FIRST INTERIM REPORT ON

ESTATE DUTY

FOR THE MINISTER OF FINANCE

Intended use of this document:

The Davis Tax Committee is advisory in nature and makes recommendations to the Minister of Finance. The Minister will take into account the report and recommendations and will make any appropriate announcements as part of the normal budget and legislative processes.

As with all tax policy proposals, these proposals will be subject to the normal consultative processes and Parliamentary oversight once announced by the Minister.

THE DAVIS TAX COMMITTEE

January 2015

Dear Minister

We, as the Members of the Davis Tax Committee, have the honour and privilege to provide you with this report which has been:

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Davis Tax Committee

First Interim Report on Estate Duty Report

January 2015

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The terms of reference extended to the Davis Tax Committee by the Minister of Finance instructed it to enquire into:

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

In real terms the contribution of estate duty collections has declined over the past 20 years.[1]

There is no prospect of capital taxes, in whatever form, being a “silver bullet” which could make a substantial difference to overall revenue from tax in South Africa. However, a number of other issues affecting donations tax and estate duty have emerged since 1997 that require examination, as part of an overall assessment.

The South African estate duty system contains generous allowances that allow most estates to be subject to both CGT and estate duty only on the death of all spouses. This defers estate duty collection for many years.

The net result is that estate duty collections have declined both in real terms and in terms of their overall contribution to National Revenue to the extent that today this represents a mere 0,1% of total tax collections.

While South Africa is significantly underperforming in terms of revenue collections in respect of estate duty and donations tax and, hence, there is scope to increase performance in this regard, this country is, however, not unique with regard to the small contribution made by wealth taxes. Many countries have no net wealth taxes, or estate, inheritance or gift taxes. In the Netherlands, inheritance and gift tax yield 0.7% of tax revenues and 0.26% of GDP.

[1] Source: National Treasury

The Katz Commission suggested that a targeted tax contribution for such taxes, of 1 to 1.5% of tax revenues, might be appropriate, which, translated into the context of the total collection for 2013/14, would amount to approximately R10 billion to R15 billion per annum.

Taking into account the challenges South Africa currently faces in reducing its national debt level, this could be a useful contribution. Viewed accordingly, there are obvious shortfalls within the present estate duty system, from which the following options have emerged:

1. Repeal the estate duty act completely, moving away from the concept of treating death as a taxation event.

   Or
2. Amend the estate duty act in order to achieve a simpler, more efficient and just system.

   Or
3. Replace the present estate duty system with a new form of wealth taxation.

Despite all its faults the current Estate Duty Act, coupled with Donations Tax levied in terms of the Income Tax Act, remains the only direct tax on wealth in South Africa. Given the huge disparity of wealth in South Africa, it is hard to justify a repeal of these taxes without any replacement. The DTC **recommends that, with some modification, the estate duty system could achieve many of the objectives outlined without resorting to the drastic measure of implementing Capital Transfer Tax.**

Chapter 3. General anti-Avoidance Regulations (GAAR)

The DTC is of the opinion that section 80 of the Income Tax Act as well as judicial precedent do not currently act as an effective deterrent against the wide range of estate duty saving mechanisms that exist today.

The DTC's further opinion is that the pursuit of further GAAR provisions to be included in the estate duty act has little prospect of success.

Enforcement of the existing Estate Duty Act could not be substantially improved through the employment and training of expert SARS estate duty assessors.

Chapter 4. Trusts

The provisions of sections 7 and 25B of the Income Tax Act allow the trustees of a trust to cause the trust income to vest and be taxed in the hands of a beneficiary. This is known as the "attribution principle."

The attribution rules in section 7 were originally intended as an anti-avoidance measure aimed at preventing a trust from being used as an income-splitting device. However, today the attribution rules are employed to avoid tax, thereby subverting the very purpose for which they were introduced.

In order to avoid the donations tax implications of implementing an inter vivos trust arrangement, many assets are transferred into trusts, allowing the transfer consideration to remain outstanding by way of an interest-free loan account.

The DTC **recommends that the many deficiencies of the current estate duty system be addressed by way of the following simple yet fundamental amendments to the existing legislation:**

- The flat rate of tax for trusts should be maintained at its existing levels.
- The deeming provisions of section 7 and 25B should be repealed, insofar as they apply to RSA resident trust arrangements.
- The deeming provisions of section 7 and 25B should be retained, insofar as they apply to non-resident trust arrangements.
- Trusts should be taxed as separate taxpayers.
- The only relief to the rule should be the “special trust definition” contained in section 1 to the Income Tax Act which allows a trust to be taxed at personal income tax rates in limited special circumstances. The definition should be revisited by National Treasury.
- No attempt should be made to implement transfer pricing adjustments in the event of financial assistance or interest-free loans being advanced to trusts.

Taxpayers must be allowed to make use of trusts when it makes sound sense to do so in the pursuit of a commercial benefit, as opposed to an estate duty benefit.

The repeal of the attribution provisions will have diverse and far-reaching implications. Thus it would be in the interests of equity and certainty that the repeal of the attribution provisions be announced in the 2015 National Budget Speech but only be implemented with effect from 1 March 2016. An extensive consultative process will have to follow during the 2015 legislative cycle to identify and address the many issues involved.

Various other countries have since implemented Capital Transfer Tax (CTT), a more advanced and sophisticated form of inheritance tax than estate duty that seeks to impose taxation periodically instead of only on death. In particular, CTT seeks to recover lost estate duty collections where assets have been transferred into trusts.

The implementation of CTT in South Africa would place an enormous burden on the resources of both SARS and the taxpayer as was evident, for example, when CGT was implemented in 2001. The resultant gain in revenue collections cannot be assured. **Thus the DTC is of the opinion that CTT implementation should be postponed, at least until such time as more substantial research justifying its implementation is conducted.**

The DTC has also considered the possibility of implementing an annual or periodic Net Wealth Tax (NWT).

The experiences within the European Union demonstrate that the actual collections of NWT are disappointing. As in the case of CTT, the complexity of a NWT and the uncertainty of a successful implementation prompt the exercise of caution as regards such a proposal without further careful investigation.

The DTC is of the opinion that by addressing the income tax regime for trusts (as outlined above) a substantial deterrent against estate planning will have been created without the necessity of devoting substantial resources towards the implementation of CTT or NWT. In so doing a combination of increased estate duty and CGT collections may have the potential of making a most useful contribution to overall tax collections.

Taxpayers who pursue the postponement of estate duty through the use of trusts will remain at liberty to do so. But upon sale of the assets of a trust a higher rate of tax will be imposed, thus compensating for the estate duty loss.

Sections 7(8) and 25B have been amended to specifically deal with the taxation consequences of offshore trusts with South African donors and beneficiaries.

The DTC is of the view that there is no need to consider a further offshore amnesty programme. Indeed, such a programme would undermine the effectiveness of the voluntary disclosure programme.

Owing to the difficulties of identifying the components of income distributed to a beneficiary **it is recommended that all distributions of foreign trusts be taxed as income**. This will discourage offshore trust formation and can be justified on the grounds of the deferral of the tax that a beneficiary obtains through the use of an offshore trust.

The DTC **recommends that the criminal offence provisions of the Tax Administration Act, 2011, be reviewed** pursuant to the possible inclusion of separate criminal charges that can be brought against taxpayers who fail to disclose their direct or indirect interests in foreign trust arrangements.

Chapter 5. The Inter-Spouse Bequest

The Katz Commission recommended that bequests in favour of surviving spouses remain exempt from estate duty in spite of there being no intellectual justification for the retention of the exemption and it being potentially in breach of the provisions of the Constitution. The recommendation was made entirely on "pragmatic grounds."

The DTC suggests that the simple justification for an exemption based on "pragmatic grounds" is entirely insufficient. No amount of refinement to the definition of spouse within the Income Tax Act can cater for the diverse circumstances and challenges facing South African families today. Thus, **it is recommended that the principle of inter-spouse exemptions and roll-overs should be either withdrawn completely, or subjected to a specified limit.**

Chapter 6. Donations Tax

Donations tax is levied at the rate of 20% on the value of any property disposed of by a taxpayer, other than a trust or public company.

It is simply impossible to determine a reasonable level of exemption for inter-spouse donations. For this reason alone **the DTC recommends that the inter-spouse donations tax exemptions contained in section 56(1)(a) & (b) be retained**, **subject to the section 56(1)(b) exemption being amended to exclude all interests in either fixed property or companies.**

Of particular concern is the practice of the donation of substantial amounts of cash in anticipation of death. Such donations are specifically exempt as a "donatio mortis causa" from donations tax in terms of section 56(1)(c).

It is suggested that in order to prevent the diminution of estates in anticipation of death the section 56 (1)(c) exemption be removed.

Donations tax is not payable if the property is donated by a person prior to becoming a South African resident, or if the property was inherited or donated to a South African resident by a non-resident taxpayer.

The DTC recommends that section 56(1)(g) be re-examined in the light of South Africa's change to residence-based taxation in 2001.

Section 56(2)(c) exempts any bona fide contribution made by the donor towards the maintenance of any person as the Commissioner considers to be reasonable. This remains an open and obvious loophole for the taxpayer to diminish an estate, which cannot be contained by SARS without the deployment of substantial resources.

The extent of the "reasonable maintenance" exemption contained in section 56(2)(c) should accordingly be refined by making it subject to various categories of expenditure. For example, food, clothing, medical, education and cost-of-living expenses and possibly even the cost of a small motor vehicle could be included. This would act as a deterrent to substantial abuse. The provision should go further and specifically exclude the donation of assets such as interests in fixed property and financial instruments.

Chapter 7. Capital Gains Tax and Duty

The DTC's terms of reference specifically direct the Committee to investigate the "double taxation on death" created by the imposition of both CGT and estate duty on death in South Africa.

CGT is widely regarded as an income tax on capital income and not a wealth tax. Estate duty and donations tax are wealth taxes. This distinction was clearly reflected in the review of the CGT proposals conducted by the International Monetary Fund in December 2000 (prior to the implementation of CGT on 1 October 2001). This conclusion is confirmed by a recent review of taxes on wealth and transfers of wealth in the European Union.

Chapter 8. Retirement Funds

Pursuant to the review of retirement savings conducted by National Treasury, death benefits paid by retirement funds were excluded from the property of an estate with effect from 1 January 2009.

The DTC recommends that the Section 3(2)(i) estate duty exemption be retained.

However, since 2009 the retirement fund estate duty exemption has created a most convenient estate planning opportunity where taxpayers are at liberty to contribute substantial amounts to retirement funds purely to achieve estate duty savings

The DTC is of the opinion that it could never have been the intention of National Treasury to create an obvious loophole of this nature. Thus the practice should be stopped by simply deeming all retirement fund contributions, made on or after 1 March 2015 and disallowed in the determination of taxable income, to be included in the estate duty computation.

Chapter 9. Abatements and Rates

The primary abatement

The primary estate duty abatement was increased to R2,5 million with effect from 1 March 2005 and to R3,5 million from 1 March 2007. It is noted that the estate duty basic abatement has not been increased for 7 years.

In order to re-establish the primary abatement to exclude the effects of fiscal drag between 2007 and 2015, calculations by the DTC reflect that the abatement would be increased to R5,7 million by October 2014.

Comment [F1]: it was estimated? Date has passed…

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The DTC is of the opinion that, save for the primary residence, no distinction should be made regarding asset classes in the determination of estate duty liability.

Thus the DTC favours a single universally applied abatement followed by a progressive estate duty rate.

It is thus **recommended that the primary abatement be increased to R6 million per taxpayer. It is noted that a surviving spouse will be in a position to increase the total abatement to R12 million by electing to use the primary abatement in the computation of the estate duty of the first dying spouse.**

Estate duty rate

The estate duty rate was reduced from 25% to 20% with effect from 1 October 2001 to coincide with the implementation of CGT.

To this end, **the DTC recommends that the current flat rate of 20% should not be increased, particularly in the light of the retention of both CGT and estate duty/donations tax being levied on capital transfers.**

The DTC expects a substantial increase in estate duty collections will result from the implementation of the above proposals, although it is difficult to quantify with any precision.

Chapter 1
Introduction

Wealth and inequality in the South African context

Any discussion of taxes on wealth which includes estate duty must be analysed through the prism of wealth and inequality.

The Gini coefficient is the international standard for measuring the distribution (or dispersion) of income and wealth in a country. It is a ratio of between 0 and 1, where the closer to 1 the coefficient is, the greater the inequality level in the country. South Africa's National Development Plan (NDP) has set out a goal for 2030 concerning inequality and states that inequality must be reduced by way of a reduction in the Gini coefficient from 0.69 to 0.6.

There is a distinction between income and wealth distribution and redistribution which impacts on the perceived inequality in a country. In general, income encompasses current (monthly) income received by households in the form of salaries and wages, interest and rent received on various forms of capital; and profits received for services rendered as entrepreneurs. On the other hand, wealth consists of households' capital assets, accumulated either by means of savings or transfers through preservation between generations. It is therefore likely in a country to find a relatively equal distribution of income accompanied with a substantial inequality of wealth distribution (Bosch, Rossouw, Claassens, & du Plessis, 2010). However, obtaining data on wealth in South Africa is not straightforward (Aron & Muellbauer, 2013).

Unlike Richard Bird's assertion that the distribution of wealth in a country is "largely the result of historical accident" (Black, Calitz, & Steenekamp, 2011), the current skewed income distribution in relation to South Africa must be analysed through the prism of colonialism, slavery and Apartheid which were not mere historical "accidents". In effect, black people were not only politically disenfranchised and socially discriminated against in South Africa, but they were deliberately subordinated economically, and systematically excluded from participating in the economy. This manifested itself through the dispossession of land and job reservation which excluded blacks from labour market advancement as well as having no access to credit or finance because banks did not lend to blacks under the apartheid regime. Additionally, the Apartheid education system undermined human capital development and blacks were debarred from running businesses (which prevented the development of entrepreneurship) and denied access to basic public services such as health, water and sanitation. Consequently, the extreme inequality currently experienced in South Africa was a result of deliberate Apartheid policies.

It has recently been suggested that inequality is greater today in South Africa, than at the end of Apartheid (Oxfam, 2014). Inequality of household consumption, measured by the Gini coefficient on disposable income, increased from about 0.67 in 1993 to around 0.69 in 2011, one of the highest Gini coefficients in the world (Bosch, Rossouw, Claassens, & du Plessis, 2010; World Bank, 2014). Daniels, Finn and Musundwa (2014) estimated the Gini coefficient on wealth (net worth) to be about 0.90 for South Africa. However, this figure is probably an underestimate, given that the South African National Income Dynamics Study (NIDS) misses the very high net worth individuals.

Nevertheless, these figures need to take account of tax and transfers. In calculating the Gini coefficient, it is necessary to determine the impact of welfare and income policies on income and welfare distribution in the country. Consequently, if one supplements income with income from social pensions and grants (i.e. old age pensions, disability grants, family and other allowances, workmen's compensation funds, alimony and other income from individuals) and in-kind income from free basic services (i.e. free water, free sanitation and free electricity), the Gini coefficient is reduced from 0.70 to 0.61. Furthermore, by adjusting incomes for direct personal income tax, the Gini coefficient declines to 0. 59 (Bosch, Rossouw, Claassens, & du Plessis, 2010; World Bank, 2014).

