadened since its inception in 1915, most notably by the introduction of a capital gains tax in 1985.¹⁶¹ Prior to its implementation, Australia had no tax on capital gains. The introduction of CGT in 1985 applied to realised gains and losses on assets after 19 September 1985.¹⁶² Until 1999, an indexation system applied, ensuring that only real gains were taxed. There also existed an averaging system, with the object of minimising the tax burden of the progressive income tax rates on gains that had accumulated over a period of time.¹⁶³ In 1999, a CGT discount was introduced to 'improve

¹⁵⁷ *ibid* 552.

¹⁵⁸ Gilding (see note 134; 1).

¹⁵⁹ see note 5 above.

¹⁶⁰ S Reinhardt, L Steel 'A Brief History of Australia's Tax System' (2006) *The Treasury* available at http://archive.treasury.gov.au/documents/1156/HTML/docshell.asp?URL=01_Brief_History.asp#P8_13, accessed on 14 October 2014.

¹⁶¹ *ibid*.

¹⁶² *ibid*.

¹⁶³ *ibid*.

capital mobility' by reducing the appeal of asset retention.¹⁶⁴ This discount system applied by reducing the CGT liability by 50 percent for individuals who held the asset for at least twelve months before disposing of it.¹⁶⁵

8.2.4.2 Reasons for the Implementation of CGT

The notion of a capital gains tax was brought about when the Australian government released a draft White Paper in 1985¹⁶⁶, whose recommendations included broadening the tax base by introducing capital gains tax.¹⁶⁷ The draft White Paper made the following argument in support of taxing capital gains:

"The ownership of assets can lead to nominal capital gains or losses when the prices of those assets rise or fall. An increase in the owner's real income or purchasing price, however, occurs only with a real capital gain. i.e. when the price of the asset increases more rapidly than the general price level. Because real capital gains represent an increase in purchasing power similar to real increases in wages, salaries, interest or dividends, they should therefore be included in any comprehensive definition of income".¹⁶⁸

It follows from the above quote, that a comprehensive definition of income was a major factor in the introduction of CGT. Also, as per the draft, the case for taxing capital gains is based on objectives of efficiency, equity and combating tax avoidance.¹⁶⁹ The draft White Paper then proceeded to elaborate on these objectives by stating that the current treatment of tax:

- violates horizontal equity because it favours individuals who obtain some or all of their income as capital gains;¹⁷⁰
- violates vertical equity because higher income groups are benefitted since ownership of capital concentrates in these high income groups;¹⁷¹

¹⁶⁴ibid.

¹⁶⁵ibid.

¹⁶⁶'Draft White Paper on Reform of the Australian Tax System' (9 May 1985) *The Treasury* available at <http://www.naa.gov.au/collection/explore/cabinet/by-year/1984-85/tax-reform.aspx>, accessed on 21 October 2014.

¹⁶⁷This was just one recommendation to broaden the tax base. Other recommendations included a consumption tax and a fringe benefits tax.

¹⁶⁸see note 166 above; 112.

¹⁶⁹ibid.

¹⁷⁰ibid.

- distorts investment decisions because individuals are more inclined to invest in assets that return income in the form of gains;¹⁷² and
- allows for avoidance arrangements because if one is able to re-characterise their income as capital, they bypass the paying of income tax entirely.¹⁷³

This list of justifications proved to be a strong case for CGT and led to the implementation of capital gains tax, effective from 20 September 1985.

8.2.4.3 Current Application of CGT

The CGT rules are governed by Chapter 3 of the Income Tax Assessment Act (Cth) 1997 (ITAA 97). Part 3-3, Division 128, deals specifically with the effect of death on CGT. The Division sets out what happens when a taxpayer dies and his or her CGT asset, owned prior to death, and devolves upon a beneficiary or legal personal representative.¹⁷⁴

The Society of Trust and Estate Practitioners discusses an overview of the specific rules and tax consequences at the time of death in an article entitled 'Disposal Down Under'.¹⁷⁵

The general rule, and as stated in section 128.10, is that "when you die, a capital gain or capital loss from a CGT event that results for a CGT asset that you owned just before dying, is disregarded". As such, any future liability for CGT is deferred until the beneficiary or the legal personal representative dispose of the asset, that is, until another CGT event occurs. The asset passes to a beneficiary when the beneficiary becomes the owner of the asset under the operation of a will¹⁷⁶ or due to intestacy laws.¹⁷⁷ It must be noted that the exemption applies only to assets that form part of the deceased estate at the time of death. Therefore, assets acquired

¹⁷¹ see note 166 above; 113.

