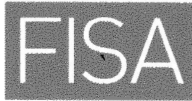

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Comments on Taxation Laws Amendment Bill

1. Estate duty: Portable spousal deduction

The purpose of the proposed amendment to Section 4A of the Estate Duty Act, 1955 is to transfer the unused portion of the spousal deduction (currently R3.5 million) to the surviving spouse(s) with the effect that a first dying spouse, together with a subsequent spouse(s), enjoys a total cumulative deduction of R7 million.

The proposed amendment reads as follows:

"Dutiable amount of an estate

4A. (1) **[The]** Subject to subsection (2), the dutiable amount of **[any]** the estate of any person, as determined in accordance with section 4, shall be determined by deducting from the net value of **[the]** that estate **[, as determined in accordance with section 4,]** an amount of R3,5 million.

(2) If a spouse of a person contemplated in subsection (1) acquired all the property that constituted the net value of the estate contemplated in subsection (1), an additional amount of R3,5 million shall be added to the amount specified in subsection (1) when determining the dutiable amount of the estate of that spouse.

(3) If more than one spouse of a person contemplated in subsection (1) acquired all the property that constituted the net value of the estate contemplated in subsection (1). an additional amount shall be added to the amount specified in subsection (1) when determining the dutiable amount of the estate of each of those spouses, which amount shall be an amount that bears to R3,5 million the same ratio as the value of the property acquired by the spouse bears to the net value of the estate contemplated in subsection (1).

(4) The additional amount contemplated in subsection (2) shall not exceed R3,5 million.".

(2) Subsection (1) comes into operation on 1 January 2010 and applies in respect of—

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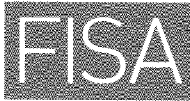

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(a) the estate of a person who dies on or after that date; and
(b) the estate of a spouse of a person contemplated in paragraph (a).

An important requirement for this transferability is that the first dying spouse bequeaths his or her entire net estate to the surviving spouse(s). In the Explanatory Memorandum to the Bill the following reason is given for this limitation: "At this stage, the portability concept is limited solely to simple estates with assets solely transferred to spouses for a variety of reasons. First, only the will document itself is kept on permanent record for an indefinite period, and concerns exist that a doubling of a single automatic deduction can occur once documents are absent."

The Institute comments as follows:

> The concept of "simple estates with assets solely transferred to spouse(s) " is in practice not the rule and neither is it advisable in many instances. This is so because testators invariably wish to benefit other parties such as children, other relatives, churches, and the like. For example, parents frequently and for very good reasons wish to bequeath a certain asset or assets to a child or children. This can be anything, from a set of Mandela inaugural coins to a gold watch that belonged to a beloved grandparent. The reasons vary from the sentimental to the practical. The gold watch can be regarded as sentimental, while practical implications will include issues like the situation where the surviving spouse(s) is not the natural father or mother of the child or children. It is therefore submitted that the transferability of the deduction will be limited to

the extent of being rather useless and may even lead to bad planning in an effort to make use of it.

The reason advanced ie. that only the will is kept on permanent record should also be able to be rectified. The will is retained by the Master of the High Court and along with the will the estate account should also be retained thus providing a complete and permanent record.

Although a will is excluded from the provisions of the Electronic Communications and Transactions Act, 2002, the estate account is not. Therefore an electronic copy of the estate account will suffice and it should be a simple matter for the surviving spouse(s) and/or the SARS and/or the Master to keep an electronic copy (or for that matter a hard copy) of the account and/or the estate duty addendum.

Furthermore, it has to be pointed out that it is also not clear from the current wording of the proposed amendment what is meant by the words "net value of the estate".

In the structure of sec 4 of the act, "net value of an estate" has a particular technical meaning, i.e. the value left after deducting all deductions under sec 4 from the value of all property (sec 3(1) and 3(2)) and deemed property (sec 3(3)).

This means that all assets that devolve upon the surviving spouse(s) are excluded from the "net value of an estate" in accordance with the provisions of sec 4(q). This may lead to confusion.

Also excluded, *inter alia*, from the term "net value of an estate" are the following:

- Property outside the Republic under certain circumstances (sec 4(e)); and
- Bequests to charities and the State (sec 4(h)).

Does the proposed amendment mean that the value of property outside the Republic that is deductible under sec 4(e) can be bequeathed to someone other than the surviving spouse without losing the benefit intended?

Similarly, does it mean that the now deceased testator and the surviving spouse(s) will still enjoy the intended benefit despite bequests to charities or the State?

It is submitted that it would be extremely cumbersome to try to legislate around all these contingencies, and any such attempt is bound to lead to further ambiguities.

It is therefore submitted that this provision be amended to exclude the limitation to the entire net estate and apply in all cases where assets pass from a deceased spouse to a surviving spouse(s).

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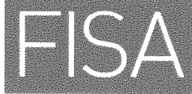
2. Estate Duty: Usufructuary Estate Planning Scheme

In terms of section 5 of The Estate Duty Act, 1955, fiduciary, usufructuary and like interests (limited interests) are currently valued over the life expectancy of the person who succeeds to the interest or property over which it is enjoyed or the period for which the interest is to be enjoyed, whichever period is the lesser. The proposed amendment to Section 5 dispenses with the "lesser of" alternative and values limited interests only over the life expectancy of the beneficiary.

The reason for the change, according to the Explanatory Memorandum, is that "Avoidance Schemes exists whereby the 12% capitalisation rule is manipulated to artificially reduce values for Estate Duty purposes."

The Institute comments as follows:

> Usufructs and other limited interests are utilised in practice for reasons not associated with avoidance schemes. An example is where a bequest of a portion of an estate is made, usually in trust, with a limited interest in favour of a child, children or some other beneficiary for a fixed period until such time as the testator or testatrix anticipates that the children will be self-sufficient. The balance of the estate would have been bequeathed directly or indirectly to a surviving spouse(s). Once the child or children have reached a certain age the limited interest ceases and the assets over which that limited interest was enjoyed devolved either directly or indirectly on the surviving spouse(s).



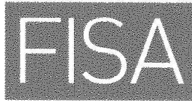
Another example is where a surviving spouse is given a usufruct over property or a vested right to income from a trust for a similar period while the children are still minors, and this usufruct or right then ceases once the children reach majority or a certain mature age, at which time they obtain the property or capital.
For example, a man with two children aged 13 and 15 may leave his wife a usufruct over assets worth R1m for ten years until the children are 23 and 25 respectively and can look after themselves. If the wife is 44 years old when he dies, the difference between the value of the usufruct calculated over her life expectancy versus over the ten year term is 43 %.

In the case where the usufruct or like right is granted to the children, the difference will be even bigger.

This and similar arrangements fulfil an extremely important function:

- The surviving spouse(s) is provided for.
- The surviving children are provided for until such time as normal maintenance obligations would have fallen away.

The function that these arrangements fulfil is to give the benefit of assets to persons who need it for the time they need it while ensuring that these assets remain an eventual benefit to some other person who should be benefited by them. This has nothing to do with avoidance of estate duty, but represents prudent planning.



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It is submitted that this provision will be severely detrimental to testators and testatrixes who wish to fulfil both moral and legal obligations towards dependants. These proposed provisions will also hit the middle of the road individuals hardest – those people who have to fulfil these different obligations from the same asset base and do not have "unburdened" assets of such high value that they can provide for all these obligations from different "blocks" of assets.

Consequently, it is submitted that, if the so-called one-year-wonder is perceived to be a big threat to the fiscus, another more creative way to block it be found.

3. The Institute endorses the amendments to sections 9A and 12 and the repeal of section 19 of the Estate Duty Act.

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