The recent South Africa Economic Update by the World Bank confirms that there has been a substantial reduction in the country's Gini coefficient brought about by a massively redistributive fiscal policy. Overall, the report finds that the tax system is slightly progressive while spending is highly progressive; meaning that the rich in South Africa bear the brunt of taxes and tax revenues are effectively redirected to the poorest in society to raise their incomes (World Bank, 2014). In spite of these measures, the level of inequality and poverty in South Africa after taxes and spending remains unacceptably high (Bosch, Rossouw, Claassens, & du Plessis, 2010; World Bank, 2014).[2] For example, in South Africa, Oxfam has claimed that the two richest people have the same wealth as the entire bottom half of the population: a platinum miner would need to work for 93 years just to earn the average CEO's annual bonus (Oxfam, 2014).

Taxes are but one form of redistribution and thus not the only available instrument to redistribute income and address inequality. Other forms of redress and restitution, such as land reform and the expenditure side of the budget (via education, health and the like), are as effective a tool to address inequality. This chapter however, is concerned with the instrument of taxation.

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[2]Mail & Guardian Business, "Medium Term Budget, Tax Transfers to poor working well", October 24 to 30.

International context

Globally, the gap between rich and poor is rapidly increasing and economic inequality has reached extreme levels. In 2013, the Oxfam report indicated that seven out of 10 people lived in countries where economic inequality was worse than 30 years ago. In 2014, it was reported that just the richest 85 people on the planet owned as much wealth as the poorest half of humanity. Between March 2013 and March 2014, it was reported that these 85 people grew richer by US$ 668 million each day. To illustrate, if Bill Gates were to spend $1m every single day, it would take him 218 years to spend it all. In sub-Saharan Africa, there are 16 billionaires who live alongside the 358 million people living in extreme poverty. According to the World Economic Forum, deepening income inequality has been identified as the most significant: the first of the top 10 trends and challenges going into 2015 (World Economic Forum, 2014).

Socio-economic consequences flow from this expanding inequality, such as a stifling of social mobility keeping some families poor for generations and thus cascading the privilege and disadvantage for generations; an increase in crime, violent conflict and social unrest; and an exacerbation of gender inequality and inequality in health, education and life chances. Overall, extreme inequality undermines the foundations of society, hinders economic growth and thus hurts us all.

Viewed within this context, the notion of fairness has become an essential part of the global discourse, with regard to taxation and its relationship to inequality. A 2013 survey undertaken in six countries (Spain, Brazil, India, South Africa, the UK and the USA) showed that a majority of people believe the gap between the wealthiest people and the rest of society is too large. In the USA specifically, 92% of people surveyed indicated a preference for greater economic equality, by choosing an ideal income distribution similar to that of Sweden's and rejecting the income distribution in the USA (Oxfam, 2014).

Two powerful driving forces have been identified that have led to the rapid rise in inequality around the world:

- Market fundamentalism, which posits that sustained economic growth only comes from reducing government interventions and leaving markets to their own devices. However, this undermines the regulation and taxation that are needed to keep inequality in check. Although market fundamentalism has brought prosperity to hundreds of millions of people, it tends to concentrate wealth in the hands of a small minority in the absence of government intervention. Nevertheless, market fundamentalism remains the dominant ideological worldview and will continue to drive inequality if deliberate policy choices are not made (Oxfam, 2014; Piketty, *Capital in the Twenty-First Century,* 2014).

- Capture of politics and power by elites reinforces inequality. Economic and political elites tend to use their heightened influence and interests to further entrench their unfair advantages in areas such as the justice system, the tax policies and lax regulatory regimes, financial institutions, government concessions and privatization and so forth (Oxfam, 2014).

According to the Oxfam report, poverty and inequality are not inevitable or accidental, but the result of deliberate policy choices that must be made to level the playing field by redistributing money and power from wealthy elites to the majority. In other words, inequality can be reversed through policies such as free public health and education services that help everyone, while ensuring the poor are not left behind; decent wages that end working poverty (indeed while the overall income as a share of GDP has been declining since the 1990s, the salaries and bonuses of the richest people have been rising, reinforced by significant income from their accumulated wealth and capital); opposing special interests of powerful elites; limiting executive pay; protected spaces where the poor can have a voice as well as progressive taxation so that the rich pay their fair share (Oxfam, 2014).

As is evident from the South African tax and transfer record, the tax system, accompanied with public spending, is one of the most important government tools to redistribute income and address inequality. However, tax systems around the world are hampered by numerous challenges, preventing them meeting their revenue-raising potential and thus tackling poverty and inequality. These include the race to the bottom on corporate tax, granting of tax incentives (tax holidays, tax exemptions, free trade zones etcetera) to attract foreign direct investment; and the lack of global coordination and transparency in tax matters that have led corporate giants to take advantage of inadequate international tax rules. As a result, in 2013, Oxfam estimated that the world was losing US$156 billion in tax revenue as a result of wealthy individuals hiding their assets in offshore tax havens. In general, the tax burden must be fairly distributed among the ordinary people and the richest companies and individuals. It has been recommended that this can be done by shifting the tax burden away from labour and consumption and towards wealth, capital and income from these assets; closing international tax loopholes; increasing transparency of tax incentives; and by imposing national wealth taxes and exploring a global wealth tax (Oxfam, 2014).

Drivers of inequality and potential solutions: Piketty's argument

The main driver of inequality, that is, the tendency of returns on capital (i.e. *r*) to exceed the rate of economic growth (i.e. *g*), today threatens to generate extreme inequalities that stir discontent and undermine democratic values.

According to Piketty (2014) who shifts the debate from overall wealth (how large is the pie?) to distribution (the size of the pieces), wealth and income distribution are becoming noticeably more unequal because of the incredible rise of the “one percent”: the truly wealthy. In his book, *Capital in the Twenty-First Century*, Piketty contends that not only are the nineteenth-century levels of income inequality returning, but there is also a shift back to “patrimonial capitalism,” in which the commanding heights of the economy are controlled not by talented individuals but by family dynasties (Piketty, 2014).

Piketty and a few colleagues (notably Anthony Atkinson at Oxford and Emmanuel Saez at Berkeley) have pioneered statistical techniques that make it possible to track the concentration of income and wealth back to the early 20th century for America and Britain, and to the late 18th century for France (*World Top Incomes Database*). They have used tax records merged with other sources to produce wealth data about the elite in these countries, as recorded in Table 1, below.

Overall, Piketty (2014) shows that, as during the Belle Époque Europe[3], unequal ownership of assets, not unequal earnings, is the driver of income disparities. In actual fact, since the 1970s, slowing growth (rate of economic growth) has meant a rising capital ratio (rate of return on capital), i.e. a high ratio of capital to income, and this accumulation of capital will eventually recreate the inequality of the past unless opposed by progressive taxation.

Table 1. Income shares

Table 1

INCOME SHARES

	Low Inequality (Scandinavia 1970s/1980s)	*Medium Inequality (Europe 2010)*	*High Inequality (Europe 1910, US 2010)*
Top 1%	7%	10%	20%
Next 9%	18%	25%	30%
Next 40%	45%	40%	30%
Bottom 50%	30%	25%	20%

Source: Piketty (2014)

In effect, a high ratio of capital to income will result in a redistribution of income away from labour (wages, salaries, bonuses) and toward holders of capital (corporate profits,

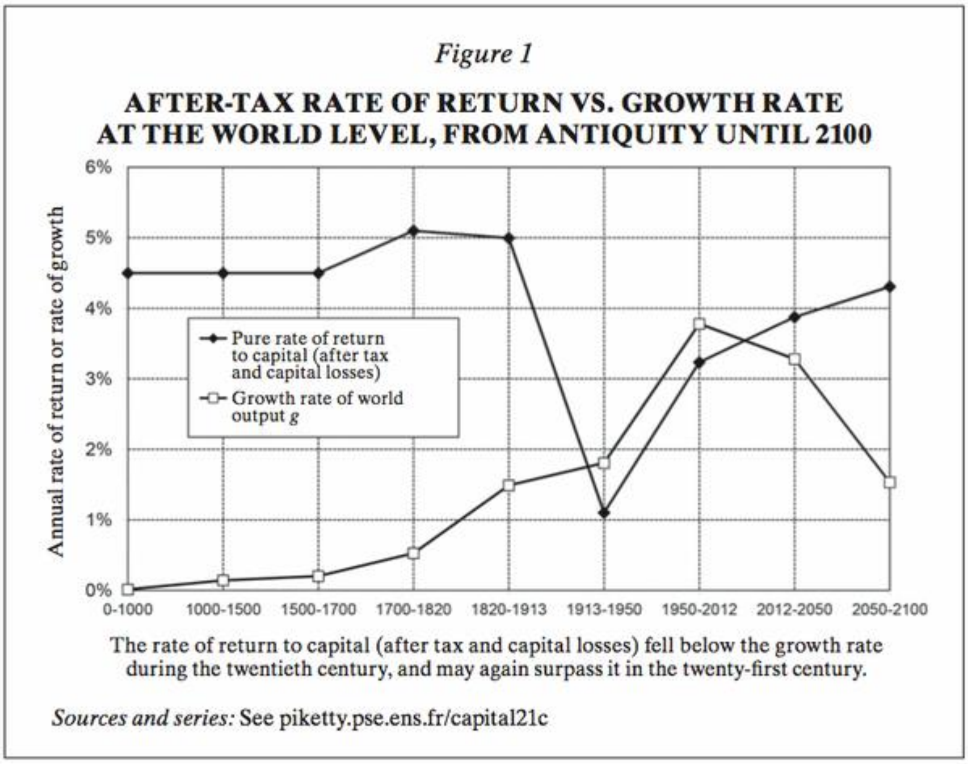
[3]The Belle Époque Europe started in France and Belgium in 1871 and ended when World War I began in 1914. The Gilded Age in the United States started in the 1870s and ended in 1900.

dividends, rents, sales of property and the like). For example, corporate profits have soared since the financial crisis began, while wages, including the wages of the highly educated, have stagnated (Piketty) (2014). Furthermore, when the rate of return on capital greatly exceeds the rate of economic growth, “the past tends to devour the future”, i.e. society inexorably tends toward dominance by inherited wealth. For instance, during the Belle Époque Europe, owners of capital could expect to earn 4 to 5% on their investments, with minimal taxation while economic growth was only around 1%. Therefore, wealthy individuals could easily reinvest enough of their income to ensure that their wealth and hence their incomes were growing faster than the economy, reinforcing their economic dominance.

On the death of these wealthy individuals, their wealth was passed on (again, with minimal taxation) to their heirs. Money that was passed on to the next generation accounted for 20 to 25% of annual income; the great bulk of wealth, around 90%, was inherited rather than saved out of earned income. In addition, this inherited wealth was concentrated in the hands of a very small minority: in 1910, the richest 1% controlled 60% of the wealth in France; in Britain, 70%.

In contemporary society, though less important than they were in the Belle Époque, both capital income and inherited wealth are still powerful drivers of inequality and their significance is increasing. In France, the inherited share of total wealth dropped sharply during the era of wars and post-war fast growth; circa 1970 it was less than 50% but it is currently back up to 70% and rising (Krugman, 2014) (Figure 1 refers).

Figure 1. After-tax rate of return vs. growth rate at the world level, from antiquity until 2100.



Source: Piketty (2014).

The threat to society is that *r* is growing by more than *g*, i.e. if the return on capital is greater than the rate of growth, wealth will concentrate among the rich and the inequality gap will widen. Therefore, the argument that the obvious way to reduce inequality is mainly to encourage growth is not necessarily the whole picture.

According to Piketty (2014) the reason why inherited wealth still plays such a small part in today's public discourse and is not yet a central political issue, despite these figures, is due to the fact that "wealth is so concentrated that a large segment of society is virtually unaware of its existence."

Krugman's argument: Wage income versus capital accumulation as the driver of inequality?

However, Krugman argued that the soaring inequality in today's world or the rise of the very rich 1% in the Anglo-Saxon world, especially the United States, has happened for reasons that lie beyond Piketty's capital accumulation argument, such as the remarkably high compensation and incomes or what he called the rise of "supersalaries." While Piketty estimates that the increased inequality of capital income accounts for about a third of the overall rise in US inequality, wage income at the top has also surged. Real wages for most US workers have scarcely increased since the early 1970s, but wages for the top 1% of earners have risen by 165%, while wages for the top 0.1% have risen by 362% (Krugman, 2014).

This dramatic rise in inequality of earnings, with the lion's share of the gains going to people at the very top, has been explained in part by changes in technology. In a famous 1981 paper titled "The Economics of Superstars," the Chicago economist Sherwin Rosen argued that modern communications technology, by extending the reach of talented individuals, was creating winner-take-all markets in which a handful of exceptional individuals reap huge rewards, even if they are only modestly better at what they do than rivals who are paid far less well.

However, Piketty argued that such people actually make up only a tiny fraction of the earnings' elite, which mainly includes high-level executives of one sort or another who set their own pay and whose soaring wage incomes at the top can be attributed to social and political rather than strictly economic forces. He added that falling tax rates for the rich have in effect emboldened this elite.

Nevertheless, Krugman concluded that the current generation of the very rich in America may consist largely of executives rather than rentiers, i.e. people who live off accumulated capital; however, these executives have heirs. As a result, two decades from now, America could be a rentier-dominated society even more unequal than Belle Époque Europe (Krugman, 2014).

What is the solution?

According to Piketty, public policy can make an enormous difference: the "drift toward oligarchy" and thus extreme inequality, can be halted and even reversed if the political system so chooses. Economic trends are not acts of God and thus political action can curb dangerous inequalities. The key point is that in the crucial comparison between the rate of return on wealth and the rate of economic growth, what matters is the after-tax return on wealth. Hence progressive taxation, in particular taxation of wealth and inheritance, global if possible, could be a powerful force restraining the growing power of inherited wealth and limiting inequality (Piketty). In effect, a highly progressive tax that patches loopholes, helps provide equality of opportunity and reduces the concentration of wealth, must be implemented.

As Krugman argued, then as now, great wealth purchases great influence, not just over policies, but over public discourse. Upton Sinclair famously declared that "*it is difficult to get a man to understand something when his salary depends on his not understanding it*" (Krugman, 2014). Piketty, looking at the history of France, arrived at a similar observation: "*The experience of France in the Belle Époque proves, if proof were* *needed, that no hypocrisy is too great when economic and financial elites are obliged to defend their interest*" (Piketty, Capital in the Twenty-First Century, 2014).

The same phenomenon exists currently, when economic rhetoric emphasises and celebrates capital rather than labour, "job creators" not workers; when political parties identify themselves with capital to the virtual exclusion of labour. This is further reflected in the fact that tax burdens on high-income Americans have fallen across the board since the 1970s, but the biggest reductions have been applied to capital income, including a sharp fall in corporate taxes, which indirectly benefits stockholders and inheritance. It appears that a substantial part of America's political class is actively working to restore Piketty's patrimonial capitalism. Furthermore, the sources of political donations, many of which come from wealthy families, bring truth to these observations (Krugman, 2014).