¹⁷² *ibid.*

¹⁷³ *ibid.*

¹⁷⁴ Section 128.1.

¹⁷⁵ A Cornford-Scott 'Disposal Down Under' (July 2012) *Society of Trust and Estate Practitioners* available at <http://www.step.org/disposal-down-under>, accessed on 12 October 2014.

¹⁷⁶ Section 128.20(1)(a).

¹⁷⁷ Section 128.20(1)(b).

by the legal personal representative to administer the estate, and which are subsequently distributed, will be liable for CGT.¹⁷⁸

There are certain circumstances under which CGT will arise, and the roll over relief will not apply.¹⁷⁹ Section 104-215 of the ITAA 97 deals with 'CGT Event K3', and applies to a CGT asset owned by the deceased which passes to a beneficiary who is: a tax-exempt entity;¹⁸⁰ the trustee of a complying superannuation entity;¹⁸¹ or not an Australian resident.¹⁸² The exception to this is found in section 104-215(5), which states that the capital or gain or loss is disregarded where the deceased taxpayer acquired the asset prior to the date of promulgation of CGT (20 September 1985).

The death of a taxpayer also affects the cost base of an asset.¹⁸³ The cost base of an asset consists of five elements, and is found in section 110-25 of the ITAA 97. These are, namely:

- Money paid or value of property given for the asset;¹⁸⁴
- Costs of acquiring the asset;¹⁸⁵
- Costs of owning the asset;¹⁸⁶
- Capital expenditure to increase or preserve the value of the asset;¹⁸⁷ and
- Capital expenditure to preserve or defend the title of the asset.¹⁸⁸

According to section 128-15 of the ITAA 97, a post-CGT asset (one acquired after the commencement date of CGT) will have a cost base equal to that of the asset in

¹⁷⁸See n. 36 supra.

¹⁷⁹ibid.

¹⁸⁰Section 104-215(1)(a).

¹⁸¹Section 104-215(1)(b).

¹⁸²Section 104-215(1)(c).

¹⁸³See n. 36 supra.

¹⁸⁴Section 110-25(2).

¹⁸⁵Section 110-25(3).

¹⁸⁶Section 110-25(4).

¹⁸⁷Section 110-25(5).

¹⁸⁸Section 110-25(6).

the hands of the deceased on the date of death.¹⁸⁹ A pre-CGT asset will have a cost base of the market value on the date of death.¹⁹⁰

As mentioned above, the CGT liability will be deferred until such time as the beneficiary disposes of the asset. There are discount rules that apply where the asset is held by the individual for at least 12 months before disposal.¹⁹¹ In this case, a 50 percent discount can apply. The rules applicable to CGT assets acquired under an estate can be found under section 115-30 ITAA 97, and are briefly as follows:

- For a post-CGT asset, the beneficiary or legal personal representative is taken to have acquired the asset when the deceased acquired the asset. Therefore, if the deceased held the asset for at least 12 months and the beneficiary immediately disposes of it, the discount will apply; and
- For pre-CGT assets, the beneficiary is taken to have acquired the asset at the date of death, and must wait at least 12 months.

From the above discussion of CGT, it is seen that death is not a trigger-event for CGT in Australia, and rather that a CGT liability is rolled over until such time as it is disposed of by the beneficiary. As mentioned, there are a few exceptions to this general rule. Further, even where the CGT liability defers to the disposal by the beneficiary, there are still avenues available that lessen the CGT burden on the taxpayers, such as the discount rules.

Having concluded the Australian Tax Law analysis, we now examine at the United Kingdom's tax system.

¹⁸⁹Section 128-15(4). This cost base does not apply to trading stock or dwellings.

¹⁹⁰Section 128-15(4).

¹⁹¹Section 115-25(1).

