

TRUSTS AND ESTATES

THE DAVIS TAX COMMITTEE'S INTERIM REPORT ON ESTATE DUTY

INTRODUCTION

The first interim report to the Minister of Finance by the Davis Tax Committee (Committee), in respect of estate duty was made public last week.

The Committee's frame of reference was to consider the continued role and relevance of estate duty in South Africa.

The context of the Committee's work was to provide a progressive tax base to address the structural inequalities in our society.

RECOMMENDATIONS

Capital Transfer Tax

The tax imposed upon a person's estate on transfer is commonly called capital transfer tax and is in essence a form of wealth tax.

Estate duty (previously quintessentially called death duties) is a particular form of wealth tax which becomes payable on the death of a taxpayer.

Other forms of wealth tax, include a so-called nett wealth tax, which is a system whereby the nett wealth of an individual is determined periodically and taxed if over a certain threshold, and pure capital transfer tax, where a duty is imposed when assets are transferred or deemed to be transferred periodically, for instance once every generation.

After much deliberation, the Committee has recommended that no other forms of capital transfer tax should be introduced to either augment or substitute estate duty.

In summation the Committee has recommended the retention of estate duty as a taxation subject to certain changes.

Estate Duty Rate

The Committee recommends that the rate of estate duty remains at a flat rate 20% above the set threshold.

It is interesting to note that estate duty was reduced from 25% to 20% on 1 March 2001, coinciding with the introduction of capital gains tax, in order to counter the notion of a perceived double taxation.

Arguments in favour of a progressive tax rate were eclipsed by the overall requirement to implement a simple practical system.

Primary Abatement

The primary abatement set out in s4A of the Estate Duty Act, no 45 of 1955 (Estate Duty Act) set the threshold above which duty becomes payable.

The Committee recommends that the primary abatement per individual be increased from R3,5 million to R6 million.

While the recommendation would result in a substantial jump from the present R3,5 million (which became effective from 1 March 2007), the increase will realistically only counter the fiscal drag brought about by inflation.

Inter-Spouse Rebate

The Committee's most dramatic recommendation is that the inter-spouse exemption be withdrawn in its entirety or subject to specific limits.

In 1985, the financially pleasing but phonetically offensive s4(q) was introduced into the Estate Duty Act, whereby the amount bequeathed to a surviving spouse (irrespective of the quantum) was exempt from estate duty taxation.

The definition of spouse was extended in April 2004 to include other forms of permanent relationships subject to the satisfaction of the Commissioner of SARS, to ensure the equal treatment of such relationships in respect of the exemption.

However, the Committee feels that the exemption granted to a spouse, even in its extended form, is unconstitutional and is no longer warranted in its existing form.

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Portable Rebate

With effect from 1 January 2010, the primary abatement was extended by s4A(2) to allow a spouse the right to any portion of the unused abatement of a pre-deceased spouse.

The result being that if the pre-deceased spouse left all of their estate to the surviving spouse, the unused abatement would become available to the surviving spouse, effectively providing for, in current terms, an abatement of R7 million.

The Committee recommends, in light of its reservations in respect of the special treatment of the surviving spouse, that this roll-over provision be withdrawn.

However, to compensate for the withdrawal of s4(q) as it stands, it is proposed that the provision be effectively reversed, in that, on the death of the first-dying the surviving spouse may elect to advance their abatement with the effect that the first-dying would have the benefit of the total abatement.

In line with the current threshold proposals, it would mean that, depending on the distribution of the assets between the spouses, up to R12 million may effectively be free from estate duty.

The Committee's recommendation appears at odds with the general thesis of the report that a surviving spouse should not be placed in a better position than a single person or a person with other family responsibility structures.

The practical implementation of such a scheme, given the possibility of multiple marriages or re marriages could prove problematic.

It is also concerning that such a dispensation may cause forced sales of assets to provide the liquidity needed to pay the Estate Duty.

Retirement Funding

With effect from 1 January 2009, s3(2)(i) of the Estate Duty Act was amended to the effect that retirement annuity benefits left to an individual, would not be subject to estate duty, bringing it in line with pension funds.

This, coupled with the amendment allowing contributions to retirement annuity after the age of 70, created an industry whereby individuals with adequate means made a once-off substantial contribution to a retirement annuity in their advanced years, which amount would be exempt from estate duty.

The Committee recommends that this avenue be closed, by simply deeming that all retirement annuity contributions made on or after 1 March 2015 be disallowed in the determination of taxable income, and be included in the estate duty computation.

CONCLUSION

One must not lose sight that at this juncture the status of the recommendations are exactly that – interim – and will now be the subject of much discussion from both the public and the professional bodies involved (the so-called fiduciary industry), before it translates into law.

However, it is interesting to note that the Committee envisages that any changes announced during the 2015 National Budget Speech will come into effect on 1 March 2016.

I would, however, advise clients not to implement drastic changes to their estate duty plans, based on these proposals, until there is greater certainty.

The one conclusion that seems relatively firm is that estate duty will not be done away with in the foreseeable future.

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