In depicting the current U.S. economic situation, Stieglitz (2014) argued that one reason the economy is not performing is the high level of inequality, which leads to lower growth, a weaker economy and more instability. However, the weak economic performance has, in turn, contributed to the increase in inequality. Poverty has increased from 11.8% in 1999 to 15.0% in 2012, accompanied by a hollowing out of the middle class. While the upper 1% of Americans takes home a staggering 22.5% of the country's income, those at the bottom or even the middle have not been participating in America's "success."

A disturbing aspect of America's outsized inequality is the inequality of opportunity where the life prospects of a young American are more dependent on the income and education of his parents than in other advanced countries (Stiglitz, 2014).

One reason explaining the performance of the US economy as being well below its potential has been the ***lack of aggregate demand***. ***As a result the design of tax reform needs to be particularly attentive to impacts on aggregate demand in general and employment in particular***. In particular, it is important to note that some taxes have a larger multiplier than others, i.e. lead to a greater reduction in aggregate demand per dollar of revenue raised. Consequently:

- Taxes on the rich and superrich, who save a large fraction of their income, have the least adverse effect on aggregate demand.
- Taxes on lower income individuals have the most adverse effect on aggregate demand.
    - Thus, ***increasing the progressivity of the tax system*** not only improves the distribution of income, reducing the inequality, but also stimulates the economy.
    - The higher demand for labour that results is especially beneficial to working class families because unemployment is reduced and wages increase.

There are even some taxes that might stimulate the economy more directly:

- An increase in the ***inheritance tax*** and ***estate duty may*** induce some of the wealthy to consume now, and this will stimulate the economy.
  - Rich individuals who would have saved to pass on their wealth to future generations, helping to create a new American plutocracy, may be induced to consume at least some of this wealth.
  - Critics of the estate tax suggest that it is unfair: (1) It allegedly constitutes double taxation as all the income that was the basis of the creation of the estate was taxed once. (2) It is regarded as unfair because death is not a matter of choice. (3) Finally, it is asserted that it is particularly unfair to small businesses, which, to pay the tax, may have to sell assets, inhibiting their operations and costing jobs.
    - These arguments are questionable and in many cases, the problem is not double taxation, but zero taxation (Stiglitz, 2014).
- A ***tax on pollution*** (carbon emissions) has even more benefits. It encourages firms to make carbon-reducing investments and to retrofit their firms to reflect the true costs of the pollution that they generate.
  - A tax on pollution yields a triple dividend because it leads to a better environment which can itself lead to stronger economic performance and it raises revenue, even as it reduces the bad externalities spilling over on the rest of us. Moreover, it incentivises firms to retro-fit, thus encouraging investment that leads to higher output and employment.

It is essential to dispel a misunderstanding with regard to the US in particular, created by advocates of lower taxes for the rich and corporations, which contends that the ***rich are the job producers, and anything that reduces their income will reduce their ability and incentive to create jobs*** (Stiglitz, 2014).

- Firstly, at the current time, it is not lack of funds that is holding back investment, but the lack of demand for the US' large corporations' products.
- It is demand that creates jobs and it is the US' current system's high level of inequality that is accordingly destroying jobs. Furthermore, not only the design of tax reform needs to be attentive to impacts on aggregate demand, but given the substantial increase and high level of inequality, **tax reform also needs to be particularly attentive to distributive impacts**:

Comment [F2]: Secondly?

- According to the generalised Henry George Principle, one of the general principles of taxation is that **one should tax factors that are inelastic in supply**, since there are no adverse supply side effects.
    - As a result, ***a land tax*** must be emphasised because land does not disappear when it is taxed.
    - Given that other exhaustive natural resources also facing a low elasticity of supply, it makes sense to ***tax natural resource rents***, from an efficiency point of view, at as close to 100 percent as possible (Stiglitz, 2014).
- According to the generalized Polluter Pays Principle, there is a class of taxes that actually increases economic efficiency (and stability of the economy and yield of revenue), i.e. **taxes that discourage activities which generate negative externalities (corrective taxes).** This principle must be supported by a further principle that should guide deliberations, which states that **it is better to tax bad things (such as pollution) than good things (such as work).**
    - The case for corrective taxes on environmental externalities, specifically those associated with carbon emissions, with their impact on global climate change (Stiglitz, 2014).

Comment [F3]: this point seems incomplete?

Recommendations in the case of South Africa

In 1994, the Katz Commission referred to a wealth tax as a measure to reduce the significant disparity of incomes and assets between the various groups in South Africa. Given the significant concentration of wealth in the hands of relatively few people, the Katz Commission concluded that the major justification for a wealth tax was that it promotes vertical and horizontal equity and that the contribution of a tax on wealth to the overall fairness of the tax system should not be underestimated. Furthermore, given the trade-offs between the objectives of administrative simplicity and certainty and of equity, and the limitations of the income tax and value-added tax, the Commission indicated that the fairness of the tax system would be enhanced by the imposition of some taxation of wealth. In this regard, the (Katz Commission, 1994) raised the question of the applicability of the following taxes:

- an annual wealth tax or possibly, a once-off wealth tax
- a transfer tax, imposed on wealth when it is transferred from one person to another, either as a gift or as a result of death
- a national land tax or other property taxes.

As described below, these recommendations are still relevant today. According to Piketty and Saez (2012), there are two possible sources of inequality:

(1) an inequality arising from differences in labour income due to differences in ability

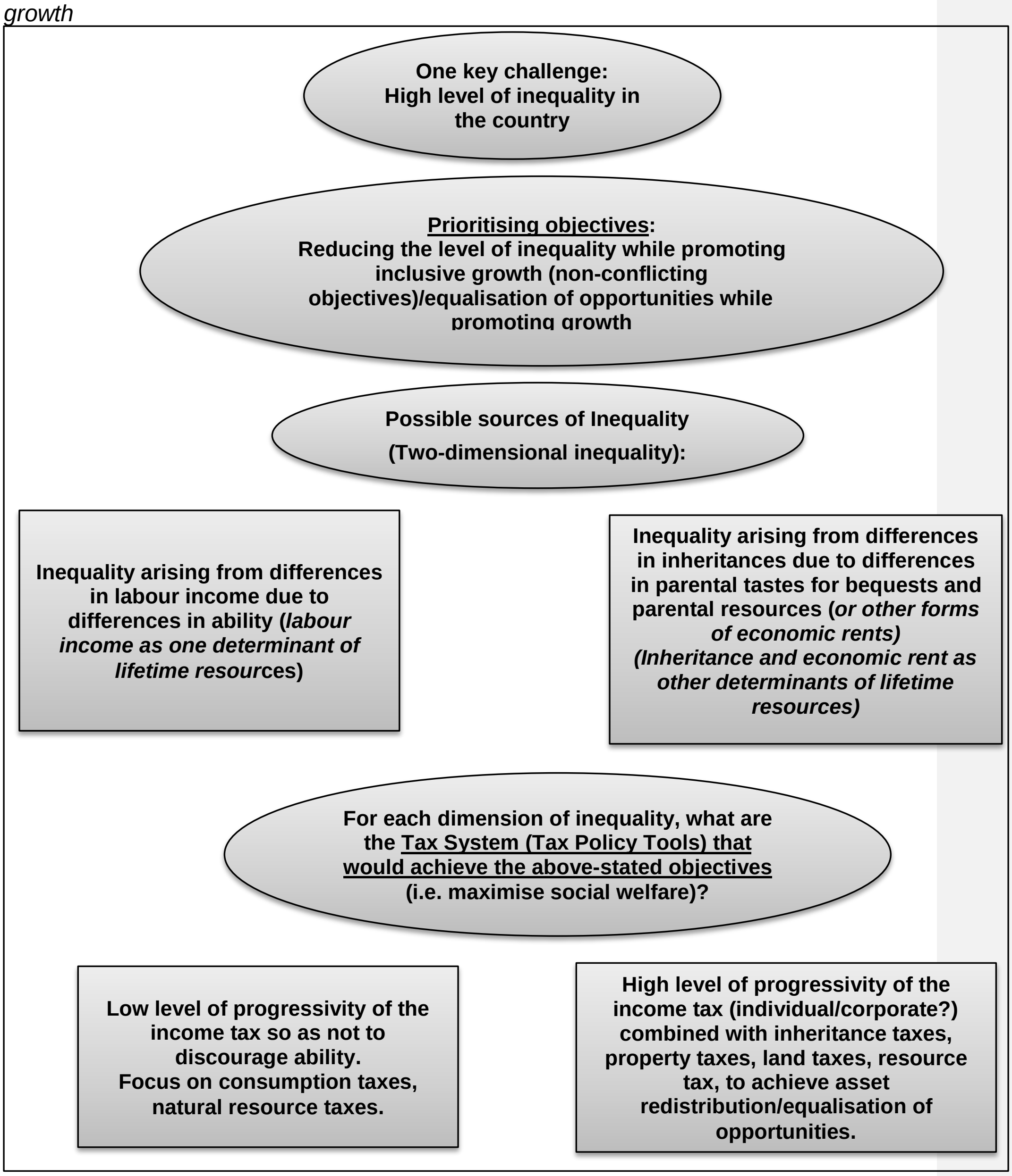
(2) an inequality arising from differences in inheritances due to differences in parental tastes for bequests and parental resources.

In a context where the main objective is to reduce the level of inequality while promoting inclusive growth and specifically, to maximise the equalisation of opportunities while promoting growth, a tax policy tool to address the first type of inequality would be to reduce the level of progressivity of the income tax so as not to discourage ability and to focus on consumption taxes and natural resource taxes (if any). On the other hand, addressing the second type of inequality would be effected through an increase in the level of progressivity of the income tax (individual/corporate) combined with inheritance taxes, property taxes, land taxes, resource taxes, to achieve asset redistribution and equalisation of opportunities. This is illustrated in Figure 2 below.

Comment [F4]: Figure 2? as Fig 1 on pg 15 refers to After tax rate if return. Or is that table 2?

Given the existence of estate duty, the Committee considered it prudent to consider its possible role in addressing the concerns raised in this introduction. If it is viable in a revised form, this would obviate the necessity of proposing a new tax with all the attendant uncertainty and complexity.

Figure 2. Some solutions to reduce the level of inequality while promoting inclusive growth



Source: Piketty and Saez (2012).

Chapter 2
Estate Duty in South Africa

Introduction

The terms of reference extended to the Davis Tax Committee by the Minister of Finance instructed it to enquire into:

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

This is not the first enquiry into the contentious issue of death taxes. The Margo Commission of Enquiry made recommendations in 1987, followed by Chapter 4 of the Third Interim Report of the Katz Commission of Enquiry in 1997.

Both the Katz and Margo commissions recommended that South Africa's capital taxes (CTT), being estate duty and donations tax, be replaced by capital transfer tax. However, the Katz commission extended the following caution:

> In summary, a form of capital transfer tax legislation exists at present and its repeal would raise serious questions about the equitable balance of the tax system whether or not its amendment would raise relatively more revenue than is presently the case.[4]

The current evaluation takes place within a context of estate duty and donations tax raising insignificant amounts of revenue.

The Katz Commission offered the following conclusion:

> The following emerges from all the comparative researches undertaken by the Commission:
>
> (a) Capital transfer taxes are prone to being extremely complex;
>
> (b) The complexities referred to above result in problems of administration and high costs of collection;
>
> (c) Anti-avoidance measures, in addition to having to comply with equitable principles, must be designed so as to result in taxation of transactions that should be subject to the relevant taxes but, on the other hand, must endeavour not to include within the tax net transactions that have legitimate commercial and other justifications;

[4] Chapter 7 of the Third Interim Report of the Katz commission of enquiry in 1997 at page 10.

(d) Capital transfer taxes have a notoriously low yield, that is, revenue collected minus costs of collection; and

(e) Regrettably, a worldwide phenomenon of capital transfer taxes is that they give rise to an unproductive estate planning industry.[5]

For this reason there is no prospect of capital taxes, in whatever form, being any type of "silver bullet" that could make any substantial difference to overall tax collections in South Africa.

However since 1997, a number of other issues affecting donations tax and estate duty have emerged that require examination, as part of an overall assessment.

A brief summary of estate duty in South Africa

Estate duty[6] tax has been levied at a rate of 20% on deceased estates on the "dutiable amount of the estate" exceeding R3 500 000.

The dutiable amount of a deceased estate represents the sum of all property of the deceased and property which is deemed to be property of the deceased as at date of death, less specific deductions.

In very general terms the "dutiable amount" of the estate is determined with reference to the following formula applied to the estate:

Market value of all property
+
Market value of all deemed property
-
Creditors
-
Abatements
Inter-spouse bequests
Retirement fund abatement
Charitable bequest abatement
R3,5 million abatement plus "portable spouse exemption"
=
Dutiable value of estate at 20%

[6]Estate Duty Act, 1955, Act 45 of 1955 'The Act'

In general, the executor of the deceased estate is liable to pay the estate duty. However, as the estate also comprises property deemed to be property of the deceased of which the proceeds are not for the benefit of the estate, the Act specifies that the *pro rata* estate duty payable upon deemed property is payable by the beneficiary thereof.

Estate Duty is generally payable within 1 year of date of death. Later payments are subject to interest, unless the Commissioner grants an extension of time to pay the estate duty free of interest. The Commissioner will consider such a request on condition that:

- a written request is forwarded for consideration prior to the expiration of the 1-year period after date of death; and
- payment of a reasonable deposit against the duty is made prior to the expiration of the said period.

The administration of deceased estates is enforced by the offices of the Master of the High Court and not by SARS. This, coupled with the minimal potential collection of estate duty, has left estate duty as a lower priority of SARS.

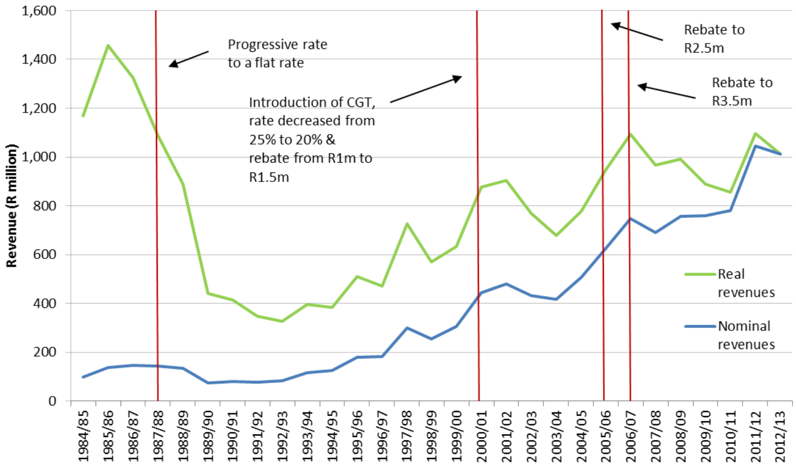
SARS has recently implemented measures to increase enforcement capacity between SARS and the Master's offices. However, this will in no way diminish legal estate saving procedures implemented by many wealthier South Africans, pursuant to the utilisation of the allowances and abatements outlined above.

The decline of estate duty collections

Figure 3 below reflects that estate duty collections have, in real terms, declined over the past 20 years.[7]

[7] *Source: National Treasury*

Figure 3. Estate duty collections 1985 -2013



Source: Piketty (2014).