8.3 The United Kingdom's Tax System

8.3.1 Introduction to the United Kingdom's Tax Law

The United Kingdom (UK) imposes Income Tax, Capital Gains Tax and Inheritance Tax.¹⁹² As part of our discussion we will look at the objectives of the tax system, criteria used to design a tax system and also the history and development of the different taxes imposed in the UK.

Firstly, some objectives of the tax system are:¹⁹³

- i. Revenue Raising;
- ii. Redistribution of wealth;
- iii. Management of the Economy;
- iv. Affecting Behaviour; and
- v. Vesting power in the State

Further, there are also specific criteria used when designing a tax system. Some of these criteria are:¹⁹⁴

- i. Fairness between persons of similar tax position;
- ii. Effect on distribution of wealth between rich and poor;
- iii. Compatibility with international standards;
- iv. Simplicity;
- v. Equity, both vertical and horizontal;
- vi. Neutrality;
- vii. Certainty; and
- viii. Administrative Efficiency;

¹⁹² J Tiley and G Loutzenhiser *Revenue Law* 7 ed (2012) 47-48.

¹⁹³ *ibid* 7-11.

¹⁹⁴ *ibid* 11-14.

8.3.2 Capital Gains Tax

CGT is levied on the disposal of an asset when capital gains are realised or deemed to be realised.¹⁹⁵ CGT is governed by the Taxation of Chargeable Gains Act 1992 (TCGA 1992). A flat rate of 18 per cent was imposed on gains on or after 6 April 2008¹⁹⁶ and for gains after 23 June 2010, a rate of 18% or 28% is imposed.¹⁹⁷

8.3.2.1 History and Development of CGT

In 1965, the Labour Government implemented CGT as a tax separate to income tax, and levied at a rate of 30%.¹⁹⁸ This 30% rate could be lowered by the many relief measures available on total income or total gains.¹⁹⁹ At this point in the legislation, death gave rise to a disposal at market value by the deceased for CGT purposes.²⁰⁰ Between 1970 and 1974, the Conservative Government implemented numerous changes to the tax system. One such change was the replacement of the deemed disposal on death. The new rule, which is still enforced, is the acquisition by the personal representatives at market value, but no disposal by the deceased.²⁰¹ This means that estate duty would be the sole tax on death, and any gains during an individual's lifetime would not be charged.²⁰² The Labour Government between 1974 and 1979 introduced anti-avoidance provisions, while the Conservative Government between 1979 and 1997 introduced indexation relief for inflation in 1982, and who also equated the CGT rate with income tax rates by treating the capital gain as the highest income tax bracket (40%).²⁰³ The Labour Government in 1997 replaced the indexation relief system with tapering relief²⁰⁴ and in 1999, two rates of CGT were introduced for individuals, namely 20% and

¹⁹⁵ *ibid* 575.

¹⁹⁶ *ibid*.

¹⁹⁷ *ibid*. This rate of 28% applies only in specific instances and is mentioned in 7.3.2.1 below.

¹⁹⁸ *ibid* 581.

¹⁹⁹ *ibid* 582.

²⁰⁰ *ibid*.

²⁰¹ *ibid*.

²⁰² *ibid*.

²⁰³ *ibid*.

²⁰⁴ *ibid*. Tapering relief refers to a system where the taper is allowed to continue until no charge is levied on an asset once it has been held for a certain number of years.

40%.²⁰⁵ The Chancellor of the Exchequer in 2007 stated that as from April 2008 the rate of CGT would be 18% (Section 4(2) of TCGA 1992) and all forms of indexation and taper relief were abolished.²⁰⁶ From 2010, a new rate of 28% was introduced for gains after 23 June 2010. It applies solely to gains accruing to the trustees of a settlement and the personal representatives of deceased persons, and individuals whose income tax is charged at the higher rate (Section 4(3) of TCGA 1992).²⁰⁷ The 18% rate still applies to other circumstances.

8.3.2.2 Reasons for the Implementation of CGT

One of the most significant reasons for implementing CGT was for purposes of horizontal and vertical equity.²⁰⁸ The argument for equity is based largely on ability to pay and one's ability to pay tax on capital gains is just as relevant as one's ability to pay income tax on income earned, and that an increase in wealth, whether income or capital, should be taxed to ensure fairness and progressivity of the tax system.²⁰⁹ Another reason for implementing CGT was to prevent the re-characterization of income assets as capital, thereby reducing the opportunities for tax avoidance.²¹⁰

8.3.2.3 Current Operation of CGT

For there to be a CGT liability, four items must be satisfied:

1. There must be a disposal;
2. A CGT 'asset' must have been disposed of;
3. The asset must have been disposed of by the person chargeable; and
4. A chargeable gain must arise.

Once these elements are satisfied, a CGT liability arises.

²⁰⁵ *ibid* 583.

²⁰⁶ *ibid*.

²⁰⁷ *ibid*.

²⁰⁸ *ibid* 576.

²⁰⁹ *ibid*. See also 2.3 above for a discussion on vertical and horizontal equity.

²¹⁰ *ibid*. See also 2.3 above for a discussion on the re-characterization of assets.

In respect of relief measures available on gains accruing to individuals, there exists an annual exemption of £10 600. This exemption is available to spouses and each spouse is entitled to claim a full annual exemption each year.²¹¹ Further, transfers between spouses and civil partners who are living together are treated as having neither a loss nor a gain in the hands of the disposing person.²¹²

There are also exempt assets, which means that no gain arises on their disposal. These include, but are not limited to, a private residence, wasting assets and passenger vehicles.²¹³

As an additional relief measure, there are certain events and disposals which do not give rise to a capital gain. These events include: death; gifts to charity; inter-spousal transfers; and foreign currency for personal use.²¹⁴

The abovementioned principles on CGT are the basic principles that guide its operation. Next, we will discuss Inheritance Tax and how it operates, and then further look at the effect of CGT and Inheritance Tax together on the death of a taxpayer.

8.3.3 Inheritance Tax

Inheritance Tax is governed by the Inheritance Tax Act of 1984 (IHTA 1984) and has been in effect from 1986.²¹⁵ Inheritance Tax is a direct tax and is designed to operate primarily on transfers of property that occur on death.²¹⁶ Inheritance tax is levied at a rate of 40%, or 36% where 10% or more is left to charity.²¹⁷ As a relief measure, there is an 'Inheritance Tax Threshold' of £325 000.²¹⁸ This means that Inheritance Tax of 40% (or 36%) will only be due where the estate of the deceased is larger than the threshold amount. Since 9 October 2007, section 8A of the IHTA 1984 allows the unused portion of the inheritance tax threshold of the first-dying

²¹¹ *ibid* 590.

²¹² Section 58 of TCGA 1992.

²¹³ Tiley and Loutzenhiser (note 192 above; 591).

²¹⁴ *ibid*.

²¹⁵ *ibid* 731.

²¹⁶ *ibid*.

²¹⁷ 'Inheritance Tax' *Gov.UK* available at www.gov.uk/inheritance-tax/overview, accessed on 14 November 2014.

²¹⁸ *ibid*.

spouse to be transferred to the surviving spouse.²¹⁹ This means that in certain situations the second-dying spouse will have a nil rate band of up to £650 000.²²⁰ Inheritance Tax, as noted above, is generally charged on the estate of a person at the time of death. However, there are circumstances where gifts by individuals attract immediate tax liability,²²¹ and in these situations, tax is levied at 20%.²²² Inheritance tax liability includes transfers out of a person's estate made within seven years of their death.²²³ In essence these types of transfers are known as lifetime gifts and allow assets to be passed on free from inheritance tax, provided that the donor lives for at least seven years thereafter.²²⁴ There are, however, exceptions to this rule and certain transfers, even if made within the last seven years of one's life, do not attract any tax. These include:²²⁵

- i. Gifts made as normal expenditure out of income;
- ii. Gifts made in one tax year for an amount not exceeding £3000,²²⁶
- iii. Individual gifts to different persons for up to £250.

In addition, there are also gifts known as 'Potentially Exempt Transfers' (PETs) and can therefore potentially be exempt from tax.²²⁷ This operates in a situation where the donor lives for at least seven years after making the transfer. Where the individual dies before the seven year period, the transfer becomes chargeable and the recipient will need to pay the tax liability if the estate and gift tax exceed the inheritance tax threshold of £325 000.²²⁸ Therefore, it may happen that in some cases even where the value of the estate is below the threshold, inheritance tax

²¹⁹Tiley and Loutzenhiser (note 192 above; 795).