South Africa abandoned a progressive rate of estate duty in 1988 in favour of a flat rate of 25% in 1988.

CGT was implemented in South Africa, effective from 1 October 2001. In order to soften some of the consequences of both estate duty and CGT being levied on death, the estate duty rate was reduced to 20%, effective 1 March 2001.

The primary estate duty abatement of R1,5 million was increased to R2,5 million, effective 1 March 2006 and then to R3,5 million, effective 1 March 2007.

In addition to the above, other abatements have been granted:

- The "portable spouse exemption", effective from 1 March 2011
- The retirement fund exemption, effective 1 January 2008

The decline in market prices following the financial crisis of 2008/9 has had an obvious, but undetermined, effect on estate duty collections.

Life expectancy may also effect collection of estate duty. In South Africa the average life expectancy is in the order of 53 years[8]. This statistic is meaningless and misleading in the context of this report. It is based on the total South African population of 53 million people, the vast majority of whom are under-privileged and thus have a far shorter life

[8] Statistics SA: 2014 Mid-year population estimates

expectancy than the small minority who may have any prospect of accumulating a meaningful estate during a lifetime.

International studies undertaken by WHO reflect that life expectancy is increasing by approximately 1,5 years per decade. This will obviously have some impact on estate duty collections as pensioners live longer and savings diminish.

Modelling by WHO reflects the average life expectancy of South Africans once they have attained the age of 60 being: males being 16 years (average life expectancy 76) and females being 18 years (average life expectancy 78).

The South African estate duty system contains generous allowances that permit most estates to be subject to both CGT and estate duty only on the death of all spouses. This defers estate duty collection for many years.

Figure 4 below depicts the net result that estate duty collections have declined both in real terms and in terms of their overall contribution to the National Revenue stream to the extent that today they represent a mere ,01% of total tax collections.

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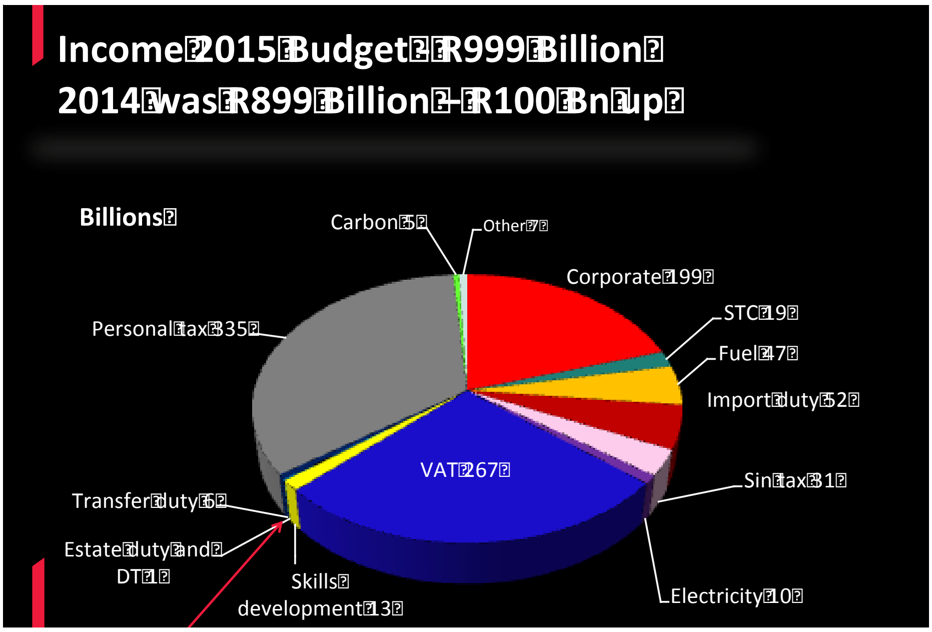
Please keep as is

Figure 4. Review of budgeted tax collections 2015/16



Source: National Budget

National Treasury estimates contained in the 2014/15 Budget review indicate that estate duty collections will only increase slightly within the medium term:

2013/14: R1, 131 billion

2014/15: R1, 237 billion

2015/16: R1, 354 billion

2016/17: R1, 486 billion.

South Africa is not unique with regard to the minimal contribution made by wealth taxes. Many countries have no net wealth taxes, or estate, inheritance or gift taxes. Examples include Australia, Canada, Mexico and New Zealand. For those countries that do have such taxes, they are relatively low yielding taxes. Examples include (OECD Revenue Statistics 2013):

- Denmark: estate and gift tax yielding 0.5% of total tax revenues and 0.26% of GDP
- France: net wealth tax yielding 0.5% of tax revenues and 0.21% of GDP, inheritance and gift taxes yielding 1% of tax revenues and 0.43% of GDP
- Germany: inheritance and gift taxes yielding 0.4% of tax revenues and 0.16% of GDP
- Japan: inheritance and gift tax yielding 1.1% of tax revenues and 0.31% of GDP
- South Korea: inheritance and gift tax yielding 1% of tax revenues and 0.27% of GDP
- Netherlands: inheritance and gift tax yielding 0.7% of tax revenues and 0.26% of GDP
- Spain: inheritance and gift tax yielding 0.6% of tax revenues and 0.21% of GDP
- UK: inheritance and gift tax yielding 0.5% of tax revenues and 0.19% of GDP
- US: estate and gift tax yielding 0.4% of tax revenues and 0.09% of GDP.

These figures suggest that South Africa is significantly underperforming in terms of revenue collections on the estate duty and donations tax and that there is scope to increase performance in this regard. The Katz Commission suggested that a targeted tax contribution for such taxes of 1 to 1.5% of tax revenues might be appropriate, which, translated into the context of the total collection for 2013/14, would amount to approximately R10 billion to R15 billion per annum. Given the challenges South Africa currently faces in reducing its national debt levels this could be a useful contribution.

Inequality

The introduction to this report provides an analysis of the distribution levels of inequality in South Africa. The pyramid structure of existing patterns of wealth, which were set out in the introduction, are reflected in an analysis of a sample of estate duty receipts, which was conducted by SARS during 2013 and reflects the following

Comment [F6]: Should this be set out as a table? If so, it will require a no – as in Table …..

I am quite happy for this to be done but I do not have the skills to do so. ML

Suggest you leave as is

Comment [LL7]: This is in table format. I have just neatened it and added borders

Table 2

Estate value	Estates by Number	Amount received R million	Estates by Number % age	Amount received % age
Less than R10 million	547	158	83	20
R10 million to R20 million	69	145	10	18
R20 million to R30 million	17	73	3	9
Above R30 million	26	418	4	53
Total	659	794	100	100

In comparison:

- The SARS sample covers R794 million of the R1,13 billion estate duty collected in the 2013 tax year, or 70%.
- 80% of the estate duty was collected from estates of value greater than R10 million.
- The number of estates exceeding R10 million within the SARS sample totalled only 112 of the 659.

It is unfortunate that it is almost impossible for the DTC to quantify the profile of taxpayers subject to estate duty and the extent of the utilisation of the principal abatements. In particular, it would be most useful to determine:

- The age profile of taxpayers subject to estate duty
- The degree to which current estate duty receipts resulting from “deemed property interests” are being included in estates as a result of testamentary dispositions made in the past. (for example the cessation of usufructs)

- The composition of the assets of estates and the effect of the controversial "double taxation" of estate duty and CGT on death
- The utilisation of deductions available, in particular
    - Inter-spouse allowances
    - Retirement fund benefit allowances
    - Primary abatement.

The Katz Commission accepted the following principal objectives of the tax system:

Efficiency: The tax system must produce sufficient income for the state, with minimum distortions to the economy (i.e. neutral).

Equity: All residents must contribute to the fiscus in proportion to their ability to do so. Both horizontal and vertical equity are important.

Simplicity: As far as possible, taxes should be simple to understand and should be collected in a timely and convenient manner. Compliance costs are thereby minimised.

Transparency and certainty: The manner in which taxes are collected and the calculation of tax liabilities should be certain. Tax rules and procedures should be transparent and applied consistently.

Applying these canons of taxation, it is clear that the current estate duty system is:

- Manifestly inefficient
- Displays various aspects that are inequitable. In particular, the wealthy are easily able to plan and implement estate duty planning mechanisms with liability largely dependent on marital status and class of asset of the estate
- Significantly complex, time consuming and inconvenient
- Lacks transparency in that it encourages the wealthy to create estate planning structure and lacks certainty as it is almost impossible to determine the true tax liability.

In general, and in contrast to the estate duty system, the fundamental features of the successes achieved by SARS since 1997 encompass the

- broadening of the tax base
- reduction of allowances, deductions and abatements

- reduction of tax rates.

Viewed accordingly, there are obvious shortfalls within the present estate duty system. This in turn raises the following options:

1. Repeal the Estate Duty Act completely, moving away from the concept of treating death as a taxation event.

   Or

2. Amend the Estate Duty Act in order to achieve a simpler, more efficient and just system.

   Or

3. Replace the present estate duty system with a new form of wealth taxation.

Despite all its faults the current Estate Duty Act, coupled with Donations Tax levied in terms of the Income Tax Act, remains the only direct tax on wealth in South Africa. Given the huge disparity of wealth in South Africa, it is hard to justify a repeal of these taxes without any replacement.

However, the replacement of the existing estate duty system with an alternative form of wealth tax would be a massive undertaking for both the taxpayer and SARS.

One possibility is to replace the existing estate duty and donations tax with an annual or periodic net wealth tax. In this regard, it should be borne in mind that capital transfer taxes and periodic or annual wealth taxes are both wealth taxes as they tax the same base; the only significant difference is in relation to the time at which the tax is levied.

However, there are numerous well known and documented disadvantages associated with an annual wealth tax (see for example OECD (2010), Tax Policy Reform and Economic Growth and Wealth Tax: Options for its Implementation in the Republic of Ireland).[9]

These most notably include the following:

- There are significant difficulties and costs associated with identifying, measuring and valuing net assets on an annual or periodic basis

- Both compliance and collection costs are likely to be high, thereby falling foul of the principle of efficiency

[9] http://www.nerinstitute.net/download/pdf/neri_wp_no_6_2013_mcdonnell_wealth_tax.pdf

- Recurring net wealth taxes are more distortionary than death and gift taxes, a disincentive to entrepreneurship and discourage savings
- Such taxes may encourage persons to transfer their wealth offshore and/or emigrate
- Such taxes do not comply with the principle that taxes should be levied at the time that is most convenient to the taxpayer and may necessitate a realisation of assets or an increase in borrowings to pay the taxes if income is insufficient to absorb the tax.

While there are also some advantages, such as contributing to vertical and horizontal equity, encouraging the productive use of assets and providing a useful check for taxes on income, it is considered that the disadvantages generally far outweigh the advantages. The result has been that the number of countries with a recurrent net wealth tax has steadily declined. Of the OECD countries, only France, Spain (temporarily), Netherlands (limited to investments), Norway, Switzerland and Iceland (temporarily) levy recurrent net wealth taxes.

The Katz Commission shared these concerns and recommended in its Third Interim Report that an annual wealth tax should not be introduced, primarily because of the difficulties related to compliance and administration. This recommendation was carried through into the Fourth Interim Report of the Katz Commission. In the opinion of the DTC, these concerns remain equally valid today and mitigate against the introduction of an annual or periodic wealth tax.

By contrast, the Katz Commission recommended retaining donations tax and estate duty for the following reasons:

- SA has a marked concentration of wealth
- Although the taxation of income and capital gains is taxed at progressive rates, these address only income inequality and not wealth inequality
- The repeal of estate duty and donations tax would raise serious questions of equity in the tax system.

These are very cogent reasons which still hold good today. The DTC recommends that, with some modification, the estate duty system could achieve many of the objectives outlined without resorting to the drastic measure of implementing Capital Transfer Tax.

Chapter 3
Estate duty avoidance

General Anti-Avoidance Regulations (GAAR)

If estate duty is to be retained, clearly it has to be vigorously applied, albeit fairly and in terms of certain legal principles. At present, however, many estate planning mechanisms undoubtedly have estate duty avoidance as their sole or main intention. However, they cannot be dealt with by SARS other than through the GAAR provisions; that is section 80 of the Income Tax Act based on the minimisation of estate duty alone.

The only other avenue open to SARS to challenge an estate duty saving structure could be to treat the structure as a simulated transaction as envisaged in the Supreme Court of Appeal judgment of CSARS v NWK.[10] However, the chances of SARS succeeding in such an attack are relatively minimal, particularly in the light of the recent clarification of the NWK judgment by the Supreme Court of Appeal in the recent judgments of Roshcon[11] and CSARS v Bosch[12]

Comment [F8]: I see that there are fewer footnotes – previous edition this was footnote[12].

Correct now.ML

Many estate duty saving structures do appear to be based upon simulated transactions and thus could be vulnerable to attack by SARS. However, each case would have to be assessed on its own merits. It is thus almost impossible for SARS to create a precedent that would create certainty for both SARS and the taxpayer. Meanwhile, the taxpayer remains able to advance a wide range of other motives in the defence of an estate duty saving structure.

The DTC is of the opinion that section 80 of the Income Tax Act and judicial precedent do not currently act as an effective deterrent against the wide range of estate duty saving mechanisms that exist today. This is consistent with the findings of the Third Report of the Katz Commission:[13]

> The Commission does not favour general (as opposed to specific) anti-avoidance measures in the context of estate duties, inter alia, for the following reasons:

[10] CSARS v NWK (27/10) [2010] ZASCA 168
[11] Roshcon (Pty) Limited v Anchor Auto Body Builders CC and Others (49/13) [2014] ZASCA 40; [2014] 2 All SA 654 (SCA), 2014 Taxpayer 185
[12] Bosch and Another v Commissioner of South African Revenue Services (A 94/2012) [2012] ZAWCHC 188; [2013] 2 All SA 41 (WCC); 2013 (5) SA 130 (WCC) (20 November 2012)
[13] Third report of the Katz Commission, 1997, at page 19

(a) At the time when the transaction is challenged, the founder would have died. This makes the entire issue of evidence and the evaluation thereof very difficult;

(b) There would be much uncertainty and confusion which would undermine the sensible planning of one's affairs; and

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

For these reasons, DTC is of the opinion that the pursuit of further GAAR provisions to be included in the estate duty act has little prospect of success. Other legal avenues must be found to close the obvious loopholes in the present system.

This is not to say that the enforcement of the existing estate duty system could not be substantially improved through the employment and training of expert SARS estate duty assessors. It is anticipated that the cost of such an initiative by SARS would be well justified by substantial additional estate duty collections.

Chapter 4
Trusts

It is perhaps trite to commence with the observation that there remain a large number of legitimate reasons to form trusts, other than the pursuit of estate duty savings. However, the use of trust structures in their various forms causes the growth of the underlying investments to fall outside of the donor, settlor or beneficiary's estate for purposes of the estate duty computation.

In the absence of specific anti-avoidance provisions within the Estate Duty Act, there is little to prevent South Africans from using trusts as effective estate duty saving mechanisms.

Currently trusts are taxed at a flat rate of tax of 40% for income and 26,64% for capital income. Thus it would appear that significant arbitrages exist between trust tax rates and personal income tax rates:

- The CGT rate for trusts is double the maximum personal income tax rate
- Trust tax rates exceed the personal tax rate where taxable income is below the current maximum marginal tax rate threshold of R673 100 per annum.

However, the provisions of sections 7 and 25B of the Income Tax Act allow the trustees of the trust to cause the trust income to vest and be taxed in the hands of a beneficiary. This is known as the "attribution principle."

The attribution rules in section 7 were originally intended as an anti-avoidance measure aimed at preventing a trust from being used as an income-splitting device. Prior to years of assessment, commencing on or after 1 March 1998, trusts were taxed on a sliding scale with the same maximum marginal rate as individuals, but without the rebates. It would therefore have been a simple matter to place income-generating investments in a number of trusts in order to take advantage of the trust's sliding tax scale. The need for section 7 in those years will be appreciated if regard is had to the extremely high individual tax rates that prevailed at the time. For example, in 1972, the maximum marginal rate of tax for an individual was 66% (inclusive of a surcharge) plus a loan levy of 12% which increased the rate to 78%.

From the 1999 to 2002 years of assessment, trusts were taxed at a dual rate of tax. For example, in the 1999 year of assessment the first R100 000 of taxable income was taxed at 35% and above that level at 45%, the latter being equal to the maximum marginal rate of an individual. The dual rate prompted some taxpayers to form multiple investment trusts to take advantage of the 35% rate, including the questionable practice of forming multiple “pour over” trusts. Thus Trust 1 would retain R100 000 and distribute the balance of its income to Trust 2 which in turn would distribute the excess above R100 000 to Trust 3 and so on. Even at this point, attribution to a donor made sense because it would have the effect of taxing the donor at 45% instead of 35%.

For the 2003 and subsequent years of assessment trusts have been taxed at a flat rate of tax of 40%. They have an inclusion rate of 66,6% for capital gains, giving an effective rate of 26,64% (66,6% × 40%). When CGT was introduced in 2001, the “attribution back to donor” rules in paragraphs 68 to 73 of the Eighth Schedule merely followed the same rules as in section 7.

Because of the flat rate of tax of 40% and effective flat rate for CGT purposes of 26,64% the attribution rules no longer serve their purpose as an anti-avoidance provision; the opposite is true. They now represent a concession to high net worth individuals. At best, income will be taxed at the same rate of 40% but it could be taxed at anything from 0% to 40%, depending on the level of taxable income of the donor. Thus, the attribution rules can be, and are now, employed to avoid tax, thereby subverting the very purpose for which they were introduced. For CGT purposes, there is a definite benefit to a donor who is a natural person, with capital gains being taxed at between 0% and 13,32% instead of at 26,64%.

A further aberration from the fiscus’ standpoint is that attribution to a donor of income has no effect on the donor’s estate for estate duty purposes, since the assets derived from the deemed income are in reality held by the trust. To make matters worse for the fiscus, a donor has the right to recover the tax on the deemed income from the assets of the trust under section 91. However, few donors would exercise that right since it would be better for them to pay the tax themselves, thus diminishing the value of their estates even further.

In summary, the attribution principle was established at a time when personal income tax rates were substantially higher than trust tax rates. This has now reversed, particularly in regard to capital tax rates where the highest rate of CGT for personal income tax (13,32%) is now half the rate of trusts (26,64%). Further benefits can be gained if trust income is taxed in the hands of the individual receiving income below the maximum marginal rate of 40% attained at taxable income level of R673 100 per annum.

Interest Free Loans

In order to avoid the donations tax implications of implementing an inter vivos trust arrangement many assets are transferred into trusts, allowing the transfer consideration to remain outstanding by way of an interest-free loan account. These amounts are then gradually repaid as and when cash becomes available to the trust. This effectively results in the gradual dissipation of a taxpayer's estate over a prolonged period, in turn ultimately dissipating the taxpayer's estate prior to death.

The transfer pricing provisions of section 31 are not of application to loans between South African resident taxpayers. In reality, this results in the donations tax provisions of the Income Tax Act being largely ineffective when assets are transferred into trusts.

The decision in *CSARS v Brummeria Renaissance (Pty) Ltd*[14] demonstrated that, in certain circumstances, a deemed return can be imputed on an interest-free loan between resident South Africans. However, this judgment can only be applied in very specific circumstances and cannot address the widespread range of interest-free loans used in estate planning today.

Recommendations: Income Tax

The attribution principle fundamentally undermines the present policy of the South African tax system towards trusts. Taxpayers are currently almost in a position to freely divert income (both capital and revenue in nature) away from trusts, to be taxed in the hands of beneficiaries with lower effective rates of tax.

Given the various forms of trust arrangements, it is impossible to prescribe universal anti-avoidance provisions to stem the loss.

The DTC recommends that many of the deficiencies of the current estate duty system be addressed by way of the following simple yet fundamental amendments to the existing legislation:

- The flat rate of tax for trusts should be maintained at its existing levels
- The deeming provisions of section 7 and 25B insofar as they apply to RSA resident trust arrangements should be repealed
- The deeming provisions of section 7 and 25B insofar as they apply to non-resident trust arrangements should be retained
- Trusts should be taxed as separate taxpayers
- The only relief to the rule should be the "special trust definition" contained in section 1 to the Income Tax Act which allows a trust to be taxed at personal income tax rates in limited special circumstances. The definition should be

[14] 2007 (6) SA 601 (SCA).

revisited by National Treasury so as to make provision for the inclusion of selected trusts used in Broad Based Black Economic Empowerment Structures

- No attempt should be made to implement transfer pricing adjustments in the event of financial assistance or interest-free loans being advanced to trusts.

Taxpayers must be allowed to make use of trusts when it makes sound sense to do so in the pursuit of a commercial justification or benefit, as opposed to an estate duty benefit. However, as is the case with present company tax rates today, the taxpayer must accept any potential adverse tax consequences.

The DTC acknowledges that the repeal of the attribution provisions will have diverse and far-reaching implications. Thus, it would be in the interests of equity that the repeal of the attribution provisions be announced in the 2015 National Budget Speech but only implemented with effect from 1 March 2016. An extensive consultative process will have to follow during the 2015 legislative cycle, so as to identify and address the many issues involved.

There would be numerous complexities associated with implementing a form of transfer pricing adjustment to deem a return on interest-free loans between SA registered trusts and SA taxpayers. The DTC concurs with the recommendations of the Katz Commission that this be avoided.[15]

Wealth Taxes and SA resident trusts

The repeal of the attribution provisions should address the income tax advantages currently available to trusts. However, this does not extend to the estate duty advantages inherent to trusts that allow estate duty to be deferred or avoided.

Capital Transfer Tax ("CTT")

South Africa implemented estate duty in 1955. Various other countries have since implemented CTT, a more advanced and sophisticated form of inheritance tax than estate duty that seeks to impose taxation periodically instead of only on death. In particular CTT seeks to recover lost estate duty collections where assets are transferred to a trust.

The Katz Commission recommended that the complex issues of tax avoidance be addressed through the introduction of capital transfer tax (CTT):

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[15] Third Report of the Katz Commission, 1997 at page 16.

> It is therefore the recommendation of the Commission that trusts be subjected to the capital transfer tax provisions on the basis that, at periodic intervals, the net assets of the trust will be valued and subjected to capital transfer tax at the rate applicable to inter vivos donations and assets without any rebates. The frequency of the period must be a matter determined by Government and it should ordinarily reflect a single generation and any period within the range of 25 to 30 years would be appropriate.[16]

The Katz commission noted that it was not the work of the Commission to draft the CTT legislation, but rather that of National Treasury. Thus, only the broadest of outline recommendations were made.

CTT has been pursued by National Treasury and SARS. However, these proposals have never reached the legislative cycle. The extent of the tax revenues that could be achieved through the implementation of CTT is unknown. Thus, there is no basis for making a recommendation for the implementation of CTT at this time, given the significant complexity attached thereto. The implementation of CTT in South Africa would place an enormous burden on the resources of both SARS and the taxpayer as was evident, for example, when CGT was implemented in 2001. The resultant gain in revenue collections cannot be assured. Thus the DTC is of the opinion that CTT implementation should be postponed, at least until such time as more substantial information justifying its implementation is available.

Net Wealth Taxes (NWT)

As is evident from the introduction to this report, the DTC has also considered the possibility of implementing an annual or periodic NWT.

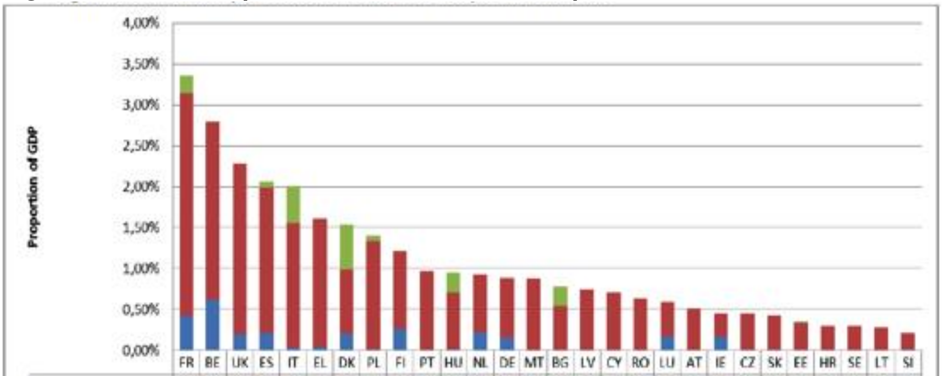
NWTs are applied to taxpayers with a large surplus wealth. As already indicated, there are only a few such taxes and therefore a comparative analysis is more limited. Within the European Union there are two general net wealth taxes, one general provision and one specific tax. For the two general taxes, one can say that:

- Large tax free thresholds apply (€700,000 / € 1,300,000);
- Business assets are exempt from the tax base
- The taxes are progressive with rates between 0% and 2,5%.

Net wealth taxes within the European Union

[16] Fourth report of the Katz Commission, 1997 at page 23

Figure 5. Relative importance of wealth taxes as part of the GDP



	FR	BE	UK	ES	IT	EL	DK	PL	FI	PT	HU	NL	DE	MT	BG	LV	CY	RO	LU	AT	IE	CZ	SK	EE	HR	SE	LT	SI
Net-wealth	0,2	0,0	0,0	0,0	0,4	0,0	0,5	0,0	0,0	0,0	0,2	0,0	0,0	0,0	0,2	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Real estate and land	2,7	2,1	2,0	1,7	1,5	1,5	0,7	1,3	0,9	0,9	0,6	0,7	0,7	0,8	0,5	0,7	0,7	0,6	0,4	0,5	0,2	0,4	0,4	0,3	0,3	0,3	0,2	0,2
Inheritance and gift	0,4	0,6	0,2	0,2	0,0	0,0	0,2	0,0	0,2	0,0	0,0	0,2	0,1	0,0	0,0	0,0	0,0	0,0	0,1	0,0	0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0

The tax base is net wealth, but only insofar as this net wealth exceeds a set amount. This is realised by both tax free thresholds and by specific exemptions for the family home (Spain) or business assets (France and Spain). Because the taxes are only intended to tax a certain surplus of wealth, their limited importance can be explained: only a very small part of the theoretical taxpayers liable will ever pay the tax.

This is even more limited, as developments over time show that several countries abolished their wealth tax because of the fact that the taxpayers were able to move much of their wealth out of reach of the said tax. Because of high compliance costs and the negative effect of taxpayers moving wealth out of the country, these Member States decided to abolish the tax.[17]

The experiences within the European Union demonstrate that the actual collections of NWT are disappointing. As in the case of CTT, the complexity of a net wealth tax and the uncertainty of a successful implementation prompts the exercise of caution as regards such a proposal.[18]

[17] Cross-country Review of Taxes on Wealth and Transfers of Wealth, Specific Contract No 8 TAXUD/2013/DE/335

Based on Framework Contract No TAXUD/2012/CC/117, Revised Final report, EY – October 2014.

[18] Cross-country Review of Taxes on Wealth and Transfers of Wealth, Specific Contract No 8 TAXUD/2013/DE/335

Based on Framework Contract No TAXUD/2012/CC/117, Revised Final report, EY – October 2014.

An alternative to CTT and NWT

It is important to note a significant trend that has emerged as a result of the introduction of CGT with effect from 1 October 2001.

At the time of the Third Katz Report (1997) many estate duty saving structures were based on the use of companies with different classes of share capital.

Today, the effective rate of tax on capital income of a company is 30,87% as a result of the implementation of CGT (66,6% inclusion rate applied against a 28% tax rate) and dividend tax at the rate of 15% applied to the after-tax gain on distribution. As a result, the tax-planning industry has made a definite move away from the use of companies in estate planning exercises.

Comment [F9]: the graphic illustrating Effective Tax Rates has been omitted here – it that correct?

Correct ML

CGT collections post 2001 were disappointing, with just R8,7 billion being collected between 2002 and 2009. This was however to be expected as taxpayers benefitted from CGT valuations at the implementation date and the time apportionment formula.[19] Table 3 records CGT raised in the period 2009/10 to 2013/14.

Comment [F10]: Added in by Ed. (explanation of a table or figure should appear in the text first).

Accepted

Table 3: CGT receipts, 2009/10 – 2013/14[20]

		CGT raised		
	R million	**Individuals**	**Companies**	**Total**
	Prior to 2008/09	3 017	5 735	**8 752**
	2008/09	3 807	4 136	**7 943**
	Prior to 2009/10	6 824	9 871	**16 694**
	2009/10	4 357	6 023	**10 380**
	2010/11	2 012	7 049	**9 061**
	2011/12	1 550	5 263	**6 813**
	2012/13	2 166	5 008	**7 174**
	2013/14	6 970	4 633	**11 603**
	Cumulative	23 879	37 847	**61 726**

[19] *SARS and National Treasury Statistics 2014*

However, a recent and material change in CGT collections has occurred. In 2012, the CGT inclusion rates were increased to 33,3% for individual taxpayers and 66,4% for corporates and trusts. In the 2013/14 fiscal year, CGT collections increased to R11,6 billion. This is indeed a most encouraging trend and demonstrates the potential of the CGT system.

Recommendations

The DTC is of the opinion that by addressing the income tax regime for trusts (as outlined above) a substantial deterrent to estate planning will have been created without the necessity of devoting substantial resources towards the implementation of CTT or NWT. In so doing, a combination of increased estate duty and CGT collections may have the potential of making a most useful contribution to overall tax collections.

Taxpayers who pursue the postponement of estate duty through the use of trusts will remain at liberty to do so. But upon sale of the assets of a trust a higher rate of tax will be imposed, thus compensating for the estate duty loss.

If this recommendation is accepted there will obviously be a call for taxpayers to be allowed a period to dissolve their existing trust arrangements. The DTC is not in favour thereof, as:

- The dissolution of a trust arrangement must be achieved in terms of the provisions of the trust deed, irrespective of tax implications
- It would be inequitable to simply allow a trust to “bank” its accumulated estate duty savings
- It would be extremely complicated for both SARS and the taxpayer.

Foreign trusts

In 2004 taxpayers were offered a generous income tax and exchange control amnesty in respect of assets accumulated by taxpayers abroad in contravention of both the Income Tax Act and Exchange Control Regulations of the Reserve Bank.