²²⁰*ibid.*

²²¹These circumstances include certain gifts by individuals to discretionary trusts or to companies.

²²²A Seely 'Inheritance Tax' (20 June 2013) available at www.parliament.uk/briefing-papers/sn00093.pdf, accessed on 16 November 2014, at 2.

²²³*ibid.* 3.

²²⁴*ibid.* See also 'The tax aspects of administering an estate after death' *Gilberts* available at http://www.gilberts.uk.com/cms/filelibrary/The_tax_aspects_of_administering_an_estate_after_death.pdf, accessed on 12 November 2014, at 1.

²²⁵*ibid.*

²²⁶If this amount is not fully used, the unused portion can be carried forward for one year only, provided that in the succeeding year the full £3000 is used.

²²⁷A Seely 'Inheritance Tax' (20 June 2013) available at www.parliament.uk/briefing-papers/sn00093.pdf, accessed on 16 November 2014, at 3; J Tiley and G Loutzenhiser *Revenue Law* 7 ed (2012) at 731.

²²⁸Seely (note 222 above; 3).

will still be due because the amount of the PETs over the preceding seven years increased the value of the estate to an extent that it supersedes the threshold.²²⁹

There are, however, gifts that are totally exempt from Inheritance Tax,²³⁰

- i. Gifts to a spouse or civil partner;
- ii. Gifts to charities;
- iii. Gifts or donations to political parties; and
- iv. Disposals for the national interest.

Therefore, in the event of a disposal for any of the above reasons, no inheritance tax will be levied, even if the donor dies within seven years after the disposal. It is important to mention that even though there do not appear to be any distinct flaws in the inheritance tax system, there have been numerous proposals to reform inheritance tax over the last 20 years. The suggestions include:

- i. Abolishing the tax - The idea of abolishing the tax had been toyed with since the early 1990s. An argument in favour of its abolition is that it hinders economic growth by taxing all wealth, and even gains or income that has already been taxed. A further argument is that it does not favour redistribution of wealth between rich and poor because it allows assets to be passed from generation to generation with ease, thereby keeping wealth in the family. Another argument for abolition is that the tax itself is inefficient.²³¹
- ii. Taxing recipients rather than estates - The suggestion is aimed at taxing the donee rather than the donor, on cumulative lifetime receipts, thereby bringing more wealth into the tax net and increasing the economic efficiency of such a tax.²³²
- iii. Increasing the zero-rate threshold - In this way, only the super-rich will be taxed and it will provide relief to middle-income individuals who have been caught in the net due to inflation.²³³

²²⁹ibid 3.

²³⁰ibid 2-3. See also J Tiley and G Loutzenhiser *Revenue Law 7* ed (2012) at 782-783.

²³¹ibid 4-6.

²³²ibid 6-9.

²³³ibid 9-12.

The suggestions to reform the inheritance tax did not fall on deaf ears. This is evident from the fact that the tax-free threshold was indeed increased; as well as the fact the transferable allowance between spouses and/or civil partners was introduced, thereby possibly increasing the threshold for the second-dying spouse or partner. Despite the improvements to the system, the case for abolition of the tax, for the reasons mentioned above, has not waned.²³⁴

The above discussion illustrates the basic principles of Inheritance Tax and provides us with an idea of its operation. The next step is to examine how CGT and inheritance tax work together on the death of an individual.

8.3.4 CGT, Inheritance Tax and its cumulative effect on death in the UK

Between 1965 and 1971, CGT and estate duty were both levied at death.²³⁵ However, now, as per section 62²³⁶ death is not a disposal for CGT purposes. A consequence of death on CGT is that the personal representatives or beneficiaries acquire the assets from the deceased person at a cost equal to market value as at the date of death.²³⁷ As per section 62(4),²³⁸ where the personal representatives dispose of an asset by passing it to a beneficiary under a will or by operation of law, there is no CGT. CGT will be levied where the personal representatives sell an asset of the estate. The base cost of this transaction will be equal to the acquisition cost, namely, market value at the date of death.²³⁹

As noted, death is not treated as a disposal of assets for CGT purposes. However, a CGT liability can arise in the following situations;²⁴⁰

²³⁴ *ibid* 21-28.