42 672 South Africans participated in the amnesty programme. Assets in excess of R68,6 billion were identified and brought within the South African tax system. Exchange control levies totalled R2,9 billion.

Sections 7(8) and 25B have been amended to deal specifically with the taxation consequences of offshore trust arrangements of South African donors and beneficiaries.

Comment [ML11]: Amended by ML

In spite of the offshore amnesty programme, there is an indication that there remains an unknown number of South African resident donors and beneficiaries associated with offshore trusts who remain in breach of sections 7(8) and 25B.

SARS has now implemented a permanent mechanism for all taxpayers to amend their taxation declarations through the Voluntary Disclosure Programme contained in sections 225 to 233 of the Tax Administration Act, 2011. Thus the DTC is of the view that there is no need to consider a further offshore amnesty programme. Indeed such a programme would undermine the effectiveness of the voluntary disclosure programme.

The DTC has recommended that the estate duty lost owing to the use of South African-registered trusts be recovered by repealing the attribution principle that allows tax-planning arrangements to enjoy the estate duty savings of trust while also benefitting from the lower tax rates afforded to individual taxpayers. This recommendation cannot be extended to foreign trusts as they are not registered for tax in South Africa. Thus SARS will have to continue along the lines specified in section 7(8) and 25B(2A). That is not to say that the effectiveness of sections 7(8) and 25B(2A) should not be reassessed and reconsidered. The Committee will continue to investigate this question.

The equivalent of section 25B(2A) for CGT purposes is paragraph 80(3) of the Eighth Schedule. This provision refers to an amount that would have comprised a capital gain had the non-resident trust been a resident, thus bringing the full range of assets into the net instead of only the assets referred to in paragraph 2(1)(b) (immovable property in South Africa or assets of a permanent establishment in South Africa). When such an amount is distributed out of the trust capital in a subsequent year of assessment it is deemed to be a capital gain of the resident beneficiary.

Capital gains distributed to a resident beneficiary in the same year of assessment in which they arise are dealt with under paragraph 80(2). However, unlike paragraph 80(3) this provision suffers from a deficiency, in that it refers to a capital gain and not to an amount that would have constituted a capital gain had the non-resident trust been a resident. It can thus only apply to the limited range of assets referred to in paragraph 2(1)(b). Consequently, SARS is powerless to subject most gains of a non-resident trust to CGT in the hands of resident beneficiaries when such gains are distributed in the same year of assessment in which they arise.

Owing to the difficulties of identifying the components of income distributed to a beneficiary it is recommended that all distributions of foreign trusts be taxed as income. This will discourage offshore trust formation and can be justified on the grounds of the deferral of the tax that a beneficiary obtains through the use of an offshore trust.

In spite of the legislation there will always be taxpayers who continue to fail to disclose their true offshore trust arrangements. In the course of time these arrangements may be unravelled by SARS through the exchange of information between worldwide tax authorities.

On 10 June SARS published a Draft Public Notice, listing arrangements that would be deemed to be reportable. Public comments in respect of the Draft Public Notice had to be submitted by 23 June 2014. Taxpayers that will qualify as participants in arrangements listed will be required to report them to SARS once the list has been finalised.

A reporting requirement will not only be triggered in respect of new transactions but also in respect of existing transactions that will qualify as a reportable arrangement in terms of the final list to be published by SARS.

The Draft Public Notice specifically lists arrangements involving foreign trusts to comprise reportable arrangements:

> Any arrangement in terms of which a resident makes contributions or payments, to a non-resident trust and acquires a beneficial interest in that trust, and the amount of all contributions/payments or the value of the interest exceeds or is expected to exceed R10 million, excluding any contributions/payments, or beneficial interest acquired in any:

(a) Foreign collective investment scheme in securities and bonds

(b) Foreign investment entity as defined in section 1(1) of the Income Tax Act.

This may certainly curtail the use of the larger foreign trust arrangements but might not go as far as to include smaller arrangements or the formation of multiple trusts below the R10 million threshold.

Recommendation

The DTC recommends that the criminal offence provisions of the Tax Administration Act 2011, be reviewed pursuant to the possible inclusion of separate criminal charges that can be brought against taxpayers who fail to disclose their direct or indirect interests in foreign trust arrangements.

Chapter 5
The inter-spouse bequest

The Katz Commission recommended that bequests in favour of surviving spouses remain exempt from estate duty in spite of there being no intellectual justification for the retention of the exemption and it being potentially in breach of the provisions of the Constitution. The recommendation was made entirely on "pragmatic grounds."[20]

Comment [F12]: Correct that this is the second ref to footnote[20] (Table 6.1)?

Corrected ML

This recommendation stood in stark contrast to the findings contained in the First Katz report:

> *The Commission's view is that gender discrimination is probably unconstitutional and that discrimination on the basis of marital status is no longer appropriate….The Commission therefore accepts that some loss of personal tax yield is inevitable. It will however seek to limit it, and suggests ways of recouping it from other parts of the tax system.*[21]

Similar exemptions are contained in the donations tax[22] and CGT[23] legislation.

Post the Katz report (1997) the definition of "spouse" in section 1(1) of the Income Tax Act was amended in 2001 to include not only all forms of marriage and customary union but also any relationship, same-sex or heterosexual, which the Commissioner is satisfied is intended to be permanent.[24]

The effect of granting a "double abatement" to married taxpayers is substantial as demonstrated in Table 4 below.

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20 Fourth report of the Katz Commission, 1997 at page 26

21 First report of the Katz Commission,1995 at page 91

22 Section 56(1)(a) and (b).

23 Paragraph 67 of the Eighth Schedule to the Income Tax Act.

24 Definition of "spouse" inserted by s. 5 (j) of Act No. 5 of 2001.

Table 4: Estate duty liability calculations by estate value

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

The DTC suggests that the simple justification for an exemption based on "pragmatic grounds" is entirely insufficient. In particular, this is because:

- The exemption is fundamental to the entire CGT, donations tax and estate duty regimes;
- The constitutional implications must be of paramount importance at all times and cannot be dismissed on the basis of pragmatism alone;
- The continued growth of the phenomenon that is the single parent family over the past 20 years, cannot be ignored: society has fundamentally changed since 1997;
- Today bequests are increasingly being used for the maintenance of the parents and extended family of the deceased and not only the spouses and children of married taxpayers;

- The inclusion of “permanent relationships” in the definition of “spouse” is open to widespread manipulation, interpretation and abuse. This abuse may even go as far as inter spouse bequests being made on the grounds of estate duty saving rather than the true wishes of the taxpayer. Furthermore, the discretion afforded to the Commissioner is open to inconsistent interpretation and application;

- The Income Tax Act was amended to exclude the joint taxation of taxpayers. Yet, it has been allowed to continue for CGT, donations tax and estate duty purposes. Thus a fundamental inconsistency exists within the taxation system;

- The Income Tax Act is unlike any other South African legislation in that it gives recognition to permanent relationships;

- A spouse who receives a donation or bequest is given no option but to accept the inherent estate duty and CGT consequences;

- The exemptions are open-ended leaving the wealthier taxpayer in a position to defer CGT, donations tax and estate duty irrespective of financial need.

No statistical data is available concerning the use of the exemptions.

An analysis of inheritance taxes in the European Union reflects that 11 out of 18 countries fully exempt the surviving spouse:

- Seven out of 18 Member States fully exempt the children;

- Finland and the Walloon Region in Belgium stand out with relatively low exemptions for the spouse *and* children;

- The Netherlands and Belgium have the lowest exemptions for children;

- Spain and the Brussels/Flanders Region in Belgium have large exemptions for the spouse, but only for that part of the inheritance consisting of the family home. Germany employs such a special asset related exemption for the family home besides its general exemption. [25]

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[25] Cross-country Review of Taxes on Wealth and Transfers of Wealth, Specific Contract No 8 TAXUD/2013/DE/335
Based on Framework Contract No TAXUD/2012/CC/117, Revised Final report, EY – October 2014.

Table 5 below provides a summary of inheritance and gift tax exemptions within the European Union.[26]

Table 5: Inheritance and gift exemptions

Member State	Exemption Spouse INH	Exemption Child INH	Exemption Spouse GIFT	Exemption Child GIFT
Belgium: *Successierechten*	Family home exempt (Not Walloon)	None, except for small abatements/ reductions	None	None
Bulgaria: *Закон за местните данъци и такси*	Total amount	Total amount	Total amount	Total amount
Denmark: *Bo og gaveafgift*	Total amount	€ 36,000[53]	€ 8,000	€ 8,000
Germany: *Erbschaft /Schenkungsteuer*	€ 500,000	€ 400,000	€ 500,000	€ 400,000
Ireland: *Capital acquisitions tax*	Total amount	€ 225,000	Total amount	€ 225,000
Greece: *Κώδικας Φορολογίας Κληρονομιών / Δωρεών / Γονικών παροχών*	€ 150,000	€ 150,000	€ 150,000	€ 150,000
Spain: *Impuesto sobre Sucesiones y Donaciones*[54]	95% real estate value; max. € 122,606.47	95% real estate value; max. € 122,606.47 + Max. € 47,858.59[55]	None	None
France: *Droits de mutation à titre gratuit par décès ou entre vifs*	Total amount	€ 100,000	€ 80,724	€ 100,000
Croatia: *Porez na nasljedstva i darove.*	Total amount	Total amount	Total amount	Total amount
Italy: *Imposta di successione e donazione*	€ 1,000,000	€ 1,000,000	€ 1,000,000	€ 1,000,000
Lithuania: *Paveldimo turto mokestis*	Total amount	Total amount	Provision	Provision
Luxembourg: *Droits de succession*	Total amount	Total amount	n/a	n/a
Droits de mutation par décès[56]	Total amount	Total amount	n/a	n/a
Droits d'enregistrement sur les donations	n/a	n/a	None	None
Hungary: *Öröklési illeték*	Total amount	Total amount	Total amount	Total amount
The Netherlands: *Successiewet*	€ 627,367	€ 19,868	€ 2,092	Max. € 100,000[57]
Poland: *Podatek od spadków i darowizn*[58]	Total amount	Total amount	Total amount	Total amount
Slovenia: *Zakon o davku na dediščine in darila*	Total amount	Total amount	Total amount	Total amount
Finland: *Perintö- ja lahjaverolaki*	€ 60,000	Max. € 40,000	€ 4,000	€ 4,000
United Kingdom: *Inheritance tax*	Total amount	€ 390,000[59]	Total amount	€ 3,680[60]

[53] General exemption, not specific to children; exemption applies to the estate, regardless of the number of heirs.
[54] State legislation.
[55] If the child is under 13. If the child is older than 21 an exemption of € 7,993.46 applies.
[56] Spouses or registered partners since more than 3 years having no common children are only benefitting from an exemption of € 38.000.
[57] One time exemption only. Highest unconditional exemption € 5,299.
[58] Total amount exempt if the inheritance is communicated to the tax office within 6 months and in case of cash. a bank transfer confirmation should be presented. Otherwise an exemption of € 2.300 applies.

[26] Cross-country Review of Taxes on Wealth and Transfers of Wealth, Specific Contract No 8 TAXUD/2013/DE/335
Based on Framework Contract No TAXUD/2012/CC/117, Revised Final report, EY – October 2014.

Recommendation

No amount of refinement to the definition of spouse within the Income Tax Act can cater for the diverse circumstances and challenges facing South African families today. Thus the principle of inter-spouse exemptions and roll-overs should be either withdrawn completely or subjected to a specified limit.

It is suggested that the answer may lie in reframing the “portable spouse” abatement.

Currently the deceased estate is permitted to increase the basic abatement by the unutilised portion of the primary abatement of any pre-deceased spouse.

If the inter-spouse abatement is withdrawn then it may be possible to advance the primary abatement of the surviving spouse(s) to be offset in the estate duty computation of the first deceased spouse. The estate of the surviving spouse would ultimately forfeit some or all of the primary abatement in the future.

This would effectively ensure that no estate duty is imposed until the basic abatement of all spouses has been exhausted. This recommendation would prevent the levels of abuse inherent in the existing unlimited inter-spouse abatement without imposing undue hardship on the surviving spouse.

The negative result of this recommendation is the potential “double taxation” that may occur if a dutiable bequest is received by a surviving spouse who subsequently dies. The effect would be dependent on the length of time that elapses between the deaths of spouses. It is suggested that a simple table could be developed to exclude dutiable inheritances from the estate duty computation of a surviving spouse over a period of up to 10 years.

Given this recommendation, consideration should be given to the repeal of section 4(q) of the Estate Duty Act whereby a deduction from estate duty liability is given for the value of a bequest made by the estate owner to his or her spouse. This section has been used together with section 4(m) of the Estate Duty Act in a well-known and widely used estate plan whereby the estate owner bequeaths the bare dominium of the estate to a family trust subject to a usufruct in favour of the surviving spouse. (See 2014 Taxpayer 64 for the specific details of this plan.) In this way huge estate duty savings are effected.

Chapter 6
Donations tax

Donations tax is levied at the rate of 20% on the value of any property disposed of by a taxpayer, other than a trust or public company[27].

Donations tax is principally intended to prevent taxpayers from disposing of their estates prior to death, thus preventing their estates from becoming liable to estate duty. It also acts as a deterrent to income-splitting.

Importantly, the sale of an asset where payment is not discharged and the balance remains outstanding by way of an interest-free or below market rate loan, does not constitute a donation but rather a disposition. Thus, such transactions are not liable to donations tax.

Section 56 contains a list of donations that are exempt from donations tax. The following are widely used in the course of reducing the taxpayer's exposure to estate duty:

Inter-spouse donations (section 56 (1)(a) & (b)

In common with various provisions of the Income Tax Act, donations tax is not imposed in respect of transactions between spouses. The definition of "spouse" contained in section 1 of the Income Tax Act includes all forms of marriage and permanent relationships. This leaves the donations tax system open to manipulation and wide interpretation.

It is simply impossible to determine a reasonable level of exemption for inter-spouse donations. For this reason alone the DTC recommends that the inter-spouse donations tax exemptions contained in section 56(1)(a) & (b) be retained, subject to the section 56(1)(b) exemption being amended to exclude all interests in either fixed property or companies.

This recommendation leaves the estate duty system potentially vulnerable to abuse through the donation of cash and other assets between spouses during their lifetime. It may also lead to donations being made to avoid estate duty rather than out of genuine generosity.

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[27] Section 54 of the Income Tax Act.

Of particular concern is the practice of the donation of substantial amounts of cash in anticipation of death. Such donations are specifically exempt as a *"donatio mortis causa"* from donations tax in terms of section 56(1)(c).

It is suggested that in order to prevent the diminution of estates in anticipation of death, the section 56 (1)(c) exemption be removed. Furthermore, the exemptions contained in sections 56(1)(a) and (b) should make specific provision for the exclusion of a *donatio mortis causa* from the inter-spouse exemption provisions.

The DTC suggests that there is ample established legal precedent regarding the *donatio mortis causa* that can be applied by SARS in the event of abuse of the inter-spouse donation exemption.

Foreign property interests (section 56(1)(g)

Donations tax is not payable if the property is donated by a person prior to becoming a South African resident, or if the property was inherited or donated to a South African resident by a non-resident taxpayer.

This exemption was promulgated in 1974 and is consistent with similar exemptions contained in the Estate Duty Act. The provisions have not been updated to take account of South Africa's change from the source basis to the residence basis of taxation in 2001.

The DTC recommends that section 56(1)(g) be re-examined in the light of South Africa's change to residence-based taxation in 2001.

Other allowances – Section 56 (2)

Casual gifts

Casual gifts of up to R10 000 per annum and other donations totalling R100 000 per annum would, *prima facie*, appear to be of little consequence or threat to donations tax or estate duty collections.

However, there exists a widespread practice of annual waivers of loan accounts between taxpayers and their estate planning mechanisms or families. This practice exists over and above the reasonable maintenance exemption (referred to below) and, collectively, could be the cause of substantial tax leakage.

Paragraph 12(5) of the Eighth Schedule acted as a disincentive to the annual waiver of loan accounts between founders and their trusts. However the provision was deleted with effect from the commencement of the 2014 year of assessment. The successor to paragraph 12(5), namely, paragraph 12A, contains an exemption in subparagraph (6)(*b*), covering donations as contemplated in section 55 or section 58), The net result is that the practice of annual waiver of loan accounts has been allowed to continue.

Reasonable maintenance

Section 56(2)(c) exempts any bona fide contribution made by the donor towards the maintenance of any person as the Commissioner considers to be reasonable. This remains an open and obvious loophole for the taxpayer to diminish an estate which cannot be contained by SARS without the deployment of substantial resources.

The Estate Duty Act has previously contained attribution provisions requiring donations made during the course of a lifetime to be included in the estate duty computation. The DTC has considered the reintroduction of similar provisions but considers that this would be extremely complicated and require the maintenance of records beyond the five-year period prescribed in the general rules of the Tax Administration Act, 2011.

It is impossible to determine the quantum of “reasonable expenditure”, in order to impose a monetary limit.

The extent of the “reasonable maintenance” exemption contained in section 56(2)(c) should accordingly be refined by making it subject to various categories of expenditure: for example, food, clothing, medical, education and cost-of-living expenses and possibly even the cost of a small motor vehicle. This would act as a deterrent to substantial abuse. The provision should go further and specifically exclude the donation of assets such as interests in fixed property and financial instruments.

Chapter 7
Capital Gains Tax and Duty

The DTC's terms of reference specifically direct the Committee to investigate the "double taxation on death" created by the imposition of both CGT and estate duty on death in South Africa. This has long been a contentious issue and was even raised by the Minister of Finance in the 2011/12 National Budget Speech.

In this regard Professor J van Roeleveld of the University of Cape Town has published a paper entitled "An argument for either excluding death as a CGT event or abolishing estate duty".[28]

The conclusion of the paper is as follows:

> This paper has discussed the fact that in South Africa CGT and estate duty is levied at the same time in respect of the same asset. There is no justification or policy decision supporting the retention of the two taxes as is evident when reviewing previous reports on the tax structure of South Africa (the Margo Commission 1987 and the Katz Commission 1997), which did not recommend two capital transfer taxes but favoured the retention of one of them, estate duty.
>
> The solution to the problem is either to provide that the act of dying does not give rise to CGT or alternatively to abolish estate duty and retain the deemed disposal of assets on death as a taxable disposal. Whichever alternative is chosen will require extensive amendments to current legislation and some of these have been highlighted. To support the recommendation to retain only one tax in South Africa on the transfer of wealth on death, a brief insight into what taxes are imposed by certain foreign jurisdictions on death was provided and it was found that there was an array of different regimes in place.
>
> The only consistent fact is that two wealth taxes are not levied at the same time on death in any of these countries. It is of extreme importance that if there is to be no CGT on death that the "stepped up" value (the market value used for estate duty) is the base cost for the beneficiary for future disposals, otherwise double taxation will still arise. It is submitted that estate duty should be abolished as CGT legislation is far reaching and more beneficial to the fiscus in that it is imposed from the moment a scheme or estate plan is conceived in the form of a donation or sale to a beneficiary or trust and imposed again on any future disposals by the recipients of the wealth.

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[28] SAJAR, Revised: June 2012, August 2012 Vol 26 No. 1, pp.143 to 16.

> CGT is also covered in most of the 70 double tax treaties entered into by South Africa and these have kept pace with radical changes in domestic legislation, in contrast to the very few and very old estate duty model double tax treaties.

Response of the DTC

Van Roeleveld's conclusion is largely based on the premise that both CGT and estate duty constitute "wealth taxes." **The DTC does not concur with this conclusion.**

CGT is widely regarded as an income tax on capital income and not a wealth tax. Estate duty and donations tax are wealth taxes. This distinction was clearly reported in the review of the CGT proposals conducted by the International Monetary Fund in December 2000 (prior to the implementation of CGT on 1 October 2001).

This conclusion has been confirmed in a recent review of taxes on wealth and transfers of wealth in the European Union[29],

> Capital gains taxes are not wealth taxes and are therefore not included in the report. They are taxes on deferred income gains. These taxes do not aim to tax the sole possession or transfer of certain assets, because tax is only due when the possession or transfer of the assets results in the realization of income. Wealth taxes on the other hand are typified by the fact that the transfer or possession itself is taxed, regardless of whether income is realized.[30]

An analysis of the effective tax rate (CGT and estate duty combined) was recently conducted by National Treasury.

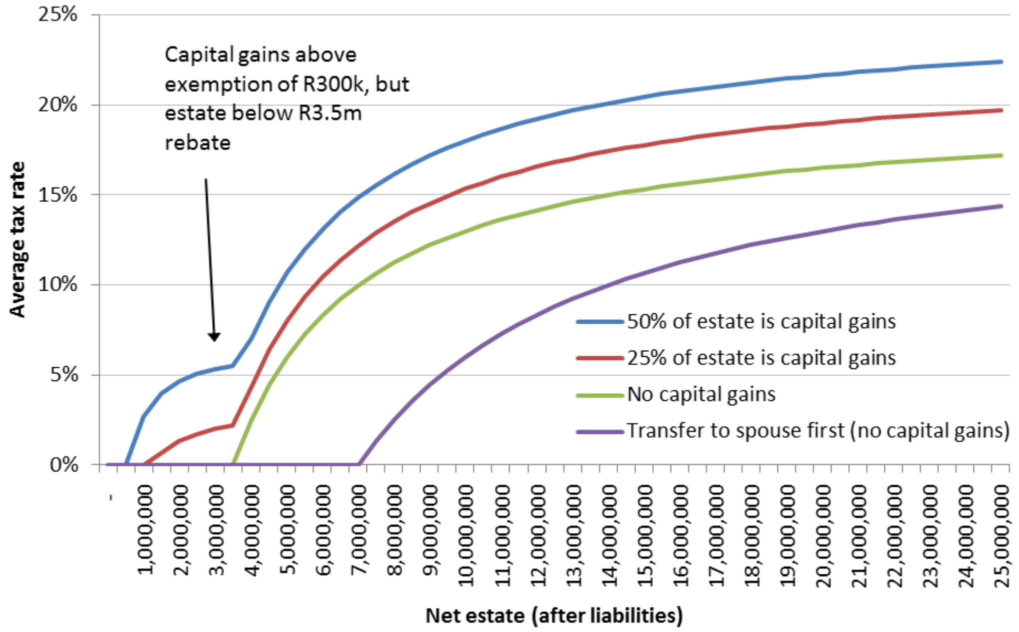
Comment [F13]: Footnote[31] missing –
Perhaps [30] and [31] are intended to be the same reference and need to be conflated?

If so, then all the subsequent footnote numbers will need to be adjusted accordingly – the footnote on the following page is [32] which would then need to become [31]…

No footnote required on this table. It was provided by NY and not included in any prior publication . ML

[29] Cross-country Review of Taxes on Wealth and Transfers of Wealth, Specific Contract No8 TAXUD/2013/DE/335
Based on Framework Contract No TAXUD/2012/CC/117, Revised Final report, EY – October 2014.

Figure 6. Analysis of effective tax rates



Source: National Treasury

Even in the event of 25% of an estate being subject to CGT, the effective combined rate of tax does not exceed 20% on an estate of R25 million. This graphic reflects a worst case scenario. It is highly unlikely that an estate will include a 50% CGT leviable component, as most estates would include assets that are exempt from CGT (life insurance proceeds, retirement fund benefits, primary residences, personal assets, motor vehicles and cash). This contention is supported by statistics furnished by SARS reflecting that only 4% of the estates reported to SARS in 2013 were liable for CGT. The debate is thus very much academic in the context of the monetary effect.

The rate of estate duty should not be increased as it is already higher than the level which is acceptable for a capital transfer tax. An increase will give rise to schemes and arrangements to avoid the tax. The Katz Commission considered the fact that international experience supports the contention that where capital taxes exceed 15% extensive avoidance and evasion results (Katz Commission, 1997).[31]

The CGT inclusion rate for personal income tax was initially established at 25% on 1 October 2001. In order to compensate for the double tax exposure created when CGT is

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[31] SAJAR, Revised: June 2012, August 2012 Vol 26 No. 1, pp.143 to 164.

combined with estate duty or donations tax, the estate duty and donations tax rate was reduced to 20 %.

When the CGT inclusion rate for personal income tax was increased to 33,3% with effect from 1 March 2012, no similar adjustment was made to the estate duty and donations tax rates. If the approach had been consistent with that of the original implementation of CGT the rate should have been reduced by 1,3%.

The real question is: "what is an acceptable combined effective tax rate?" This needs to be reconsidered, as it is now 18 years since the Katz Commission report of 1997.

Chapter 8
Retirement funds

Pursuant to the review of retirement savings conducted by National Treasury, death benefits paid by retirement funds were excluded from the property of an estate with effect from 1 January 2009.[32]

The obvious logic surrounding the retirement fund exemption is based upon:

- Death benefits already being subject to personal income tax as comprising a fully taxable annuity or lump sum benefit (taxed in terms of the second schedule to the Income Tax Act.)

- Death benefits forming an integral part of the on-going financial security of a family.

However, this logic is flawed:

- Estate duty is a wealth tax. Thus the fact that the retirement fund death benefits are subject to income tax should be of no consequence. This would be consistent with the argument advanced in support of both CGT and estate duty on death.

- Contributions to retirement funds are generally tax-deductible. Thus the taxation of retirement benefits represents the recoupment of past tax allowances. However, as retirement income levels are generally below income levels during years of employment the taxation actually paid on the recoupment is generally less than the tax saving achieved on contribution.

- By treating retirement fund proceeds as being exempt from estate duty an uneven playing field is created where retirement funds have an obvious advantage over other forms of investment.

In any event the relief offered through the retirement fund exemption is of limited effect in assisting younger families in the event of the untimely death of a taxpayer. In the case of the death of taxpayers below the age of 50 years old the accumulated retirement fund savings are generally small in relation to the security provided by life insurance policies. Thus there is a fair argument that the estate duty exemption for retirement fund death benefits should be extended to the risk component of life insurance policies.

[32] Section 3(2)(i) of the Estate Duty Act inserted by Act 60 of 2008

However, based on statistics furnished by the life insurance industry it was determined that less than 5% of life insurance benefit payments exceed the current basic abatement of R3,5 million. Thus, there is limited scope for the argument that estate duty has a material effect on families in receipt of life insurance benefits.

Recommendations

In considering estate duty in the context of retirement fund benefits the critical issue is that the estate duty system must not differentiate between retirement fund death benefits paid in the form of an annuity and those paid by way of a lump sum amount.

The principle behind including retirement fund death benefits within the estate is sound, since it is a transfer of wealth towards a beneficiary in the same manner as any other transfer of wealth. Any lump sum retirement death benefit is taxed according to the deceased retirement lump sum tax table, but like capital gains upon death, this tax should not be considered as double taxation. The tax on the lump sum amount is a proxy for an income tax, which was not paid at the time of contribution, while the estate duty is a tax on the transfer of wealth.

The difficulty with including retirement fund death benefits in the estate is how to treat benefits paid as an annuity as opposed to benefits paid by way of a lump sum. Theoretically, any payment of an income stream to a beneficiary will have a capital value, which can be estimated through actuarial techniques, and this capital value could be included in the estate alongside any other lump sum benefit. Administratively, a value could be calculated using a similar methodology to that utilised for the estimation of the fringe benefits for defined benefit contributions, to be introduced from 2016. However, there may be a negative impact on the beneficiaries if they are expected to pay an estate duty on a notional value of capital (that makes up the income stream). A number of options could be considered, such as decreasing the value of the annuity by the value of the estate duty tax or paying the amount over a longer time period to avoid negative cash flow implications.

Importantly, the original rationale of providing the exemption to assist families at death should be followed. However, this is not a strong reason to provide a blanket exemption for estates of all sizes. To align the proposal with this objective the value of the retirement fund death benefits that would be a part of the estate could be above a certain exempt threshold.

It is simply not practical to impose estate duty on retirement benefits whilst they remain within the retirement fund, and it will lead to an inconsistent treatment of retirement death benefits if lump sums are subjected to estate duty. This was clearly identified by National Treasury when the retirement fund death benefit exemption was promulgated, effective from 1 January 2009.

Consequently the DTC recommends that the Section 3(2)(i) estate duty exemption be retained.

However, since 2009, the retirement fund estate duty exemption has created a most convenient estate planning opportunity where taxpayers are at liberty to contribute substantial amounts to retirement funds purely to achieve estate duty savings. As taxpayers are now at liberty to continue contributing to retirement annuity funds after the age of 70 and irrespective of whether they are already drawing pension annuities from other funds, once-off payments to retirement annuity funds are even being made in anticipation of death. This practice is being widely marketed within the financial planning industry.

It is highly questionable as to whether the general anti avoidance legislation contained in section 80 of the Income Tax Act could be applied to curb this practice and it would take years to drive a test case through to the Supreme Court of Appeal.

The DTC is of the opinion that it could never have been the intention of National Treasury to create an obvious loophole of this nature. Thus, the practice should be stopped by simply deeming all retirement fund contributions, made on or after 1 March 2015 and disallowed in the determination of taxable income, to be included in the estate duty computation.

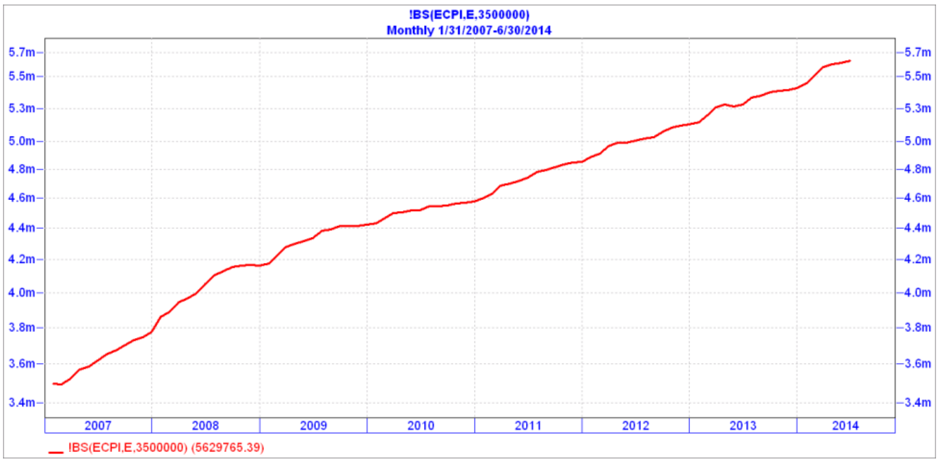
Chapter 9
Abatements and rates

The primary abatement

At the time of the Third Katz Report (1997) estate duty was levied at the rate of 25% on the dutiable value of an estate exceeding R1 million.