²³⁵ Tiley and Loutzenhiser (note 192 above; 656).

²³⁶ TCGA 1992.

²³⁷ J Tiley and G Loutzenhiser *Revenue Law* 7 ed (2012) at 656; 'The tax aspects of administering an estate after death' *Gilberts* available at http://www.gilberts.uk.com/cms/filelibrary/The_tax_aspects_of_administering_an_estate_after_death.pdf, accessed on 12 November 2014, at 1.

²³⁸ TCGA 1992.

²³⁹ Tiley and Loutzenhiser (note 192 above; 656).

²⁴⁰ 'The tax aspects of administering an estate after death' *Gilberts* available at http://www.gilberts.uk.com/cms/filelibrary/The_tax_aspects_of_administering_an_estate_after_death.pdf, accessed on 12 November 2014, at 1.

- i. Disposals were made before death by the deceased;
- ii. A gain on an earlier disposal was held over; or
- iii. During administration of the estate, a gain has been made due to the rise in the value of the asset from the time of death until the time of disposal.

Inheritance tax is assessed on the decrease in value to the donor's estate.²⁴¹ The estate has decreased by both the value of the asset and the CGT that has been paid.²⁴² Inheritance tax rules ensure that any CGT already paid by the donor is then not subject to inheritance tax, too. This is achieved by excluding the amount of CGT paid when calculating the loss to the estate. Section 5(4) of IHTA 1984 provides that any tax liabilities due as a result of the transfer are not to be included when calculating the value of the donor's estate. The effect therefore is that no CGT is levied on the CGT itself.²⁴³ The above principles on the operation of Inheritance Tax and CGT on death illustrates that the only tax that applies on death in the UK is Inheritance Tax. We have seen that the TCGA 1992 excludes CGT on death, except in the instance where a personal representative disposes of the asset during the course of administration, other than to a beneficiary or legatee. We have also seen in the IHTA 1984 that inheritance tax will only operate on estates that exceed a value of £325 000 in the case of a single individual. Further, there are other measures available that reduce the inheritance tax liability, such as PETs, and the portable inheritance tax threshold between spouses.

8.4 An overview of the taxes than apply on death in South Africa, Australia and the United Kingdom.

Using the information thus far concerning taxes on death in these three jurisdictions, a comparative table describing the salient characteristics has been compiled, as shown below.

²⁴¹Section 3 of IHTA 1984.

²⁴²A Edwards 'Lifetime Gifts' (April 2009) available at <http://www.step.org/lifetime-gifts>, accessed on 14 November 2014.

²⁴³ibid.

Table 1: Overview of taxes on death

| | South Africa | Australia | United Kingdom |
|-------------------|--|---|--|
| Capital Gains Tax | CGT is charged on disposal including deemed disposal by way of death | Applicable in limited circumstances | Not applicable on death. |
| Estate Duty | Applicable on the net value of the estate on death | N/A | See Inheritance Tax. |
| Gift Tax | Applicable to gifts made during one's lifetime | N/A | See Inheritance Tax. |
| Inheritance Tax | See Estate Duty. | N/A | Applicable on the value of an estate on death and on certain transfers or gifts during one's lifetime. |
| Income Tax | Applicable on income up to the date of death. | Applicable on income up to the date of death. | Applicable on income up to the date of death. |

8.5 Conclusion

In summary, South Africa is the only country in the analysis between these three jurisdictions that applies a full CGT and a full Estate Duty on death. While it can be said that the UK Inheritance Tax system is more comprehensive, I submit that it only appears so because it encompasses both a Donations Tax and an Estate Duty, whereas South Africa applies separate taxes in each situation.

The next chapter focuses on methods of improving the tax system in South Africa, if at all, by applying principles from Australia and the UK.

Chapter Nine

Suggestions on Applying International Tax Principles in South Africa and Closing Statements

The aim of this chapter is to set forth proposals on possible strategies that South Africa can implement to eradicate the double tax effect on death, taking into account the established international principles of Australia and the UK.