The primary estate duty abatement was increased to R2,5 million with effect from 1 March 2005 and to R3,5 million from 1 March 2007. It is noted that the estate duty basic abatement has now not been increased for 7 years. This has allowed a substantial element of fiscal drag to enter the estate duty system whilst, at the same time, national treasury has been making substantial efforts to curb fiscal drag within the personal income tax tables. Figure 7 below illustrates the primary estate duty abatement plotted against the consumer price index since last amended in March 2007

Figure 7. The Primary estate duty abatement plotted against the consumer price index since last amended in March 2007



Source: I-Net Bridge

In order to re-establish the primary abatement to exclude the effects of fiscal drag between 2007 and 2015 it is estimated that the abatement should be increased to R5,7 million by October 2014.

There does not appear to be much research supporting the quantum of the estate duty abatement of R3,5 million per estate. The broad line of thought seems simply to be to exempt the taxpayer's primary residence, personal effects and retirement savings from estate duty up to a reasonable level.

The primary residence allowance for CGT purposes is currently R2 million. However, this is not necessarily indicative of the value of the property but rather of the extent of the capital gain resulting from the deemed disposal.

The DTC is of the opinion that, save for the primary residence, no distinction should be made regarding asset classes in the determination of estate duty liability.

The quantum of a reasonable abatement for estate duty would obviously be dependent on the circumstances of the taxpayer. However, it would defeat the very objective of simplifying the tax system to propose a range of allowances depending on the taxpayer's age, marital status and family commitments.

Thus the DTC favours a single universally applied abatement followed by a progressive estate duty rate.

Comment [F14]: Should this perhaps be put in bold, similar to the recommendations made by DTC?

As a very general rule the DTC considers that, on average, the financial consequences of the death of a taxpayer would endure for 15 years. During such period it would cause undue hardship for the family of the taxpayer if the estate were to be diminished by estate duty. The inter-spouse abatement currently helps keep estate duty at bay during this period. But, for reasons contained in Chapter 4 of this report, it is proposed that the inter-spouse abatement now be limited. Table 6,based on statistics furnished by SARS, demonstrates that the loss of estate duty anticipated as a result of the increasing the primary abatement is not substantial.

Table 6. Anticipated Loss of estate duty as a result of the primary abatement

Estate value	Estates by Number	Amount received	Estates by Number	Amount received
		R million	% age	% age
Less than R10 million	547	158	83	20
R10 million to R20 million	69	145	10	18
R20 million to R30 million	17	73	3	9
Above R30 million	26	418	4	53
Total	659	794	100	100

Source: South African Revenue Services 2014

At present, only 20% of estate duty collections is paid by estates with a value of less than R10 million.

It is thus recommended that the primary abatement be increased to R6 million per taxpayer. It is noted that a surviving spouse will be in a position to increase the total abatement to R12 million by electing to use the primary abatement in the computation of the estate duty of the first dying spouse.

Estate duty rate

The estate duty rate was reduced from 25% to 20% with effect from 1 October 2001 to coincide with the implementation of CGT.

It is noted that the estate duty rate was not adjusted as a result of the increase in the CGT inclusion rate for personal income tax on 1 March 2012 from 25% to 33,3%. If the estate duty rate were reduced by 5% as a result of the implementation of a maximum CGT rate of 10%, then logically the estate duty rate should have been reduced by a further 1,3% as a result of the increase of 3,32% in the maximum CGT rate.

The DTC has considered the implementation of progressive rates of estate duty. There is clearly merit to the argument in favour of a progressive estate duty rate. This was recognised by both the Margo and Katz Commissions.

> As pointed out in the Report of the Margo Commission, views may differ regarding the appropriate tax treatment of persons with different taxable capacities, as approaches to vertical equity inevitably involve value judgments. It is recognised, furthermore, that redistribution is better achieved by other means, particularly through the expenditure side of the budget. The actual and perceived redistributive effects of the tax system are nonetheless important, particularly in the current circumstances in South Africa. In the Commission's view, the contribution which a tax on wealth can make to the overall fairness of the tax system should not be underestimated.[33]

Progressive rates of estate duty were considered by the Katz Commission:

> A flat rate is simpler to administer. Each year is treated separately insofar as donations are concerned. A system which attempts to have a lifetime cumulative regime requires that a lifetime list of donations be maintained. This would be administratively burdensome[34]. … Whilst equity considerations appear to point towards a progressive regime and high rates with regard to estate duty, there are

[33] Fourth Report of the Katz Commission, 1997 at page 1.
[34] Fourth Report of the Katz Commission, 1997 at page 14.

considerations which appear to point to a relatively low flat rate. These factors include the following:

(a) International experience supports the contention that where capital taxes materially exceed 15%, extensive planning results in significant avoidance and evasion, which reduces the effective yield. In this regard there is a useful discussion in J Whalley, (1974), "Estate Duty as a Voluntary Tax", 84 Economic Journal, 638; and

(b) An extensive avoidance industry represents a wasteful utilisation of resources.[35]

Increased revenue collections should be achieved through targeted amendments to curb estate planning rather than through change of rates and abatements.

The DTC is of the view that far more can be achieved by increasing the estate duty threshold than lowering the overall rate. In particular, a higher estate duty threshold will:

i. On its own, discourage most South Africans from pursuing estate duty saving mechanisms.

ii. Encourage South Africans to pursue the objectives of retirement planning rather than estate planning.

iii. Achieve the objectives of simplicity and the consistent treatment of taxpayers.

iv. Simplify the inter-relationship between estate duty and CGT and donations tax.

SA currently levies both the donations tax and estate duty at a rate of 20%. Internationally, rates vary dramatically, which makes comparison difficult. A summary of international rates is provided in annexure A.

For example, in Belgium the rate of inheritance tax varies from 3% to 80% depending on the family relationship and the geographic region.

The rate in the UK is 40%, as is the maximum rate in the US. However, the thresholds at which these rates apply are substantially higher than for SA (GBP325, 000 for the UK and $5, 340, 000 for the US). Germany has rates ranging from 7% to 50% depending on the nature of the recipient and the value of the inheritance/gift. The top tax rate of 30%, for close relatives, applies at Euro26 million.

[35] Fourth Report of the Katz Commission, 1997 at page 15.

France's tax rates and thresholds are the most onerous with the top rate of 45% applying at Euro1, 805, 677.

In view of these statistics, the present estate duty rate of 20% coupled with an abatement of R6 million is relatively low by international standards.

Progressive tax rates are commonly applied internationally. However, complexities do arise in this regard, particularly insofar as alignment between donations tax and estate duty is concerned. To this end, the Katz Commission seemed to lean towards a flat rate. Concerns were also expressed that high rates tend to result in significant avoidance and evasion.

To this end, the current flat rate of 20% should not be increased, particularly in light of the retention of both CGT and estate duty/donations tax being levied on capital transfers.

Table 7 provides an illustrative demonstration that a flat rate of estate duty as proposed does not prevent the effective rate of estate duty from having a progressive quality.

Table 7. An illustrative estate duty calculation by estate value bands

Estate Value	Estate Duty	Effective rate	Estate Duty	Effective rate
	Single		1 spouse	1 spouse
5000000	0	-	0	-
10000000	800000	8,00	0	-
20000000	2800000	14,00	1600000	8,00
30000000	4800000	16,00	3600000	12,00
40000000	6800000	17,00	5600000	14,00
50000000	8800000	17,60	7600000	15,20
60000000	10800000	18,00	9600000	16,00
70000000	12800000	18,29	11600000	16,57
80000000	14800000	18,50	13600000	17,00
90000000	16800000	18,67	15600000	17,33
100000000	18800000	18,80	17600000	17,60
110000000	20800000	18,91	19600000	17,82
120000000	22800000	19,00	21600000	18,00
130000000	24800000	19,08	23600000	18,15
140000000	26800000	19,14	25600000	18,29
150000000	28800000	19,20	27600000	18,40

This table is indicative of the fact that even though the current 20% estate duty rate may be above the 15% recommendation of the Katz commission, the effective rate does not exceed 15% unless the estate exceeds R20 million in the case of single taxpayers and R50 million in the case of one spouse.

The DTC expects that a substantial increase in estate duty collections will result from the implementation of the above proposals. But it would be entirely speculative to predict the exact quantum thereof.

The DTC hopes that the above estate duty proposals, coupled with the substantial recent increase in CGT collections, will be a sufficient additional contribution from wealthy South Africans to avoid the widespread implications of increasing the top marginal rate of income tax.

In short, all that may be required to achieve a simper and fairer system is to:

1. Address the fundamental deficiencies in the current system that has led to widespread implementation of estate planning structures;

2. Encourage and simplify estate duty compliance;

3. Treat all taxpayers equally, regardless of marital status;

4. Create a reasonable primary abatement which still allows an element of relief for families and makes fair provision for inflation.

5. Encourage retirement savings without creating estate planning loopholes.

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Comment [F15]: Usually titles only have the initial letter of the first word capitalised – however, since this seems to be consistent throughout – caps for all important words in titles, I have left them unedited except for one set of Initial Caps in first item.

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Reference list needs to be organised alphabetically according to author's name (or report name where applicable). Unable to sort using Word.

Annexure

International comparison of Estate Duty and CGT rates

Australia

Australia does not have any inheritance, estate or gift taxes.

Wealth taxes

Australia does not have a recurring wealth tax.

CGT

Australia has special rules that apply to the transfer of assets to a beneficiary from a deceased estate for CGT purposes.

CGT in this sense can be disregarded if the asset is passed to:

- their deceased legal personal representative;
- a beneficiary; or
- from their legal personal representative to a beneficiary;
- under the Cultural Bequests Program (which applies to certain gifts of property – not land or buildings – to a library, museum or art gallery); or
- to a deductible gift recipient and the gift would have been income tax deductible if it had not been a testamentary gift.

CGT cannot be disregarded when an asset is passed on to:

- an advantaged entity; or
- foreign resident.

Special tax rules apply to a transfer of superannuation entitlements to beneficiaries of a deceased person.

New Zealand

New Zealand does not levy gift duty, since 1 October 2011, and estate duty was abolished for deaths after 17 December 1992.

Wealth taxes

New Zealand does not have a recurring wealth tax.

CGT

It also does not have a separate CGT regime.

Canada

There are no federal or provincial/territorial inheritance, estate, or gift taxes.

CGT

An individual who dies is deemed to have disposed of any capital property immediately before death. This can result in accrued capital gains.

Other charges

In addition, all provinces and territories impose probate fees or administrative charges for probating a will.

Wealth taxes

Canada does not have any recurring wealth tax regime.

USA

The United States imposes a federal estate tax on the fair market value of assets that an individual owns at death.

Individuals who are domiciled in the United States are subject to federal estate tax on their worldwide assets (usually including life insurance proceeds).

Individuals who are not US-domiciled are subject to US federal estate tax only on US-status assets.

Tax credit

The American Taxpayer Relief Act of 2012 makes permanent the indexed USD 5.34 million estate, gift, and generation skipping transfer tax exemption enacted as part of The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

United Kingdom

Inheritance tax (IHT) is a transfer tax payable on a taxpayer's chargeable worldwide estate. IHT is unified with gift taxes. IHT is also payable during life on certain "chargeable lifetime transfers", the most common of which is transfers into most types of trusts.

Comment [D16]: United?

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If a non-UK domiciled individual has been resident in the United Kingdom in 17 out of the previous 20 years, they will be considered as "deemed domiciled" in the United Kingdom and will be liable to IHT on their entire worldwide assets unless this is overridden by an applicable tax treaty.

Non-UK domiciled individuals are only charged IHT on chargeable lifetime transfers of UK assets or assets situated in the UK on their death.

Generation skipping

There is no specific legislation that deals with generation skipping.

Inheritance tax charge

Where an individual makes a lifetime transfer that is not immediately chargeable, it may become chargeable if the donor dies within seven years of making the gift.

However, certain trusts are subject to a periodic charge on assets within the trust every 10 years and on transfers out of a trust.

Exemptions

Any amount above the nil rate band (NRB), which has been GBP 325,000 since 6 April 2009, will be subject to IHT. Since 8 October 2007, a UK domiciled taxpayer's NRB may be extended by any part of the NRB that was not used on the death of their (UK domiciled) spouse or civil partner who predeceased them.

Foreign situated property, certain UK funds, and exempt gifts are considered as "excluded property" for IHT purposes and will not form part of the non-UK domiciled individual's UK estate.

The transfer of property between a UK domiciled spouse or civil partner is exempt.

The transfer of property by way of gift to UK registered charities is also exempt.

Headline rate

IHT is charged at 40% of the net estate (which includes pensions and lump sums and life insurance pay-outs and donations 7 years before death with an exemption of GBP325,000 on the total.

CGT

On death all assets are given a tax free uplift to their market value at that date. Therefore, there is never any CGT due on death.

Wealth Tax

The UK does not have a recurring wealth tax.

Other countries in the European Union

Member State	Most favorable group		Most heavily taxed group	
	Lowest rate	Highest Rate	Lowest rate	Highest Rate
Belgium (Brussels): *Successierechten*	3%	30%	40%	80%
Belgium (Flanders): *Successierechten*	3%	27%	45%	65%
Belgium (Walloon): *Successierechten*	3%	30%	30%	80%
Bulgaria: *Данък върху наследствата*	0.4%	0.8%	3.3%	6.6%
Denmark: *Bo og gaveafgift*	15%	15%	36.25%	36.25%
Germany: *Erbschaft-/Schenkungsteuer*	7%	30%	30%	50%
Ireland: *Capital acquisitions tax*	33%	33%	33%	33%
Greece: *Κώδικας Φορολογίας Κληρονομιών / Δωρεών / Γονικών παροχών*	0%	10%	0%	40%
Spain: *Impuesto sobre Sucesiones y Donaciones*	7.65%	34%	15.3%	68%
France: *Droits de mutation à titre gratuit par décès*	5%	45%	60%	60%
Croatia: *Porez na nasljedstva i darove.*	5%	5%	5%	5%
Italy: *Imposta di successione e donazione*	4%	4%	8%	8%
Lithuania: *Paveldimo turto mokestis*	5%	10%	5%	10%
Luxembourg: *Droits de succession*	0%	0%	15%	48%%
Droits de mutation par décès	0%	0%	15%	48%
Hungary: *Öröklési illeték*	9%	18%	9%	18%
The Netherlands: *Successiewet*	10%	20%	30%	40%
Poland: *Podatek od spadków i darowizn*	3%[48]	7%[49]	12%	20%
Slovenia: *Zakon o davku na dediščine in darila*	0%	0%	12%	39%
Finland: *Perintö- ja lahjaverolaki*	0%	19%	0%	35%
United Kingdom: *Inheritance tax*	0%	0%	0%[50]	40%
AVERAGE	6%	17%	19%	41%