In terms of the tax principles applied in the UK, we have seen that death does not trigger the operation of CGT, and further, that an Inheritance Tax is levied on the deceased estate, as well as on transfers made by the donor in the seven years preceding his or her death. By applying taxes on death in this manner, there is little, if not zero, avenue for double taxation. Therefore, employing this in South Africa will work in eradicating the double tax problem. To employ the UK method, legislation will have to be changed in the following ways:

- i. Death will have to be removed as a trigger event for CGT purposes;
- ii. Estate Duty as a separate tax will need to be abolished;
- iii. Donations Tax will need to be modified in its current form; and
- iv. An Inheritance tax will need to be effected, and encompass both donations tax principles and estate duty principles.

I submit that the idea of an inheritance tax has already been dealt with in Chapter 6 above. However, in that discussion of inheritance tax, the idea was for the tax to operate on its own as a replacement for Estate Duty. If, however, we apply inheritance tax and CGT the way the UK does, we remove the double tax effect that currently plagues our tax system on death.

With reference to the Australian method of tax on death, the system appears to be a simpler one to adopt. In Australia, there are no death duties or gift taxes. Further, CGT does not apply on death. Instead, any CGT liability only comes to the fore when a beneficiary eventually disposes of the asset. It is therefore clearly evident

here that there is no issue of double taxation. If the Australian method of taxation is employed, South Africa would need to make the following legislative changes:

- i. Death will have to be removed as a trigger event for CGT, and instead a roll-over provision will need to take effect;
- ii. Estate Duty will need to be abolished;
- iii. A donation on death will need to be removed as a trigger event for CGT purposes;
- iv. CGT provisions will need to be made more comprehensive, in order to ensure that CGT is not lost in between transactions.

This method, in essence, will involve CGT operating as a donee-based tax. It will ensure that there is no double tax effect on death, as there will be no estate taxes or CGT on the estate of the deceased. The only tax will be on the asset when the donee finally disposes of it.

I submit that it may not be administratively possible to reform the entire tax system on death all at once, however, by making small policy changes we can work toward a tax system that is fair, efficient and equitable.

I further submit that the South African CGT system is fairly new compared to those in the UK and Australia, and it is therefore possible that they have had more time to experiment and resolve any issues they have encountered since its inception. It is also possible that our CGT system is not as sophisticated as either the Australian CGT or the UK's CGT, and therefore, being simplistic, we do not have adequate mechanisms in place to deal with issues of administration and economic efficiency that arise in tax collection.

A further possibility that prevents the South African Revenue Service from abolishing Estate Duty is that, as a developing nation, the state needs all the financial resources it can derive, and therefore the loss of revenue that will result from abolishing estate duty, however minimal, will have a larger impact on the economy and development of South Africa, than it would on first world countries like the UK and Australia. After all, part of the reason CGT was implemented in

2001 was so that tax avoidance could be minimised and more revenue could be collected. Being first world countries and having strong, internationally competitive economies, would also explain how Australia and the UK can grant such high concessions to taxpayers. It is possible for them to engage in greater legislative development because they are already established as great economic powers.

I submit that even though the above arguments mitigate the harsh stance of the South African government in its collection of tax, this phenomenon of double taxation remains a fundamental unfairness. In a developing nation, with taxpayers who already struggle in a harsh economic climate, with stresses such as inflation and recession, these taxpayers should be assisted in any manner possible. Eradicating a double tax effect and preserving some wealth of the deceased for future generations, which may initially seem a decrease in contribution to the state's coffers, is a small loss to bear in comparison to the taxpayers who are being taxed extra, and ultimately will actually enable the development of individual wealth and contribute to a stable economy. It is one thing to have to pay a single tax at high rates, but to have to bear the burden of two separate, continuously increasing taxes on one estate is fundamentally flawed and unfair.

I therefore propose that Estate Duty should be abolished and proposal of possible tax collection alternatives, like increasing the CGT rate, should be adopted. This will diminish the burden on the taxpayer. Once this has been done, due consideration should be given to reforming the CGT system along similar lines to that of Australia as it is the most beneficial for the taxpayer. However, we must remember the caveat attached to Australia's success. That is, they have a stronger economy and their system has been in place for longer. This does not mean that South Africa cannot achieve the same result, it will just take more planning and perhaps a longer time. Regardless of the challenges we may face in attaining an equitable system in the short term, the long run may prove to be more beneficial to both the fiscus and taxpayers alike.

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APPENDIX A: Ethical Clearance